

The regulation of directors' self-serving conduct: perspectives from Botswana and South Africa*

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Abstract

Recent scandals in the corporate world have drawn attention to the extent and diversity of corporate malpractice and the need to curb them. Effective corporate governance practices encourage vigilance, transparency, accountability and proper levels of disclosure which, in turn, inspire investor confidence. This paper examines the regulatory mechanisms dealing with some forms of directors' self-serving conduct in the light of recent reform initiatives in Botswana and South Africa. It looks at directors' benefits and emoluments, loans to directors, compensation for loss of office, directors' interests in their companies' securities, insider dealing and directors' indemnity and insurance. Similar statutory provisions regulate most of these matters, but more needs to be done to effectively control those practices most likely to lead to abuse. It seems that successful supervision of directors' conduct is best achieved by a combined effort of legislative and market regulation, active shareholder participation, comprehensive reporting to shareholders and proof from the market that adhering to sound principles of corporate governance leads to long-term corporate health. Such regulation should, however, not stifle the company's ability to attract and retain directors, nor should it discourage robust yet responsible entrepreneurship and risk-taking.

*The authors are greatly indebted to Professor Harry Rajak of the University of Sussex for his invaluable comments on an earlier draft of this paper, and to Victor Chimbwanda for his assistance in the research for the paper. The usual disclaimer applies.

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INTRODUCTION

Recent scandals in the corporate world clearly indicate the extent to which corporate misconduct is on the rise.¹ Problems in the performance of leading companies, the perceived lack of effective board supervision that contributed to these problems, and pressure exercised by institutional investors for this to change, have led to the development of corporate governance guidelines and codes of best practice.² Corporate misconduct takes many forms including tax evasion, fraud, false accounting and directors' self-serving conduct. By the latter we mean any conduct by directors by which they are enriched at the

¹In the USA alone corporate scandals, like *Enron* (company used special purpose vehicles for \$8.5bn of deals to hide the real level of debt); *Worldcom* (over £3.8 billion pounds revenue costs spent on network maintenance treated as capital expenditure to inflate profits and loans of \$2.5bn misreported, resulting in the biggest ever bankruptcy); *Adelphia* (rebates counted as income. The company guaranteed personal debts of one of its executive directors); *Tyco* (the company purchased the CIT Group in order to manipulate profits and was involved in tax evasion); *AOL Time Warner* (questions raised over the revenue recognition practices of this company — the company admitted it may have overstated revenues by \$49m over two years); *Elan* (company failed to report sale of royalties of key products to special purpose vehicles for \$360m to raise cash. The SEC has launched its second investigation into the company's accounting practices in three years); *Rite Aid* (company involved in false accounting — its earnings restatement cut income by \$2.3bn, the largest correction in US corporate history); *Vivendi Universal* (the company overstated the value of goodwill and other intangibles. It is now undergoing urgent restructuring); *Imclone* (allegations of insider dealing by the company's directors. The company's CEO and founder was convicted of insider trading. He was sentenced to 7 years in prison and fined \$4.3m. One of the company's shareholders has been found guilty of lying to US Federal authorities and obstruction of justice); *K-Mart* (company accounting practices under investigation because misreported volume discounts from suppliers led to bankruptcy); *Xerox* (overstated four years' worth of profits and subsequently paid a \$10 million fine in a no fault settlement with the SEC); and *Global Crossing* (start-up telecommunications firm based in Bermuda filed for bankruptcy in January 2002 amid a series of accusations that accounting gimmicks inflated revenues) shook investors' confidence. In Italy, *Parmalat* collapsed in December 2003 after it disclosed a 4bn euro accounting hole. A letter from the Bank of America vouching that the money was held by Parmalat's Cayman Island subsidiary (Bonlat) turned out to be a forgery. Deloitte & Touche, Parmalat's main auditor since 1999, did not discover the fraud. Grant Thornton, long-time auditors of Parmalat itself and of Bonlat also did not discover the forgery and kept approving fake accounts over the years. The company's founder, now in jail, has admitted misappropriating hundreds of millions of euros in company funds. In South Africa, the *Leisurenet*; *Regal Bank*; *Krion*; *Macmed* and *Coronet Equities* inquiries have underscored the extent of bad governance practices. At the time of writing of this article, the company secretary and financial director of *Macmed* had just been declared personally liable for R647 million under s 424 of the Companies Act in the largest civil action to date in South Africa (see *Nel and Others NNO v McArthur and Others* (TPD, unreported case no 19228/01)).

²In the United Kingdom, the *Report of the Committee on the Financial Aspects of Corporate Governance* (1992) (Cadbury Report); *Report of the Study Group on Directors' Remuneration* (1995) (Greenbury Report); *Report of the Committee on Corporate Governance* (1998) (Hampel Report) culminated in *The Combined Code on Corporate Governance* (1998) (*Combined Code*). In South Africa, two reports were published by the King Committees: see Institute of Directors in Southern Africa *The King Report on Corporate Governance* (1994) (King I) and Institute of Directors in Southern Africa *King Report on Corporate Governance for South Africa 2002* (King II).

expense of the company. This type of conduct includes golden handshakes,³ golden parachutes,⁴ golden halos,⁵ insider dealings, loans to directors or people connected to them, property transactions, resignation pay-offs, share options and dubious pension schemes. In this article we examine the regulatory mechanisms in company law intended to deal with some aspects of this conduct in the light of developments in Botswana and South Africa.⁶ Where appropriate, other jurisdictions are considered.

The main companies legislation in Botswana is the Companies Act 1959.⁷ This Act is based on the 1948 English model. A new Companies Bill⁸ has just been passed by parliament and is awaiting presidential assent. The Bill is largely based on the New Zealand Companies Act 1993.⁹

South African companies are regulated by the Companies Act 61 of 1973. The Act is, however, not a complete codification of the company law applicable to the companies it regulates, and common law principles also apply. This is particularly true in respect of directors, for, while some statutory provisions regulate certain aspects, the law regarding directors' duties generally, is based largely on the common law. Listed companies must comply with the listings requirements of the JSE Securities Exchange, South Africa,¹⁰ which have incorporated certain recommendations of the King Committees on Corporate Governance. Some of the King recommendations have also been superseded by legislation.¹¹

³A 'golden handshake' is monetary compensation paid to a resigning or retiring director.

⁴A 'golden parachute' is monetary compensation that the company has agreed to pay to a director in the event that the company collapses. For example, in the United Kingdom, in May 2003, GlaxoSmithKline arranged to pay 22m pounds to its chief executive officer in case the company collapsed. In an historic show of shareholder activism, the shareholders rejected the package.

⁵A 'golden halo' is a payment made by the company to an incoming director as an inducement to take up the position.

⁶It is clearly not possible to do justice to all aspects in one paper. We have therefore not discussed directors' fiduciary obligations to the company, but have focused on certain aspects specifically regulated by statute.

⁷Cap 42:01 as amended by the Companies (Amendment) Act 1995 (No 7 of 1995). See further Kiggundu 'Company law reform in Botswana: the agenda for the twenty-first century' (1996) 113 *SAIJ* 496.

