APPLYING EMPLOYEE SHARE-OWNERSHIP SCHEMES AS A TRANSFORMATION MECHANISM AIMED AT DECREASING POVERTY LEVELS IN SOUTH AFRICA: A COMPARATIVE SOCIO-LEGAL PERSPECTIVE

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Declaration

I, the undersigned, declare that the work contained in this thesis is my own original work and that I have not previously in its entirety or in part submitted it at any University for a degree.

Signature……

Date……

Dedication

I dedicate this thesis to my dear aunt, Hermine Petra Somaes. Although she already went to be with the Lord, all the sacrifices she made continue to bear fruit in my life.

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Abstract

In South Africa, the black majority suffered socially and economically during the apartheid government. The effects of the apartheid government are still evident today in South African societies, as millions of South Africans do not have daily access to the most basic resources such as food, water, health care and accommodation. Hence, this thesis explores the possibility of applying employee share-ownership plans to alleviate poverty in South Africa. The administration of Employee Share-Ownership Plans (ESOPs) is regulated by sections 96 (1) (c) and 97 of the Companies Act 71 of 2008. This thesis indicates that though ESOPs have the potential to alleviate poverty, they are under-utilised in South Africa. ESOPs are one of the powerful mechanisms that can be employed in fighting poverty in South Africa. What make ESOPs so powerful is the fact that they can be tailored for employees of any type of company. A financially healthy company can implement ESOPs by transferring share ownership to its employees. This can be done by issuing unissued shares within the company's authorised capital and providing financial assistance for purchase considerations, where necessary. Furthermore, companies may also repurchase already issued shares and then re-issue them to employees, as necessary. A company in financial distress can rely on Corporate Law reforms such as business rescue to restructure the business and subsequently implement ESOPs. A terminally ill company can sell the realised assets to employees to allow employees to start an ESOP. The thesis demonstrates that ESOPs cannot be effective in fighting poverty without capital growth, and thus, the government's involvement through policy changes and financial aid could enable the effective implementation of ESOPs. Though various economic theories have been advanced for economic growth, the thesis supports Kelso's view of binary economics, where employees rely on capitalism and capital ownership.

Key Terms: ESOPs, poverty, inequality, capitalism, employees, ownership, economic growth, development.

Acronyms

ACHPR	African Charter on Human and People's Rights
AEC	African Economic Community
Afcfta	African Continental Free Trade Area
AU	African Union
BEE	Black Economic Empowerment
CAT	Convention against Torture and other Cruel Inhuman and Degrading Treatment or Punishment
CEDAW	Convention on the Elimination of All Forms of Discrimination Against Women
CKD	Chronic Kidney Disease
CIPC	Companies and Intellectual Property Commission
CT-SCAN	Computed Tomography
DTI	Department of Trade and Industry
ECOSOC	Economic and Social Council
EPWP	Expanded Public Works Programme
ESOPs	Employee Share-Ownership Plans
ESOS	Employee Share-Ownership Schemes
IBDC	Indigenous Business Development Centre
ICCPR	International Covenant on Civil and Political Rights
ICESCR	International Covenant on Economic, Social and Cultural Rights

IDZ	Industrial Development Zone
IEC	Independent Electoral Commission
ILO	International Labour Organisation
LRAD	Land Redistribution for Agricultural Development
LRA	Labour Relations Act
LTIP	Long-Term Incentive Plan
OECD	Organisation for Economic Co-operation and Development
SAHRC	South African Human Rights Commission

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CHAPTER ONE

INTRODUCTION AND BACKGROUND OF THE STUDY

1.1 Introduction

South Africa's Gini-coefficient, which currently stands at an estimated 0.70 provides evidence of undeniably high poverty levels in the country. According to Bosch,[1] even though the South African people attained their freedom in 1994, the South African Government is still faced with various challenges ranging from poverty eradication to equitable distribution of wealth. There appears to be an inherent unequal distribution of income and wealth, a development that cannot continue without a principled policy and regulatory considerations. South Africa has nine provinces, and there must be a concerted effort from both the public and the private sector to ensure that the country's developmental goals are met in all its provinces.