⁸Act 30 of 2003.

⁹See further Kiggundu 'Modern company law for the new millenium: the Botswana model' (2004) 4 *Internasional and Comparative Corporate Law Journal* 101.

¹⁰Paragraph 3.84 of the 2003 *Listings Requirements* makes several recommendations of King II obligatory, eg that the chief executive officer must not also hold the position of chairperson of the board, and that all issuers must have an audit committee and a remuneration committee.

¹¹For example, by Amendment Acts to the Companies Act like the Companies Amendment Act 37 of 1999, which incorporated some of the King recommendations with regard to the company secretary and directors' emoluments, or new legislation like the Employment Equity Act 55 of 1998. See also Naidoo *Corporate governance* (2002) 12.

DIRECTORS' BENEFITS AND EMOLUMENTS

It is unlawful for a company to pay remuneration to a director free of income tax or which varies in accordance with his income tax or his tax rate.¹² Apart from the difficulty of calculating precisely what the company would be liable to pay — and shareholders accordingly being unable to ascertain what a company is paying for the services of a director — a provision for such payments is objectionable as what appears to be a modest remuneration could prove exorbitant.¹³ It can also be regarded as contrary to public policy, in that it creates a class of persons immune from increases in taxation.¹⁴ Accordingly, any provision for such remuneration has the effect that the net sum for which it purports to provide is a gross sum subject to income tax.¹⁵

King I recommended that there should be separate, full and clear disclosure of the total of executive and non-executive directors' earnings, with separate figures given for salary, fees, benefits, share options and bonuses.¹⁶ This recommendation led to the amendment of section 297 of the South African Companies Act.¹⁷ The section now provides that the annual financial statements of a company must disclose the amount of the emoluments received by the directors; the amount of the pensions paid or receivable by present and past directors; the amount of any compensation paid to directors and past directors in respect of loss of office; and details of directors' service contracts.¹⁸ The information must be provided in two categories: executive directors (past and present) in aggregate, and non-executive directors in aggregate. Emoluments for services rendered as directors, and services rendered while serving as directors of the company (as directors of any subsidiaries and otherwise in connection with the affairs of the company or its subsidiaries) must be shown. The section provides comprehensive instructions on amounts to be disclosed.¹⁹ The disclosure requirements did not go as far as those in the United Kingdom, where the Hampel Combined Code requires that the company's annual report contain a statement of

¹²Companies Act (Cap 42:01) (Botswana) s 146 (1); Companies Act (South Africa) s 225. See further Kiggundu *Company and partnership law in Botswana* (2000) par 329; and Davies (ed) *Gower's principles of modern company law* (6ed 1997) 626–627 on the corresponding English law.

¹³*Gower* n 12 above at 626.

¹⁴In the *Final Report of the Company Law Amendment Enquiry 1947–48* UG No 69–1948 par 148, the Millin Commission (in South Africa) noted this objection of the Cohen Committee in England (*Report of the Committee on Company Law Amendment* Cmnd 6659 (1945) par 88.

¹⁵Companies Act (Botswana) s 146(2). See also *Gower* n 4 above at 626. Section 225(2) of the South African Companies Act provides that the provision shall be construed as if it provided for the payment of that amount without such manner of determination thereof.

¹⁶King I, ch 8 par 9.

¹⁷By s 19(e) of the Companies Amendment Act 37 of 1999.

¹⁸Section 297(1). The Botswana Companies Bill 2003 introduces a similar provision: see cl 215(f).

¹⁹Section 297(3), (3A) & (4).

remuneration policy and details of the remuneration of each director.²⁰ However, in view of revelations about senior executives allegedly receiving excessive salaries, there was little surprise when King II recommended that companies should provide full disclosure of their directors' individual remuneration packages, including details of earnings, share options, restraint payments, and all other benefits.²¹ The listings requirements of the JSE Securities Exchange, South Africa, as amended in 2003, already include disclosure of a greater variety of fees, including fees received on a group-wide basis, and share purchase schemes.²²

The Botswana Companies Bill 2003 introduces very important safeguards relating to the approval and disclosure of director's remuneration and benefits. Subject to clause 157(5)-(9) and the company's constitution, the company must, by ordinary resolution, approve directors' remuneration and any other benefits payable to them including compensation for loss of employment.²³ But subject to clauses 157(3) and (4), the company's constitution may permit the board, rather than the general meeting, to grant such approval.²⁴ Where approval is given by the board, and the payment is made or a benefit is provided, the board must ensure that the particulars of the payment or benefit are immediately entered in the interests register, if any, and in the minutes of directors' meetings.²⁵

Where a payment is made or other benefit provided under clause 157(2), shareholders who consider that the payment was not fair to the company and who between them, hold not less than ten per cent of the company's voting share capital, may, within one month of the date on which the existence of the payment was first made known to them, require the directors to call a general meeting to approve the payment by way of ordinary resolution. Any payment that is not approved by the general meeting constitutes a debt payable by the director to the company.²⁶

LOANS TO DIRECTORS

This is a notorious form of potential self-serving conduct by directors where, for example, they arrange and approve soft or interest-free loans to themselves, or to people connected with them. Several of the recent corporate scandals in the United States have involved dubious loans to directors.²⁷

The common law position is that it is undesirable for directors to borrow from their companies. In 1945, the Cohen Committee (United Kingdom) pointed out that if a director could offer good security, he could borrow from other

²⁰See *The combined code on corporate governance* (chairman: Sir Ronald Hampel) (1998).

²¹King II, at 61.

²²*Listings Requirements* par 7B 7.

²³Botswana Companies Bill 2003, s 157(1).

²⁴Clause 157(2).

²⁵Clause 157(3).

²⁶Clause 157(4).

²⁷See n 1 above.

sources. If he could not put up good security, he should not obtain credit from the company that he could not obtain elsewhere. The Committee therefore recommended that, subject to certain exceptions, it should be illegal for any loan to be made to any director of the company by the company, or by any of its subsidiary companies, or by any other person under guarantee from or on security provided by the company, or any of its subsidiary companies.²⁸ This position was entrenched in the company legislation of Botswana and South Africa.

The two Acts contain similar provisions.²⁹ Companies are prohibited from making a loan,³⁰ providing security or a guarantee to a director of that company, its holding company, or, in South Africa, to any other company which is a subsidiary of its holding company. This provision also extends to any other company or other body corporate controlled by one or more directors or managers of the company, or of its holding company or of any company which is a subsidiary of its holding company. The prohibition is, however, not absolute. In South Africa, a company may, directly or indirectly, make a loan to, or provide security for its holding company or subsidiary, or a subsidiary of its holding company.³¹ These inter-group transactions are governed by section 37 which, while not prohibiting them, does require full disclosure.³²

Both Acts also contain specific exceptions. A company may provide funds to a director to meet expenditure incurred or to be incurred by him for the purposes of the company, or to enable him properly to perform his duties as an officer of the company.³³ This type of transaction must be approved by a general meeting of the company at which the purposes of the expenditure and the amount of the loan/guarantee/security are disclosed.³⁴ Alternatively, the transaction may be entered into on condition that if the company's approval is not given at or before the next general meeting, the loan will be repaid, or the liability under the guarantee/security discharged within six months of the meeting.³⁵ Where the approval of the company is not secured as indicated above, the directors authorising the loan/guarantee/security, are jointly and

²⁸*Report of the Committee on Company Law Amendment* Cmd 5559 (1945) par 94.

²⁹Botswana Act, s 147; South African Act, s 226.

³⁰'Loan' has a wide meaning and includes loans of money, shares, debentures or any other property. Section 226(1A)(a)(ii) of the South African Act also includes any credit extended by the company, where the debt concerned is not payable or being paid in accordance with normal business practice in respect of the payment of debts of the same kind.

³¹Section 226(1B).

³²The section imposes liability on the directors or officers of the subsidiary making the loan or granting the security, to compensate their company if it is unfair or unreasonable. The importance of s 226(1B) is that such inter-group transactions do not fall within the prohibition even where the holding company is controlled by one or more of its (or its subsidiary's) directors or managers: Blackman, Jooste & Everingham *Commentary on the Companies Act vol 2* (2002) at 8-132.

³³Botswana Act, s 147(1), proviso (ii); South African Act, s 226(2)(b).

³⁴Botswana Act, s 147(2)(a); South African Act, s 226(3)(a).

³⁵Botswana Act, s 147(2)(b); South African Act, s 226(3)(b).

severally liable to indemnify the company against any resultant loss.³⁶ A money lending company may advance funds to a director in the ordinary course of business.³⁷ The current Botswana provision further provides that a private company may make a loan, or give a guarantee or security in respect of a loan, to one of its directors or to a director of its holding company, provided the transaction has the unanimous assent of all its members.³⁸ The South African section specifically allows the making of a loan to, or the provision of security for the company's own director or manager, or a company or body corporate controlled by one or more of its directors or managers, subject to the prior³⁹ consent of all the members of the company, or in terms of a special resolution relating to the specific transaction.⁴⁰ It also allows a company to provide money or make loans for the purchase of shares as contemplated in section 38 of the Act.⁴¹ A company may further, with the approval of the general meeting, make a loan or provide security for housing for its director or manager.⁴² The prohibition does not apply in respect of loans by a company to a director or manager of its subsidiary or the provision of security by a company to another person in connection with an obligation of a director or manager of its subsidiary, provided that such director or manager is not a director or manager of the company itself.⁴³ These 'downward' loans do not offer the same opportunity for abuse in that the director or manager to whom the loan is made or for whom the security is provided, has no influence over the decision and is therefore in the same position as any other third party.⁴⁴

Clause 157 of the Botswana Companies Bill 2003 retains the general rule,⁴⁵ but has introduced wider exceptions and far-reaching remedies. A company may make a loan, or give a guarantee or security in connection with a loan made by any person to a related company.⁴⁶ Furthermore, any company may make a loan to a director who is engaged in the salaried employment of the company in accordance with a directors' loan scheme approved by the company in general meeting.⁴⁷ The exceptions in provisos (ii) and (iii) of the

³⁶Botswana Act, s 147(3); South African Act, s 226(4) which also provides that such director or officer shall be guilty of an offence.

³⁷Botswana Act, s 147(1), proviso (iii); South African Act, s 226(2)(c).

³⁸Section 147(1), proviso (i).

³⁹The section was amended to insert the word 'prior' after the then Appellate Division held in *Neugarten v Standard Bank of South Africa Ltd* 1989 2 SA 797 (A) that the consent needed to have been given by the time the loan was made or the security provided.

⁴⁰Section 226(2)(a).

⁴¹Sections 226(2)(d), 38(2)(b) & (c).

⁴²Section 226(2)(e).

⁴³Section 226(2)(f).

⁴⁴*Blackman et al* n 32 at 8–314 argue that it is an oversight that loans to a company controlled by the director of the lending company's subsidiary are not also excluded from the prohibition.

⁴⁵Companies Bill 2003 (Botswana), cl 157(5)(a) & (b).

⁴⁶Companies Bill (Botswana), cl 157(6)(a).

⁴⁷Clause 157(6)(b).

current Act have been retained.⁴⁸ Where a loan is made in contravention of clause 157(5) of the Botswana Bill, it is, notwithstanding the terms of any agreement relating to the loan, voidable at the option of the company and immediately repayable upon being avoided.⁴⁹ By contrast, a loan granted or security provided in contravention of the South African provision, is void.⁵⁰ Where a transaction other than a loan to a director is entered into in contravention of clause 157(5), the director is liable to indemnify the company for any loss or damage resulting from the transaction. The transaction is, further, voidable at the option of the company unless the company has been duly indemnified, or a third party has acquired rights in relation to the transaction in good faith and for value, and without actual notice of the circumstance giving rise to the breach.⁵¹ This is also the position in South Africa.⁵² A company that fails to comply with clause 157(5) commits an offence and is liable on conviction to a penalty as set out in clause 492(2).⁵³ Every director of the company who authorises or permits the company to enter into the relevant transaction commits an offence and is liable on conviction to the penalty set out in clause 493(2).⁵⁴

After the latest American corporate scandals,⁵⁵ the Bush Administration enacted the Corporate Fraud Accountability Act 2002⁵⁶ — the Sarbanes-Oxley Act — in order to regulate corporate fraud and misconduct. The Act specifically addresses the issue of loans to directors. It is unlawful for any company to which the Act applies⁵⁷ — directly or indirectly — including through a subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer of the issuer.⁵⁸ There are limited exceptions to this rule: section 402(1) does not apply to home improvement and manufactured home loans, consumer credit, or any extension of credit under an open ended credit plan or a charge card. It is also excluded from any extension of credit by a broker or dealer registered under section 15 of the

⁴⁸Clause 157(6)(d) & (e).

⁴⁹Clause 157(7).

⁵⁰*Neugarten v Standard Bank of South Africa Ltd* n 39 above.

⁵¹Clause 157(8).

⁵²Section 226(4).

⁵³Clause 157(9)(a). It seems rather odd that in this case, the company should be liable when it is in fact the victim.

⁵⁴Clause 157(9)(b). The South African Act has a similar provision in s 226(4)(b) in respect of directors, but not in respect of the company itself.

⁵⁵See n 1 above.

⁵⁶116 Stat 745. On this Act generally, see White & Greig 'Sarbanes-Oxley Act of 2002 — a new regime of corporate governance' 2002 *International Business Lawyer* 415; Friedland 'The Sarbanes-Oxley Act: corporate governance, financial reporting and economic crime' (2002) 23 *Company Lawyer* 384; Ehrat 'Sarbanes-Oxley — a view from the outside' 2003 *International Business Lawyer* 75; O'Neill 'Conflicts between French law and practice and the US Sarbanes-Oxley Act of 2002' 2003 *International Business Lawyer* 59.

⁵⁷The section applies to issuing companies as defined in s 2 of the Act.

⁵⁸Sarbanes-Oxley Act, s 402(1).