Furthermore, section 9 of the Constitution of the Republic of South Africa guarantees everyone equal protection and benefit before the law. More specifically, section 9(2) places an obligation on the legislative branch of government to enact legislation that addresses the inequalities of the past. In particular, there is a need to ensure the improvement of the lives of persons who have been socially and economically disadvantaged by past discriminatory laws.[2] However, section 9(2) does not negate the principle of equality before the law by allowing the enactment of laws that may seem discriminatory because of advantaging one group as opposed to the others.[3] It should be understood that the aims of section 9(2) are simply to redress the inequalities caused by past discriminatory laws. Moreover, apart from section 9, section 27 aims to significantly reduce poverty by guaranteeing access to basic services and proper social assistance. Employee share-ownership plans could be one of the ways in which South Africa can

[1] Bosch, A. “A Second look at measuring inequality in South Africa: A modified Gini coefficient” (2010) Working Paper No 58; available at http://sds.ukzn.ac.za/files/WP%2058%20web.pdf, accessed on 8 July 2020.
[2] Section 9(2) of the Constitution of South Africa.
[3] Section 9 (5) of the Constitution of South Africa

address the issue of poverty and inequality.[4] In accordance with this constitutional imperative, the post-apartheid government of South Africa has introduced Vision 2030 through its National Development Plan. The eradication of poverty and inequality are constitutional imperatives.[5] The primary aim of the National Development Plan is to eliminate poverty and reduce inequality by 2030.[6] In addition, the South African legislature has also enacted the Broad-Based Black Economic Empowerment Act, 2003, [7] with one of its key objectives being promoting investment programmes that can lead to broad-based and meaningful participation in the economy by black people in order to achieve sustainable development and general prosperity, and consequently, reducing poverty and income inequality in the long run.

To decrease poverty and promote the equitable development of resources, economic programmes must be put in place and effectively implemented. Since the attainment of freedom in 1994, the government of South Africa has remained committed to developing equitable development policies. The National Public Works Programme, Expanded Public Works Programme (EPWP), and The Land Redistribution for Agricultural Development sub-programme (LRAD) are some of the government's initiatives aimed at addressing poverty and ensuring equal access to resources.[8] This is in line with the call made by the International Covenant on Economic, Social, and Cultural Rights for State Parties to implement policies and programmes to achieve economic, social, and cultural development.[9] Employee share-ownership plans (ESOPs) are one of the approaches that

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4 Apart from Section 9 (2) and section 27, section 217 of the Constitution speaks similar language of taking proactive steps to redress the effects of past discriminatory laws and practices in South Africa. Hence section 217 solidifies the Constitution's aim to redress the inequalities of the past and allow all persons in South Africa to participate in the ownership and economic development.

5 This is evident from section 9 of the Constitution which necessitates the use of legislative means to address inequalities. The Constitution's inclusion of socio-economic rights such as the right to water, food and health care in terms of section 27 and the right to accommodation under section 26 is a clear indicator of that the Constitution is the first tool with which the South African government fights poverty.

6 Spaull, N. & Jansen, J. D. eds., 2019. *South African Schooling: The Enigma of Inequality a Study of the Present Situation and Future Possibilities*. 1 ed. Switzerland: Springer International Publishing. p. 85, available at: https://www.gov.za/sites/default/files/Executive%20Summary-NDP%202030%20-%20Our%20future%20-%20make%20it%20work.pdf, accessed on 6 March 2021.

7 Broad-Based Black Economic Empowerment Act 53 of 2003.

8 Friedman, I., & Bhengu, L. 2008. *Fifteen-year review of income poverty alleviation programmes in the social and related sectors*. Durban: Health Systems Trust 21-22, available at: http:/www.healthlink.org.za/uploads/tiles/15yrreview_report.pdf., accessed on 6 March 2021.

9 Article 6 of International Covenant on Economic, Social and Cultural Rights.

could be employed to address poverty and inequality in South Africa. ESOPs are a plausible mechanism for allowing employees to own shares in a company where they are employed, receive dividends, and even become owners of the company concerned later on.

Employee share-ownership plans can be located in either social justice theories or economic theories. Approaching employee share-ownership plans from a social perspective with a view of eradicating poverty is problematic as the available literature demonstrates that any form of redistribution cannot be sustainably achieved in an economy that is not growing.[10] It is believed that by extending shares to the employees, share ownership plans can curb poverty and reduce inequality. Therefore, the quest is to advocate for 'growing the pie' and allowing each participant to get a larger share of the pie.

An ESOP involves the movement of the share-ownership from one party to another. According to the Companies Act 71 of 2008 (hereinafter the 2008 Act),[11] a share issued by a company is movable property, which can be transferred in any manner as provided for or recognised by the Companies Act or other applicable law.[12] Furthermore, in defining what a share is, the South African courts often cite with approval the case of *Borland's Trustees v Steel,*[13] where the court defined a share to mean:

> '*the interest of the shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second… A share is*

[10] Steele submits that the provision of social grants, for example, is not an effective means to reduce poverty as this could lead to dependency syndrome. Furthermore, according to Bourguignon F, the transfer of income to the poorest segment of society may reduce poverty only in the short term and are too small to really make a substantial difference. Bourguignon, thus suggests that it is crucial to boost people's capacity to generate income, both now and in the future. Deaton is of the view that ensuring equality of opportunity is important in the thirst for achieving social justice. Hence, instead of being receivers of resources, individuals should be afforded an opportunity to generate income and consequently have access to these resources.