Securities Exchange Act to its employee to buy, trade, or carry securities permitted under rules or regulations of the Board of Governors of the Federal Reserve System pursuant to section 7 of the Act. Such loans or facilities must, however, be made or provided in the ordinary course of the consumer credit business of such company; must be of a type that is generally made available by such company to the public; and must be made on market terms, or terms that are no more favourable than those offered by the issuer to the general public for such extensions of credit.⁵⁹ These provisions are more stringent than those in Botswana and South Africa and clearly reflect the Bush Administration's determination to root out one of the major causes of corporate misconduct.

COMPENSATION FOR LOSS OF OFFICE

Directors have a tendency to vote themselves extravagant exit packages even where this is not justified by the company's profitability. Both the Botswana and South African Companies Acts contain rules regulating directors' compensation for loss of office.

It is unlawful for a company to make any payment to any of its directors of the company by way of compensation for loss of office, or as consideration for retirement from office, without full particulars of the proposed payment (including its amount) being disclosed to members of the company and approved by the company in general meeting.⁶⁰ Furthermore, without such disclosure and approval it is unlawful for the company to make a payment to a director relating to the transfer of the whole or any part of the undertaking or company property, as compensation for loss of office or retirement.⁶¹ The South African and Botswana provisions are substantially the same, although in South Africa the members must, after full disclosure, approve the payment or grant/benefit/advantage in question by special resolution.⁶² Any payment made, or benefit or advantage granted, contrary to this provision is deemed to have been received by the director or past director concerned in trust for

⁵⁹Section 402(2).

⁶⁰Botswana Act, s 148; South African Act, s 227. In *Peens and Swart v MKTV Beleggings Beberend BK* (2003) 3 All SA 426 (T) the court held that the true nature and circumstances of the payment made are conclusive in establishing whether s 227 applies. If it was made as a result of considerations other than the loss of office or retirement of the director, the section does not prohibit the payment even though it may be coincident with such retirement or loss of office.

⁶¹Botswana Act, s 149; South African Act, s 227(c). The 'affected transaction' to which the latter subsection refers, includes a disposition of the undertaking or greater part of the assets of a company.

⁶²Section 227(1) of the Companies Act 61 of 1973. A special resolution must, in terms of s 199 of the Act, be taken by at least three quarters of the number of members entitled to vote on a show of hands at the meeting and who are present in person. Twenty-one clear days' notice must be given of such a meeting and members in the aggregate, holding at least one quarter of the total votes of all members entitled to vote at the meeting, must be present in person or by proxy.

the company.⁶³

Both Acts deal specifically with compensation of directors in a takeover situation.⁶⁴ In addition to the approval required from the company, particulars of the compensation/benefit/advantage received must be disclosed to the members of the company. Any payment or benefit received by a director, or price received in connection with any takeover scheme for shares held by the director in excess of that received by the other shareholders, is deemed to be held in trust for any persons who have sold their shares as a result of the takeover offer.⁶⁵ Unless the contrary emerges, any payment/benefit/advantage is deemed to fall within the ambit of the section, if it is shown to have been part of any arrangement in any agreement relating to any scheme or take-over; or if, one year before, or two years after, the company or transferee company under the scheme or offer, was aware of the arrangement.⁶⁶ However, bona fide payments to directors as damages for breach of contract by the company or as pension in respect of past services, are not affected.⁶⁷

DIRECTORS' INTERESTS IN COMPANY SECURITIES

Through share options and other dealings in the company's securities, directors are able to generate remuneration over and above their stated pay packages. It is widely recognised that this practice may be open to abuse. Provisions aimed at ensuring transparency in relation to directors' dealings in company shares and debentures are, therefore, essential.

Every Botswana company must keep a register showing the number, description and value of any shares in or debentures of the company or any subsidiary or holding company within a group of companies, held by or in

⁶³Section 227(2)(a). The Botswana Act contains a similar provision: see s 149(2). The Botswana Companies Bill 2003 greatly improves on the current situation by introducing the enhanced approval and disclosure requirements discussed above (see notes 23–26).

⁶⁴Botswana Act, s 150; South African Act, ss 227(b) & (c).

⁶⁵Botswana Act, s 151(2) & (3); South African Act, s 227(2)(b). Professor Davies points out (see *Gower* n 13 at 814) in respect of the corresponding s 315 of the English Companies Act 1985 (c 6), that this avoids the absurdity illustrated in *Regal (Hastings) Ltd v Gulliver* (1967) 2 AC 134n; [1942] 1 All ER 378 (HL) by providing restitution to those truly prejudiced, rather than to the company, which would in effect result in an undeserved reduction of the price to the successful bidder. Blackman *et al* n 44 8–321 suggest that all shareholders, excluding any shareholder who was a party to the improper payment, should be beneficiaries, and not only those who sold their shares. The authors also indicate that s 227(2)(b) of the South African Act should be redrafted to provide that where the takeover was accomplished by means of a scheme of arrangement involving a redemption of shares, the benefit or advantage should be held in trust for the shareholders whose shares have been redeemed and where the disposal is one as contemplated by s 228 (disposal of whole or substantially whole of assets of the company), the company should be the beneficiary.

⁶⁶Botswana Act, s 151(1); South African Act, s 227(5).

⁶⁷Botswana Act, s 151(3); South African Act, s 227(6). The South African provision includes as 'pension' any superannuation allowance, gratuity or similar payment in respect of past services. See also *Taupo Totara Timber Co v Rowe* [1978] AC 537; Kiggundu n 13 paras 332 and 333; *Gower* n 13 at 814–815.

trust for each director, or of which a director has any right to become the holder.⁶⁸ The register must be kept at the company's registered office and must be open to inspection during business hours.⁶⁹ It is the duty of every director or shadow director of the company to notify the company of any personal circumstances relevant to section 152.⁷⁰ Such notice must be in writing, and where it is not given at the directors' meeting, the person giving it must take reasonable steps to ensure that it is raised and read at the next directors' meeting.⁷¹ A director or shadow director who fails to give such notice commits an offence and is liable to a fine, or imprisonment, or both.⁷²

The South African Act does not require a separate register of directors' shareholdings. The Listings Requirements of the JSE Securities Exchange, South Africa do, however, require a statement showing the direct and indirect interests of the directors' holdings in the share capital of a company applying for a listing.⁷³ Details of all transactions, including off market transactions in securities relating to the issuer by or on behalf of directors, their associates and independent entities in terms of which the directors or their associates may derive a benefit, must be announced by listed companies. And from 1 January 2004 directors of listed companies must receive clearance from the chairman to deal in securities relating to the issuer.⁷⁴ A director may not deal in any securities relating to the issuer during a closed period as defined, or when the director is in possession of unpublished price-sensitive information in relation to those securities, or when the required clearance has not been received.⁷⁵

Several provisions in the South African Act are aimed at restricting directors' powers with regard to shares. Directors have the power to allot or issue shares only with the prior approval of the company in general meeting.⁷⁶ The approval may be general or specific, but any general authority is only valid

⁶⁸Botswana Companies Act, s 152(1).

⁶⁹Section 152(5).

⁷⁰Section 152(12).

⁷¹Section 152(13).

⁷²Section 152(14).

⁷³The statement must distinguish between beneficial and non-beneficial interests (par 7.B.20). All relevant particulars regarding the nature and extent of any material beneficial interests, whether direct or indirect, of directors of the applicant in transactions that were effected by the applicant during the current or immediately preceding year; or during an earlier financial year and which remain in any respect outstanding or unperformed; or an appropriate negative statement must also be provided (para 7.B.21).

⁷⁴*Listings Requirements* par 3.66. The chairman obtains similar clearance from the board, or a designated director.

⁷⁵*Listings Requirements*, par 3.69–70. See also the recommendation by King II at 62 that every listed company should have a practice, determined by way of a formal policy established by the board and implemented by the company secretary, prohibiting dealing in its securities by directors, officers and other selected employees for a designated period preceding the announcement of its financial results or in any other period considered sensitive.

⁷⁶South African Act, s 221. The Botswana Companies Bill introduces a similar requirement: see clauses 50 (1) & (2).

until the next annual general meeting and may be varied or revoked by the general meeting prior to that general meeting.⁷⁷ A director who contravenes the section is liable to compensate the company for any loss, damages or costs which it may incur or sustain.⁷⁸ No provision in any memorandum or articles or in any resolution of a company authorising the directors to allot or issue shares or debentures convertible into shares of the company at the discretion of the directors, may authorise the allotment or issue of any such shares or debentures to any director of the company or his nominee, or to any body corporate which is, or whose directors are, accustomed to act in accordance with the directions or instructions of such director or nominee, unless certain provisions have been complied with.⁷⁹ Nor may the allotment or issue be made at a general meeting where the director or his or her nominee is entitled to exercise or control one-fifth or more of the voting power, or to a subsidiary of such body corporate, unless the same conditions have been met.⁸⁰ The Act further provides that share option plans giving a director or future director the right to subscribe for shares are valid only if the director receives no undue preference.⁸¹ This provision has, however, largely been neutralised by the exclusion of options and rights given to a director or future director who holds salaried employment or office in the company and is given such option or right in his or her capacity as an employee.⁸²

The Botswana Companies Bill 2003 contains more detailed provisions on the disclosure of share dealings by directors and restrictions on such dealings:

Disclosure

A director of a public company must disclose to the board the number and class of shares in which he holds an interest and the nature of such interest, and must ensure that the particulars disclosed to the board are entered in the interests register.⁸³ Furthermore, a director of a public company who acquires or disposes of a relevant interest in the company's shares, must forthwith after the acquisition or disposition disclose to the board the number and class of shares in which the relevant interest has been acquired, or the number and class of shares which the relevant interest was disposed of, as the

⁷⁷Section 221(2) & (3).

⁷⁸Section 221(4). The recovery proceedings must be commenced within two years of the date of the allotment or issue.

⁷⁹Section 222.

⁸⁰These conditions, aimed at curbing abuses which arose from the practice of having an article which empowered directors to issue unissued shares to such persons and on such terms and conditions as they may determine, are: that the particular allotment or issue should be approved in advance by the shareholders in general meeting; or the shares or debentures should be allotted under a contract underwriting such shares or debentures; or the shares or debentures are allotted or issued in proportion to existing holdings, on the same terms and conditions as have been offered to all the members or debenture-holders of the company or the particular class being allotted or issued; or the allotment or issue is made on the same terms and conditions as have been offered to members of the public.

⁸¹Section 223.

⁸²In s 223(b). See Blackman *et al* n 44 above at 8-302.

⁸³Companies Bill 2003, cl 143(1).

case may be. He must further disclose the nature of the relevant interest; the consideration paid or received; and the date of the disposition. He must also ensure that the particulars disclosed to the board are entered in the interests register.⁸⁴ For the purposes of clause 143, a director of a company has a relevant interest in the company's shares if he is the beneficial owner of the shares; has the power to exercise any right to vote attached to the shares, to control the exercise of any right to vote attached to the shares, to acquire or dispose of the shares, to control the acquisition or disposition of the shares by another person; or can by virtue of any trust, agreement, arrangement or understanding relating to the shares have power to do any of the above.⁸⁵

Where a person would, if he were a director of the company, have a relevant interest in a company's shares by virtue of clause 141(1), and that person or the company's directors are accustomed or under an obligation, whether legally enforceable or not, to act in accordance with the directions, instructions, or wishes of a director of the company in relation to the exercise of any right to vote attached to the shares; or the control of the exercise of any right to vote attached to the shares; or the acquisition or disposition of the shares; or the exercise of the power to control the acquisition or disposition of the shares by another person; or the director has the power to exercise the right to vote attached to twenty per cent or more of the shares of that person; or the director has the power to control the exercise of the right to vote attached to twenty per cent or more of the shares of that person; or the director has the power to control the acquisition or disposition of twenty per cent of the shares of that person; then that director has a relevant interest in the shares.⁸⁶

A person who has or may have a power referred to in clause 141(1)(a)–(f) has a relevant interest in a company's shares regardless of whether the power is express or implied; direct or indirect; legally enforceable or not; is related to particular shares or not; is subject to a restraint or restriction or is capable of being made subject to a restraint or restriction; is exercisable presently or in the future; is exercisable only on the fulfilment of a condition; or is exercisable jointly or severally.⁸⁷

Clause 143 does not apply where the ordinary business of the person who has the relevant interest consists of, or includes the lending of money or the provision of financial services, or both, and that person has the relevant interest only as security given for the purposes of a transaction entered into in the ordinary course of his business; where that person has the relevant interest by reason only of acting for another person on behalf of the other person in the ordinary course of business of a stockbroker, and that person is a member of a stock exchange; where that person has the relevant interest solely by reason of being appointed as a proxy to vote at a particular meeting

⁸⁴Companies Bill 2003, cl 143(2).

⁸⁵Clause 141(1).

⁸⁶Clause 141(2).

⁸⁷Clause 141(3).

of members, or of a class of members of the company and the instrument of that person's appointment is produced before the start of the meeting in accordance with clause 6(4) of the Second Schedule of the Bill or by a time specified in the company's constitution as the case may be; or where that person is a trustee corporation or a nominee company and has the relevant interest by reason only of acting for another person in the ordinary course of business of that trustee corporation or nominee company; or the person has the relevant interest by reason only that the person is a bare trustee of a trust to which the shares are subject.⁸⁸

Restrictions on share dealing by directors

Where a director has information in his capacity as a director or employee of the company or a related company, that information being information that would not otherwise be available to a director, but which is material to an assessment of the value of the shares or other securities issued by the company or a related company, the director may acquire or dispose of those shares or securities only if, in the case of an acquisition, the consideration given for the acquisition is not less than the fair value of the shares or securities, or, in the case of a disposition, the consideration received for the disposition is not more than the fair value of the shares or securities.⁸⁹ The fair value of shares or securities is determined on the basis of all information known to the director or publicly available at the time.⁹⁰

Where a director acquires shares or securities in contravention of clause 144(2)(a), he is liable to the person from whom the shares or securities were acquired for the amount by which the fair value of the shares or securities exceeds the amount he paid.⁹¹ Where a director disposes of shares or securities in contravention of clause 144(1)(b), he is liable to the person from whom the shares or securities were acquired for the amount by which the fair value of the shares or securities exceeds the amount he paid.⁹²

INSIDER DEALING

Insider dealing, or insider trading, is one of the most problematic areas in the regulation of directors' self-serving conduct. Insider dealing is understood broadly to cover situations where a person trades in securities when he is in possession of unpublished price-sensitive information. The confidential information will generally be in the insider's possession because of some connection he or she has with the company whose securities are to be dealt in. Directors, employees and professional advisers are good examples of such insiders.⁹³ Directors might try to disguise their dealing in the company's

⁸⁸Clause 142.