[11] Companies Act 71 of 2008.

[12] Section 35 (1) of the Companies Act 71 of 2008.

[13] [1901] 1 CH 279 at 288. The courts in the case of *Liquidators, Union Share Agency v Hatton* 1927 AD 240 and *Smuts v Booyens, Markplaas (Edms) Bpk en 'n Ander v Booysens* [2001] 3 All SA 536 (A) (2 April 2001) have both made reference to the Borland's judgment with approval as far as the definition of a share is concerned.

an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.'

Ideally, it would appear as though the somewhat circular definition provided for in the Companies Act, which provides very little room for clarity on what exactly a 'share' is, was well consolidated in the *Borland* case.[14] This has significant jurisprudential influence as not only a working definition was laid out by the courts but also a formula for how a share is to be determined. However, what is evident is that case law and legislation have observed that a share is 'property' that creates enforceable rights.

The author asserts that allowing employees to own shares in their employers' businesses as a means to reduce poverty may involve a two-fold approach. Firstly, one may adopt a radical approach, where business owners with specified companies will be required to provide an opportunity to all their employees to own a certain number of shares or percentages in the particular company. On the other hand, the business owners may opt for a negotiated settlement to negotiate with the employees on how and when shares will be made available to the employees. However, the determination of the approach to be adopted plays a cardinal role bearing in mind the interests of both parties involved.

A comparative study has been undertaken with Brazil and Canada to establish the prospects and pitfalls of South Africa employing employee share ownership plans as a tool for decreasing poverty levels in the country.

1.2 Problem Statement

Like most African countries, South Africa, is at the point where the disparity between the rich and the poor is widening continuously. This is evident even though the South African Constitution calls for the implementation of policies to improve the welfare of its citizens. One such example is the Broad-Based Black Economic Empowerment Act, 2003.[15]

[14] *Borland's Trustees v Steel* [1901] 1 CH 279 at 288.
[15] Broad-Based Black Economic Empowerment Act 53 of 2003.

It is a moral requirement for businesses to fulfil their corporate social responsibility by giving back to the community. Often times, during this process of giving back to the community, employees of a business are excluded from benefiting from the company which employs them, either in the short-term or long-term. However, in an economy that is not growing, it is impractical for businesses to meaningfully assist the government with wealth distribution. You cannot distribute something which you do not have. For a long time, the South African government has been enacting and introducing social programmes to address poverty. However, poverty cannot be effectively addressed for so long as it is misplaced and tackled from a social perspective. Poverty can be better addressed by viewing it from the economic perspective, while appreciating the impact of social theories on wealth creation and distribution.

Furthermore, there is a limited legal framework that promotes the use of ESOPs in South Africa. Thus, owing to this *lacuna* in the law and policy, this thesis seeks to establish how ESOPs can be used as a mechanism to close the gap between the rich and the poor by simultaneously focusing on the theory of capitalism and how it can be used for social benefit. The thesis explores the concept of ESOPs through the existing South African legislative, regulatory and administrative framework and how this framework can effectively be employed in eradicating poverty and meeting South African developmental goals. Moreover, this thesis calls for the government's efforts in employing economic theories and practices to grow the economy. Positive economic growth will help ensure the successful implementation of the ESOPs and the regulation thereof.

1.3 Research Questions

The following research questions were used to investigate and explore the possibility of using ESOPs to address the problem of poverty in South Africa.

1.3.1 How can employee share ownership plans be utilised as a means to decrease poverty levels in South Africa?

1.3.2 Whether and how Corporate Law principles can be applied to ensure that companies have sufficient share capital to effect ESOPs in South Africa?

1.3.3 How do Corporate Law provisions in South Africa compare to similar rules in other countries in effecting ESOPs?

1.4 Hypothesis

The author identifies an inherent social inequality acute to poverty and unfair wealth distribution as being deeply rooted within the socio-economic injustices of the past. As pointed out in the introduction section of this thesis, South Africa's inequality continues to widen, despite the various approaches endorsed by the government to address poverty. Hence, the author identifies the current misplaced focus on fighting poverty as one of the fundamental flaws in the thirst to reduce poverty. Employing the right approach in fighting poverty assists with yielding the desired results. Thus, the idea is to seek a remedy that can address the surge of poverty in South Africa and, by extension, promote economic justice. The author accordingly proposes that poverty eradication should not only be viewed from an idealistic or socialist perspective, but rather it should involve the amalgamation of legal principles and economic theories. The author argues that by looking at ESOPs in a socialist system, one can argue that they offer very little sustenance to the problem of poverty. Consequently, it would seem that a balanced approach involving inclusive principles of economic justice could be sufficient to address poverty. Thus, South Africa can become a prosperous country where every individual lives above the poverty line.[16]