⁸⁹Clause 144(1).

⁹⁰Clause 144(2).

⁹¹Clause 144(4).

⁹²Clause 144(5).

⁹³See Great Britain: Department of Trade *The conduct of company directors* Cmnd 7307 HMSO (1979).

securities in these circumstances by passing on the price-sensitive information to people connected with them such as their spouses, children, and other relatives and friends who then proceed to deal in the company's securities.

There are arguments for and against insider trading. Proponents of insider trading argue that it improves market efficiency, that it speeds up the accurate pricing of securities, and that it can be a justifiable and efficient way of compensating directors for having discovered the information.⁹⁴ The argument against insider trading is that it is inherently unfair and that failure to regulate it could destroy the public's confidence in the markets and those who operate in them.⁹⁵ Irrespective of one's point of view, most countries now have legislation to regulate insider trading.⁹⁶

In Botswana, insider trading is regulated by the Botswana Stock Exchange Act.⁹⁷ The Act prohibits any person from dealing directly or indirectly in a company's securities when he is in possession of unpublished price-sensitive information about such securities.⁹⁸ 'Unpublished price-sensitive information' is defined as information relating to the internal affairs of a company or its operations, assets, earning power or involvement in a transaction or proposed transaction, and which is not generally available to the investing public, and being information which would reasonably be expected to materially affect the price of the company's securities.⁹⁹ A person who deals in the company's securities in contravention of section 70(1)(f) commits an offence and is liable to a fine of P25 000 and imprisonment for five years.¹⁰⁰ There are no civil sanctions.

It is important to note that the Act prohibits any 'person' from dealing in a company's securities while in possession of unpublished price-sensitive information and that the Act does not define an 'insider'. This means that the

⁹⁴See Blackman *et al* n 44 vol 1, at 5-377.

⁹⁵On the arguments for and against insider dealing, see Mannolini 'Why regulate insider trading?' and Rider 'Insider trading: an English comment in New Zealand' in Rickett & Grantham (eds) *Essays on insider trading and securities regulation* (1997) 1-18, 60-145.

⁹⁶In Great Britain, the Company Securities (Insider Dealing) Act 1985 was repealed and replaced by Part V (ss 52-64) of the Criminal Justice Act 1993, enacted as a result of the adoption of the European Community Directive on Insider Dealing (89/592/EE). The provisions of Part V of the Criminal Justice Act 1993 have been broadened and strengthened by the far-reaching provisions of the Financial Services and Markets Act 2000. See further Linklater 'The market abuse regime — reshaping the insider dealing prohibitions' in De Lacy (ed) *The reform of United Kingdom company law* (2000) 459 *et seq*. See also Hannigan *Insider dealing* (1994); Rider & French *The regulation of insider trading* (1979); Rider (ed) *The regulation of the British securities industry* (1979); Rider *Insider trading* (1983); Suter *The regulation of insider dealing in Britain* (1989). In Australia, insider trading is regulated by Part 7.11 Division 2A of the Corporations Law. The New Zealand provisions are found in the Securities Amendment Act 1988, Part 1. The decision in *Percival v Wright* (1902) 1 Ch 421 is indicative of the problems that arise in common law, where the rules are not clearly defined.

⁹⁷Act 11 of 1994.

⁹⁸Botswana Stock Exchange Act, s 70(1)(f).

⁹⁹*Id* at 70(4).

¹⁰⁰*Id* at s 70(3)(b).

legislation is intended to cover a wide range of individuals other than directors and company employees who are the traditional insiders. Accordingly, the legislation would cover the company's accountants, legal advisers, directors' family members and associates, and others who deal with the company such as financial journalists. It is also important to note that the Act contains no defences. This is a further indication that the legislation is very narrow.

The main weakness of the legislation is the lack of civil sanctions. Establishing the criminal liability of an alleged insider beyond reasonable doubt is no easy matter. It is therefore imperative to supplement the criminal sanctions with effective civil sanctions. The Government of Botswana announced at the beginning of 2004¹⁰¹ that it intends to repeal the Botswana Stock Exchange Act and to introduce a modern and comprehensive Securities Act with a new Financial Services Board. All indications so far are that the insider trading provision will be revamped and harmonised with legislation in New Zealand and South Africa.¹⁰²

In South Africa, insider trading has been a criminal offence since the introduction of section 233 of the Companies Act 1973. After a singular lack of success in the prosecution of offenders, the legislation regulating insider trading underwent major transformation in 1989. But section 440F, the new anti-insider trading provision, was replaced before it even came into effect.¹⁰³ Despite the fact that the provisions were potentially broad in their application, no successful prosecutions followed. This led to a comprehensive review of both insider dealing and the issue of who should regulate it,¹⁰⁴ culminating in the Insider Trading Act 135 of 1998.¹⁰⁵ The Act prohibits three types of conduct, namely dealing; encouraging or discouraging; and improper disclosure or tipping. It applies to all securities and financial instruments listed on a regulated market in South Africa or internationally, as well as to instruments and securities issued by public sector bodies.¹⁰⁶ The prosecution need not show that the information concerned was unpublished and price-sensitive information. It suffices to prove that the offender knew that she was in possession of inside information¹⁰⁷ and that she had dealt, encouraged or discouraged dealing in the relevant securities, or disclosed that information to another person. In order to escape liability, the accused must establish one of the defences referred to in the Act on a balance of

¹⁰¹See *Mmegi* (Botswana) 12 February 2004, 9.

¹⁰²*Ibid.*

¹⁰³See the Second Companies Amendment Act 69 of 1990.

¹⁰⁴See *King Task Group Draft Report on Insider Trading* (1997); *Final Report by the King Task Group into Insider Trading Legislation* (1997); *Minority Report on Insider Trading* (1997). The latter report concentrated on who should regulate insider trading.

¹⁰⁵See, generally, Luiz 'Insider trading — if at first you don't succeed ...' (1999) 11 *SA Merc LJ* 136; Pretorius (ed) *Hablo's company law through the cases* 6ed (1999) 330–331.

¹⁰⁶'Securities' and 'financial instrument' are defined in s 1.

¹⁰⁷As defined in s 1(vii).

probabilities.¹⁰⁸ The new legislation also attempted to provide a meaningful civil remedy, without prejudicing the common law rights of a person who suffers as a result of insider trading.¹⁰⁹

INDEMNITY AND INSURANCE

The modern phenomenon of directors' and officers' liability insurance ('D&O insurance') allows directors to take out insurance policies at the company's expense to protect themselves against claims for compensation. Whatever its merits and demerits,¹¹⁰ such a scheme could easily be abused by the directors. It therefore requires proper regulation.

A company may indemnify any director (or officer or auditor) against any liability incurred in successfully defending any proceedings brought against her. However, it is not possible, in the articles of association or by contract, to exempt directors from personal liability for negligence, default, breach of duty or breach of trust.¹¹¹ Any attempt to do so in the articles, the contract of employment or any other document is void.¹¹² The company cannot give a director a blanket exemption from liability.¹¹³ A court may, in its discretion, relieve a director from liability where it is shown that he acted honestly and reasonably.¹¹⁴ It should also be noted that the general meeting may always condone a breach of directors' fiduciary duties that was committed in good faith. Breaches committed in bad faith cannot be condoned.

The Botswana Companies Bill 2001 restates the general rule in section 159 of the Companies Act, but introduces some major modifications. A company must not indemnify, or directly or indirectly effect insurance for a director or secretary or employee of the company, or a related company, in respect of liability for any act or omission in his capacity as a director or secretary or employee, or costs incurred by that director or employee in defending or settling any claim or proceeding relating to any such liability.¹¹⁵ An indemnity given in breach of clause 159 (1) is void.¹¹⁶ However, a company

¹⁰⁸The possible defences are set out in s 4(1).

¹⁰⁹Section 6 introduces a civil derivative action that may be instituted by the Financial Services Board against individuals involved in a contravention of the insider trading provisions. Money awarded to the board as a result of any civil action will be distributed to those individuals who were affected by the insider dealing.

¹¹⁰See generally Finch 'Personal accountability and corporate control: the role of directors' and officers' liability insurance' (1994) 57 *MLR* 880; Parsons 'Directors' and officers' liability insurance: a target or a shield?' (2002) 23 *The Company Lawyer*; Parsons 'Managerial liability, risk and insurance: an international view' 2001 *International and Comparative Corporate Law Journal* 1.

¹¹¹Botswana Act, s 159; South African Act, s 247.

¹¹²*Timmers and Another v Spansteel (Pty) Ltd* 1979 3 SA 242 (T); *Barlows Manufacturing Co Ltd v RN Barrie (Pty) Ltd* 1990 4 SA 608 (C).

¹¹³Botswana Act Section 159. See also *Movitex v Bulfield* (1988) BCLC 104.

¹¹⁴Botswana Act, s 303; South African Act, s 248. For examples from the English law, see *Re Claridge's Patent Asphalte Co* (1921) 1 Ch 543; *Dorbester Finance Co Ltd v Stebbing* (1989) BCL 498.

¹¹⁵Companies Bill 2003 Botswana, clause 159(1).

¹¹⁶Clause 159(2).

may, unless its constitution provides otherwise, indemnify a director or employee of the company or a related company for any costs incurred by him in any proceedings that relate to liability for any act or omission in his capacity as a director or employee, and in which judgment is given in his favour, or in which he is acquitted, or which is discontinued, or in which he is granted relief under clause 517.¹¹⁷ This clause provides that a court may grant a person relief from liability in actions before it for negligence, default or breach of duty against that person where it appears to the court that the person may be liable in respect thereof, but has acted honestly and reasonably and that, with due regard to all the circumstances, the person ought fairly to be excused for the negligence, default or breach.¹¹⁸ Furthermore, subject to the provisions of its constitution, a company may indemnify a director or employee of the company or a related company in respect of liability to any person other than the company or a related company for any act or omission in his capacity as a director or employee, or costs incurred by that director or employee in defending or settling any claim or proceeding relating to any such liability, not being criminal liability or liability in respect of a breach, in the case of a director, of the duty specified in clause 130(1)(c).¹¹⁹

As pointed out above, D&O insurance requires strict and careful regulation in order to avoid possible abuse by directors. The South African Act provides, as a proviso to section 247(1),¹²⁰ that the subsection (prohibiting indemnification) is not applicable to insurance taken out and kept by the company as indemnification against any liability of any director or officer towards the company in respect of any negligence, default, breach of duty, or breach of trust. The Botswana Companies Bill 2003 determines that, subject to the provisions of a company's constitution, and subject to the approval of the board of directors, the company may effect insurance for a director or employee of the company or related company in respect of civil liability for any act or omission in his capacity as a director or employee, or costs incurred by that director or employee in defending or settling any claim or proceeding relating to any such liability or costs incurred by that director or employee in defending any criminal proceedings that have been brought against the director or employee in relation to any act or omission in that person's capacity as director or employee and in which that person is acquitted.¹²¹ The board must ensure that particulars of any indemnity given to, or insurance effected for any director or employee of the company or related company, are forthwith entered in the interests register, if the company has one, or

¹¹⁷Clause 159(3).

¹¹⁸Clause 517(1).

¹¹⁹Clause 159(4).

¹²⁰This proviso was added to s 247 by s 12 of the Companies Amendment Act 35 of 1998 following a recommendation by King I (par 24.7 read with par 23.3). King II at 44 recommends that the question of D&O liability insurance be revisited, since the current s 247 is ambiguous and does not fully cover the King I recommendation.

¹²¹Clause 159(5).

otherwise in the minutes of the directors' meeting.¹²² Where insurance is effected for a director or employee of a company or related company in violation of clause 159(5) and (6), the director or employee is personally liable to the company for the cost of the insurance except to the extent that he proves that it was fair to the company at the time the insurance was effected.¹²³ The New Zealand Companies Act specifically excludes proceedings which result from a breach of the directors' fiduciary obligations from the ambit of permissible D&O insurance.¹²⁴ We believe that this is a sound approach.

THE WAY FORWARD

The success of a company depends very much on its directors. Directors' self-serving conduct can reduce the profitability of a company, can make corporate debt more risky, and may threaten the continued ability of the firm as an employer.¹²⁵ It is therefore important that their conduct is closely monitored and regulated. It has also been shown that sound corporate governance practices have a direct influence on the company's potential to draw investors and in the pricing of its shares.¹²⁶ Vigilance, transparency, accountability, and disclosure are of great importance in this regard. As was shown above, the company statutes in Botswana and South Africa contain various measures aimed at the regulation of those practices most likely to lead to abuse. In most instances the provisions are similar. Statutory regulation is, however, not enough. In order effectively to regulate directors' self-serving conduct and to avoid the re-occurrence of the recent host of corporate scandals, other measures should be introduced or strengthened.

While levels of pay and remuneration should be sufficient to attract and retain directors who can run the company successfully, any element of reward within the remuneration package should be linked to corporate and individual performance. There should be a formal and transparent procedure for developing a policy on executive pay and on fixing the remuneration package of individual directors. Such a remuneration policy should be stated clearly in the company's annual report, together with details of the remuneration of each director.¹²⁷ Directors, whether executive or non-executive, should not participate in decisions relating to their own remuneration packages.¹²⁸ Each public company should have a remuneration committee.¹²⁹ This committee, composed wholly or substantially of non-executive directors, should have agreed terms of reference and be tasked with the determination of the remuneration package for each director. Its function in relation to non-

¹²²Clause 159(6).