1.5 Research Methodology

[16] In 2007 STATS SA through the government's initiative established a threshold used for measuring poverty in South Africa. The establishment of a threshold for measuring poverty is key to addressing poverty. This is because it helps the country to target development policies and programmes towards identified groups and regions in the country. This is a focused-approach on alleviating poverty. A national poverty line can be used as a measure for policy decisions such as allocation of resources and the country's assessment of social and development needs. In measuring the official poverty line, it is essential to measure the money income required to attain a basic minimal standard of living. At commencement, the poverty line stood at R322 per person per month. (A National poverty line for South Africa- Statistics South Africa National Treasury, February 2007). In 2020, the food poverty line (FPL) stood at R 585 per person, the Lower-bound poverty line (LBPL) stood at 840, and the Upper-bound poverty line stood at R 1268 (Statistics South Africa-National Poverty lines 2020).

As evident from the title and the problem statement, this thesis aimed to test the plausibility of applying ESOPs to reduce poverty in South Africa. To achieve this goal, the author relied on various research methodologies to conduct this research.[17] The type of research that was used includes desktop research and literature review.[18] In a nutshell, the author employed the analysis and critical evaluation of the existing legal rules. The purpose of the analysis and critical evaluation was to find out how the country can correctly employ ESOPs to achieve its long-term development goals, particularly eliminating poverty and ensuring sustainable development. This requires a unified approach cutting across the fields of economics and law while primarily discussing ESOPs within the context of capitalism in an attempt to find the adequate policy for poverty eradication. This, therefore, calls for doctrinal legal research to evaluate the existing legal rules and theories and provide a supported view on the way forward. The primary pieces of legislation under discussion in this thesis include the 2008 Companies Act[19] as well as the Broad-Based Economic Empowerment Act, 2003.[20] Relevant case law were analysed where applicable, to answer pertinent legal questions and discuss legal principles. A doctrinal thesis requires mandatory incorporation of a theoretical foundation. Hence, chapter 2 of the thesis provided a theoretical framework, expounding on the works of Adam Smith, David Ricardo and Robert Ashford to further qualify the hypothesis. The thesis has been partly comparative in nature, as can be seen from chapters 5 and 6. Therefore, the author made use of a comparative study with countries that have implemented ESOPs, particularly Brazil and Canada, and considered the efficacy of such practices. This was done to investigate if the same practice can work in South Africa. The thesis also referred to secondary sources such as scholarly publications from various experts in the fields of law and economics, as well as commentary and

[17] Methodology, which refers to the research methods used and the theoretical orientations, is different from ontology and epistemology. Ontology deals with the fundamental nature of the world and what existence in the world means. Epistemology, on the other hand, refers to the study of the ground on which we claim to know something about the world. (See Oliver P., 'Writing Your Thesis' SAGE Publications Ltd.)
[18] It is at this stage where the thesis explained various concepts such as economic development, ESOPs, poverty, and capitalism as it pertains to the thesis. The aim of this is to ensure that the reader understands these concepts in the context that the author aimed to use them throughout the thesis.
[19] This was extensively done under chapter 3.
[20] This was extensively done under chapter 3.

academic writings of such experts in legal and interdisciplinary journal articles. Additionally, the author utilised internet sources to access other relevant sources.

1.6 Justification of the Study

South Africa, a country rich in mineral resources, namely, iron, copper, steel, diamonds and countless other mineral products, has one of the highest numbers of poverty in the world.[21] For long, many South African people have experienced severe effects of poverty, inequality and discrimination. It is now more than 26 years after attaining freedom, but there are still millions of South Africans living in extreme poverty.[22]

Therefore, the time has come for all South Africans to join hands to look for ways to address the plight of poverty and inequality. The research of this nature provides a platform to continue the conversations relating to the transformation that started shortly after attaining freedom. Hence, it is worth investigating whether the use of ESOPs can bring about positive results aimed at reducing poverty and inequality in South Africa. ESOPs contribute towards community development strategies.[23] Furthermore, trusts capitalise on public ownership and management of natural resources acting as sovereign wealth funds, providing revenue streams and directly funding public services.[24] Hence, because of ESOPs, even unemployed people can indirectly benefit from ESOPs.[25]

Using Brazil as a comparative jurisdiction is crucial as it is perhaps the country that resembles South Africa the most, considering its extreme income inequality, propensity to attract hot money capital flows, resource dependence and relatively sophisticated private sector.[26] Furthermore, the Brazilian corporate governance went through some

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[21] Statistical release Mining: Production and sales 2021, available at http://www.statssa.gov.za/publications/P2041/P2041January2021.pdf, accessed on 11 May 2021.

[22] Statistical Release National Poverty lines 2020, available at http://www.statssa.gov.za/publications/P03101/P031012020.pdf, accessed on 11 May 2021.

[23] Howard T, 'Democratising Ownership to Address Wealth Inequality' (2017), available at https://community- wealth.org/sites/clone.community-wealth.org/files/downloads/IPPR-TESTIMOMY-TDC-WEB.pdf, accessed on 30 September 2021.

[24] Ibid.

[25] Ibid.

[26] Odendaal, D 'South Africa and Brazil: A tale of two countries': How we made it in Africa', (2014) available at https://www.howwemadeitinafrica.com/south-africa-brazil-tale-two-countries/55580/, accessed on 22 March 2021.

major changes, which made Brazilian firms more attractive to raise equity capital, making Brazil the ideal country to use in the study.[27] In addition, in terms of the economic landscape, some Brazilian firms, such as Petrobas (operating in oil and gas) and Vale (operating in iron and steel), became world-class competitors. Also, the country's overall economic growth has improved radically over the past years due to changes in its Corporate Law reforms.[28] These factors, therefore, call for the need to use Brazil as comparative jurisdiction. Furthermore, employing a comparative study with Canada is essential for several reasons. One of the reasons for selecting Canada as a jurisdiction used in the study is that Canada is amongst the first countries that have introduced Corporate Law reforms. Throughout the thesis, it can be noted that although ESOPs find their basis in Corporate Law, labour law, to a certain extent influences the operation and continued existence of ESOPs.[29] Despite that fact that South Africa and Canada have different historical trajectories, both are members of the Commonwealth and have adopted various policies that reflect government intervention to promote employment equity.[30] Hence, it becomes crucial to undertake a comparative study between Canada and South Africa in terms of legislative instruments that impact the implementation of ESOPs. Canada is a developed country and a member of the Organisation for Economic Co-operation and Development (OECD), an organisation that seeks to promote the economic welfare of its members. Hence, studying South Africa and Canada together is advantageous for South Africa as a developing country in order to learn valuable lessons regarding the use of economic principles and policies on the use of ESOPs to achieve development goals, particularly poverty reduction.

Interestingly, the current thesis discusses socio-economic rights as derived from the constitution. The principles of the constitution find themselves in constitutional law, and one may ask why a thesis of this nature refers to issues of the constitution. The justification for this is two-fold. In a constitutional democracy such as in South Africa, the

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[27] Black, S., Carvalho, A., Sampaio, J. "The Evolution of Corporate Governance in Brazil", (2012) available at http://ssrn.com/abstract=2181039, accessed on 23 March 2021.
[28] Ibid.
[29] The influence of Labour law on ESOPs is discussed in detail in chapters 4,5 and 6 of this thesis.
[30] Jain H & Wikin C ''Employment Equity in Canada and South Africa: A Comparative Review'' 2012 23 (1) 2. *International Journal of Human Resource Management* 2.

constitution is the supreme law, and all other pieces of legislation, including Corporate Law, derive their legitimacy from the constitution. The second justification finds its place in the thesis topic, "Applying employee share-ownership plans as a transformation mechanism aimed at decreasing poverty levels in South Africa: A comparative socio-legal perspective''. Although the central theme of the thesis relates to the use of ESOPs, the second leg is on poverty reduction. The author would have committed injustice if the discussion on how poverty deprives one from enjoying fundamental rights such as the right to food, water, housing and health care. Hence, the thesis refers to socio-economic rights as a way to demonstrate that without the necessary means, one cannot enjoy the most basic rights.

1.7 The Conceptual Framework of Employee Share-Ownership Plans

1.7.1 Defining Principles of ESOPs

Employee share plans have been in existence as early as 1956.[31] The first Employee Share Ownership Scheme was formed by Luis O. Kelso, who has his origin in San Francisco.[32] The establishment of 'Kelso's employee share-ownership scheme' was born out of Kelso's belief that the company's employees are the ones who made the business successful as they knew the business in and out.[33]

If employees are granted tax advantages to buy shares in their own company, this could foster a sense of ownership and encourage employee share owners to work toward improving the company's performance.[34]

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[31] Menke J D & Buxton D C 'The origin and history of the ESOP and its Future Role as a Business Succession Tool (2010) 62(3) *Journal of Financial Service Professionals*, 5.

[32] Ibid.

[33] Hutchinson J D 'Employee Stock Ownership Plans: A New Tool in the Collective Bargaining Inventory (1976) 26 *American Unam Law Review* 536.