¹²³Clause 159(7).

¹²⁴New Zealand Companies Act 1993, s 162.

¹²⁵See Cheffins *Company law: theory, structure and operation* (1997) 123.

¹²⁶Smerdon *A practical guide to corporate governance* (1998) 13.

¹²⁷See *Hampel Report* n 2 Principles BI-III.

¹²⁸*Ibid.*

¹²⁹See King II at 68 where it is recommended that all companies should have, as a minimum, audit and remuneration committees.

executive directors should be limited to making recommendations to the full board and, as applicable, to the shareholders.¹³⁰

Shareholder passivity is a global concern. Shareholders, especially institutional shareholders, must become more involved in the management of their companies and not merely be the grateful recipients of dividends declared.¹³¹ They must be encouraged to exercise the power they have to police directors and thereby contribute to the regulation of directors' self-serving conduct.¹³² King II made a number of recommendations to encourage shareholder activism in South Africa. These include better communication between companies and shareholders, improved reporting by the financial press, creation of a safe 'whistle-blowing' facility for staff who become aware of mismanagement, and the concept that institutional investors and investment analysts take into account and insist on the highest standards of corporate governance from the companies they invest in or recommend.¹³³ It was also suggested that the bodies representing institutional investors look to steps taken in the United Kingdom to enhance shareholder participation. In particular, it was recommended that pension fund trustees should always vote the shares in which their funds are invested and indicate the extent to which corporate governance issues are taken into consideration in investment decisions relating to funds under their control and/or the extent to which such policies are required to be taken into account by investment managers with whom such funds might have been placed.¹³⁴

Legislation should be enacted providing for the maintenance of a register of delinquent directors.¹³⁵ King II recommends that the establishment of such a register should be a function of the Registrar of Companies.¹³⁶ The register should be updated regularly and should be available for public inspection.¹³⁷ In addition, delinquent directors should be disqualified from acting as directors of any other company.¹³⁸ Company boards should,

¹³⁰*Greenbury Report* par A4. See also *Cadbury Report* par 4.42; King II at 194.

¹³¹For examples of the increasing public awareness of this concern, see further Meyer 'Institutional shareholders finally realize that the individual shareholder must be king' *Saturday Star* (South Africa) 6 July 2002 (Personal Finance 4); Cameron 'Fund trustees must look after your interests' *Saturday Star* (South Africa) 21 September 2002 (Personal Finance 1); Clayson 'Corporate complacency is a thing of the past' *Saturday Star* (South Africa) 21 September 2002 (Personal Finance 3); Clayson 'Shareholders must police governance' *Saturday Star* (South Africa) 21 September 2002 (Personal Finance 3).

¹³²For an analysis of the reasons for shareholder passivity, see Cheffins n 125 above at 61–64.

¹³³See also Naidoo n 10 above at 95.

¹³⁴King II at 45.

¹³⁵Section 421 on the South African Companies Act compels the registrar to establish and maintain a register of directors of companies who have been dissolved and were unable to pay their debts. This register has, however, not been effectively maintained.

¹³⁶King II at 42. Steps in this regard have been initiated in South Africa.

¹³⁷For example, on the website of the Registrar of Companies.

¹³⁸See, for example, the British Company Directors Disqualification Act 1986 (c 46), s 1.

further, prior to their appointment, investigate the backgrounds of prospective directors to ascertain whether they are fit and proper.¹³⁹

Existing measures to prevent abuse with regard to the allocation of share options were discussed above. In order to ensure improved reporting and transparency, the cost of share options for directors and employees should be fully disclosed.¹⁴⁰

Auditors clearly have a central role to play in the regulation of directors' self-serving conduct. The majority of the corporate scandals in America¹⁴¹ involved terrible failures on the part of the auditors who audited the company's books. Either they colluded with the directors to fudge the accounts and cover directors' wrongdoing (eg *Enron* and *Parmalat*), or they simply failed to blow the whistle when they discovered the misconduct. It is therefore imperative to strengthen and tighten the law relating to auditors' duties and liability.¹⁴² Auditors should be restricted to the auditing function alone *vis-à-vis* a particular company. They should either not be allowed to be involved in non-audit work of a company whose books they are auditing,¹⁴³ or their involvement in such matters should be disclosed and monitored. It has been suggested that legislation should provide for the compulsory rotation of auditors, as is the practice in Brazil and Italy. This does not, in our view, seem practical.¹⁴⁴ An alternative approach is to rotate the lead partner responsible for a specific company.¹⁴⁵ Auditors' obligations to disclose any actual or apparent fraudulent activities by the directors of companies whose books they are auditing, should, moreover, be strengthened and enforced. Failure to make such disclosure should amount to a criminal offence punishable by either fine or imprisonment or both. Each public company should have an audit committee.¹⁴⁶ This committee should have a discussion with the auditors at least once a year, without executive board members present, to ensure that there are no unresolved issues of concern. The committee should also have explicit authority to investigate any matters within its terms of reference, should be provided with the resources it needs to do so and have full access to information. The audit committee should also be able to obtain outside professional advice and, if necessary, to invite members with relevant experience to attend its meetings.

¹³⁹This approach is required for listed companies by the JSE Securities Exchange, South Africa and under the Banks Act 94 of 1990.

¹⁴⁰See further Wessels 'New rules may force firms to include share options on balance sheet' *The Star* (South Africa) 8 November 2002 (Business Report 1). See also King II at 62, where it is, *inter alia*, recommended that the overriding principle of full disclosure by all directors, on an individual basis, should apply to all share schemes and any other incentive schemes proposed by management.

¹⁴¹Referred to in n 1 above.

¹⁴²On the initiatives under way in South Africa, see Naidoo n 11 at 110–113.

¹⁴³See for example, the US Sarbanes-Oxley Act 2002, s 201.

¹⁴⁴See also Lipson G 'Rotating auditors fail to remedy ills of Enronitis' *Sunday Times* (South Africa) 3 November 2002 (Business Times 6).

¹⁴⁵See for example, the US Sarbanes-Oxley Act 2002, s 203.

¹⁴⁶See King II 186 on the suggested terms of reference for such a committee.

Criminal sanction, which often accompanies statutory regulation of directors' conduct, has not always proved very effective. The King Committees' underlying assumptions were that self-regulation, rather than statutory regulation and enforcement, is the optimum way to improve corporate governance.¹⁴⁷ It was felt that companies that fail to reach acceptable standards of corporate governance are likely to be more effectively policed by the financial markets than by any form of legal regulation. Reliance is therefore placed heavily on professional associations and other institutional entities to bring pressure to bear on companies to comply with their duties.¹⁴⁸ Successful regulation of directors' self-interested conduct must necessarily be a combined effort — by statutory and market regulation where appropriate, active shareholder participation, comprehensive reporting to shareholders in the directors' annual report, and proof from the market that adhering to sound principles of corporate governance leads to long-term corporate health.

¹⁴⁷King II par 5.6.

¹⁴⁸Leaving enforcement largely to the stock exchanges may have the undesirable result that many companies may elect to delist their securities.