[34] Palcic D & Reeves E 'Employee Share Ownership Plans. In *Privatisation in Ireland*. London (2011) Palgrave Macmillan. pp. 132.

The above statement gives a glimpse of what employee share-ownership schemes are and why such schemes are introduced in a company. Therefore, in this section, the thesis provides a synopsis of the understanding of employee share-ownership plans.

An employee share ownership plan is a process that facilitates the holding of shares in a company for the benefit of the company's employees.[35] An ESOP is a form of investment where companies and employees put aside their resources with the expectation of earning returns in the future.[36] This process is administered through a trust, and as such, it has to follow all the legislative and policy frameworks of a trust.

Generally, an ESOP is a generic term representing a set of incentives meant for employees of a corporate entity.[37] It is a vehicle that permits both employees and management to share in the firm's profits.[38] The company and the employees should derive certain forms of benefits from the ESOP. Thus, contrary to popular belief, an ESOP should not be one-sided. The Companies Act defines an employee share scheme as a scheme established by a company allowing the company's employees and officers to have some form of participation in the company.[39] The participation can be enabled through the issuing of shares or by granting options for shares in the company.[40]

ESOPs are structured in different ways, but characteristically, they provide the beneficiaries of the scheme with similar features comprising the option of buying shares, voting rights and obtaining dividends.[41] Furthermore, company law provides businesspeople with a wide range of options to select from when deciding to establish a business. A single individual may decide to form a sole proprietorship, while another may decide to incorporate a private limited company, commonly known as a Pty. In the same manner, ESOPs have various objectives, depending on the size and liquidity of the

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35 Cassim F H I *et al*, Contemporary Company Law 2 ed (2012) 10.
36 Laopodis N *Understanding Investments: Theories and Strategies* 2ed (2021) 15.
37 Prabhakar K S 2018. ESOP – Income Tax Perspective (2018) 27 *The Institute of Cost Accountants of India Tax Bulletin* 15.
38 Mazibuko N E & Boshoff, C, 'Employee Perceptions of Share Ownership Schemes: An Empirical Study (2003) 34(2) *South African Journal of Business Management* 31.
39 Section 95 (1)(c)(i) of the Companies Act 71 of 2008.
40 Section 95 (1)(ii) of the Companies Act 71 of 2008.
41 Botha M Evaluating the United Kingdom Employee shareholder status provisions in the context of South Africa (2015) 78 *Journal of Contemporary Roman-Dutch Law* 556.

business, some of which are mutually beneficial to both the employer and the employees. Generally, an ESOP aims to achieve the following:

Firstly, to ensure that the employees identify with the organisation and, as such, promote greater loyalty. In other words, the employees become loyal to their employer if they get some form of ownership and reward.[42] This is, more important because as joint-owners of the employer's business, the employees feel the need to ensure that they remain loyal to the employer as this is mutually beneficial.[43] Organisational integration is the most effective way to promote employee loyalty. If the employees are loyal to the employer, they will act exclusively in the employer's interest.[44] In the case of *National Union of Mineworkers of South Africa obo Khanyile Nganezi and Others v Dunlop Mixing and Technical Services (Pty)* Limited,[45] it was shown that loyalty and self-denial require the worker to act solely in the employer's interest, [46] and this is what all employers desires from their workforce. In other words, both the employer and the employee should play for the same team in order to guarantee maximum benefits for the employer. For instance, if the employees' loyalty lies with the employer and/or the employer's business, this will increase turnover and loyalty, ultimately guaranteeing the overall success of the employer. The net assumption is that allowing or enabling employees to have access to ESOPs will encourage them positively, ensuring that they act in the best interest of the employer's business at all times.

Secondly, ESOPs align shareholder interests within the organisation. This will assist with better checks and balances, resulting in improved governance and information disclosure to trade unions, employees and the community. Employees who could otherwise not have insight into the employer's financial affairs become entitled to such information. Since employees become owners through ESOPs, they are entitled to certain information regarding the financial dealings of the employer's business, not as employees but as shareholders. This helps to promote good governance and accountability. In addition,

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42 Ibid.
43 Ibid.
44 Idensohn K 'The Nature and Scope of Employees: Fiduciary duties' (2012) 33 *Industrial Law Journal* 1539.
45 Unreported case no CCT202/18, 28-6-2019).
46 [2019] ZACC 25.

proper checks and balances guarantee efficiency, transparency, and better functioning of the business operations. Thus, accountability can be achieved in both ways. For example, employees will be accountable to the employer through meeting the targets set by the employer, and the employer will be accountable to employee-shareholders with regards to the profits made and dividends declared. Accordingly, Lord Acton, in 1887, wrote that; ‘‘power tends to corrupt; absolute power corrupts absolutely. Great men are almost always bad.’’ [47]

The above quote can be interpreted to mean that in the absence of accountability, it is easy for corruption to creep in. Thus, it is for this very reason that proper checks and balances are needed in all facets of the private and public administration to promote good governance. No system or administration can succeed without proper structures of corporate governance.

Thirdly, ESOPs are believed to provide more resources for employee retirement or resources that can be used as collateral for loans, and thus, create a form of investment for employees. Furthermore, ESOPs demand greater commitment by the employees to be productive and thereby promoting the long-term survival of the company or organisation. [48] Employees that have beneficial interests in the affairs of their employer tend to be motivated and committed to the duties owed to the employers. This has the potential to increase productivity and maximise returns. In the end, the employee’s commitment to the employer is beneficial to both the employee and the employer.

Finally, businesses normally form ESOPs with the purpose to align the employees’ interests with those of other shareholders and provide employees with compensation for business restructuring in the form of a share of enterprise profits.[49]

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[47] Online Library of Liberty (OLL), available at https://oll.libertyfund.org/quote/lord-acton-writes-to-bishop-creighton-that-the-same-moral-standards-should-be-applied-to-all-men-political-and-religious-leaders-included-especially-since-power-tends-to-corrupt-and-absolute-power-corrupts-absolutely-1887, accessed on 05 May 2021.

[48] Institute for the Study of Employee Ownership and Profit Sharing. 2019. Building the Assets of Low and Moderate Income Workers and their Families: The Role of Employee Ownership.

[49] Palcic D & Reeves E 2011. Employee Share Ownership Plans Op Cit note 34 at 132.

1.7.2 Why ESOPS?

a) Business Succession or Ownership Succession

Business succession is important to business owners. Companies are formed with long-term goals, and perpetual succession is at the core of the strategic goals of each corporation. In order to guarantee the continuity of business operations, business owners have to choose between financial investors, competitors or employees to take over the ownership of the business.[50] Therefore, private owners may decide to sell their businesses to the employees to guarantee perpetual succession. Transferring ownership to employees ensures that the business operations continue without any potential job losses.[51] ESOPs can therefore be formed to implement this aim.[52] Most often than not, owners of companies do not want to sell their business to anybody. Their wish might be that the company be left in the hands of those who are 'familiar' with its operations and aim to continue the legacy built by the owners. Principles of intellectual property such as patents, trade secrets, and employee-centred factors such as loyalty and commitment may influence business owners to form ESOPS and 'hand over' the business to their employees. The eligibility of ownership trust to borrow funds to purchase shares ensures that owners receive their fair market value of the business, while ensuring that employees receive an ownership stake without buying using their personal savings.[53] Even though business succession would be one of the potential reasons to implement ESOPs, it is not a clear-cut case. The factors such as workforce, the stock-in-trade, the business's premises, contracts with clients or customers, the business's assets, and the business's debts are all worth considering before selling the business to employees.[54]

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[50] Social Capital Partners ''Building an employee ownership economy'' Discussion paper, available at http://www.employee-ownership.ca, accessed on 09 May 2021.

[51] Ibid.

[52] Ibid.

[53] Ibid.

[54] *National Education Health & Allied Workers Union v University of Cape Town & others (2002) 23 ILJ 306 (LAC).*

b) Insolvency

Businesses are formed to make a profit and remain liquid and solvent. However, due to the changes in the world economic order and the effects of competition, some companies run the risk of insolvency. Insolvency occurs when the business cannot finance its liabilities through its assets. In other words, insolvency is when the business cannot pay its debts when they become due and payable. The transfer of companies to employees can be used as an effective route towards recovering failing businesses, thereby avoiding insolvency. An important aspect that guards against insolvency is the increased productivity in ESOP companies. The South African legislature has introduced the business rescue process to salvage companies in financial distress, thus preventing liquidation.[55] In the case of *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others,*[56] the Supreme Court of South Africa was for the first time called upon to clarify certain issues relating to business rescue law in South Africa. The court reiterated the importance of section 128 of the Act, stating that business rescue aims to bring the company to a solvent state. Another reason for the business rescue is to secure a better business deal for all stakeholders involved. ESOP companies attract higher-quality employees and promote cooperation between employees.[57] This leads to higher productivity, which positively affects the company's financial stability.[58] Hence, a combination of the business rescue process and the introduction of ESOPs can help prevent insolvency. Of course, the business rescue process precedes the introduction of ESOPs. The concept of business rescue is explored in detail in chapter 3.

c) Privatisation

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[55] Lotheringen A 2013, Going out of business rescue or getting rescued. What are the odd?, available at http://www.tma.sa/events/events-presentations/60,presentation-by-amenda-lotheringen-of-cipc-october-2013/file.html, accessed on 09 May 2021.

[56] (609/2012) [2013] ZASCA 68 (27 May 2013).

[57] Social Capital Partners op cit note 50.

[58] Ibid.

Privatisation is the transfer of ownership from state-owned property to individual persons or groups with the intention to utilise such property for private benefits and profit maximisation.[59] Due of its aim to maximise profits, privatisation is believed to have favourable effects on the previously ailing financial health of the sector by reducing the deficits and debts. However, unlike the public sector, which initiates socially viable adjustments in critical cases, the private sector largely concentrates on profit maximisation and less on social objectives, , and this is seen as a major drawback. Even though the purpose for establishing the enterprise usually is to achieve economic benefits, privatisation is believed to encourage malpractices like the producing lower quality products, and elevates hidden indirect costs, all in the name of maximising profits.[60]

1.7.3 Administration of ESOPs

As previously stated, an ESOP can be administered through a trust. For this reason, companies need to have a good grasp of the principles of a trust and the functions of trustees. A trust may be defined as a legal relationship created in a trust instrument.[61] A trust instrument is also commonly known as a trust deed.[62] A trust instrument is the founding document of a trust and serves the same purpose as the memorandum of incorporation required in relation to a company. In terms of section 95 (1) (c), the employee share-ownership plan may be managed through a trust. If a company intends to use a trust, it must establish a trust to create a trust fund and appoint trustees to manage the employee share-ownership plan.

As an alternative to creating a trust for managing ESOPs, the law[63] requires the appointment of a compliance officer to deal with the administration of the fund. This compliance officer has a statutory duty of accounting to the board of directors in relation

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[59] Kousadikar A & Singh T 'Advantages and disadvantages of Privatization in India' (2013) 3(1) *International Journal of Advance System and Social Engineering Research* 20.
[60] Ibid.
[61] Davis D *et al Companies and other Business Structures in South Africa* 3 ed (2013) 35.
[62] Ibid.
[63] Companies Act 71 of 2008.

to the employee share ownership plans.[64] Therefore, all the companies in South Africa that intend to establish employee share-ownership schemes must either appoint a compliance officer or use a trust to administer ESOP funds for that purpose. This is a peremptory requirement.

A trust is a vital and flexible mode of business and may be used for a number of reasons.[65] This may include estate planning, facilitating share incentive schemes, or providing an investment vehicle.[66] Its flexible nature makes it the ideal form of business for ESOPs. Hence an employee ownership trust most commonly provides employees with a vehicle to have indirect ownership as beneficiaries in a trust[67], and assist the employees to borrow trust funds to purchase shares for their benefit so that there is no need for a cash investment to be made by the employees.[68]

As permitted by statute, the operations of employee share-ownership plans may take the form of a trust or otherwise.[69] In South Africa, the operation and administration of trusts are regulated by The Trust Control Property Act, 1988.[70]

Section 1 of the Trust Property Control Act[71] provides an elaborative definition of a trust. In terms of this statute, a trust is defined as the process through which one person's property ownership is transferred to another by the execution of a trust instrument. The act identifies various parties to a trust agreement, namely, the trustee and the beneficiaries. Additionally, the Act clarifies that property is entrusted to a trustee, to be administered or disposed of in accordance with the trust instrument's provisions for the benefit of the beneficiaries. The administration of one's property as an executor or curator in accordance with the provisions of the Administrative Code (Act 66 of 1965) is, however, not covered by the definition of trust in terms of the Act.[72]

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64 Section 97 (1) of the Companies Act 71 of 2008.
65 Collier-Reed D & Lehman K *Basic Principles of Business Law* 2 ed (2010) 347.
66 Ibid.
67 Social Capital Partners op cit note 45.
68 Ibid.
69 Section 95 (1) (c) of the Companies Act 71 of 2008.
70 Trust Property Control Act 57 of 1988.
71 Ibid.
72 Ibid. section 1 (a) and (b).

The study of the legislative definition of a trust as outlined above enables one to deduce some components of a trust. Firstly, a trust consists of a founder who makes available the trust instrument. In other words, the founder provides the trust instrument. The second component of the trust is the trustees. Trustees are responsible for administering the trust. Beneficiaries are the third component of a trust. These are identified persons for whose benefit the trust was founded. The last component of a trust is the purpose or the objectives for which the trust was established. It is important that trustees must administer a trust in a manner to achieve the objectives of the trust, chiefly to benefit the beneficiaries or advance the stated purpose or objective.

Furthermore, establishing a trust involves various stages, and drafting a trust deed is the first step. A trust deed is a document that outlines all provisions related to the governance and operations of a trust. It includes information with regards to the trust capital, which is the amount that the founder donates or contributes to the trust fund to utilise and further the objectives of the particular trust. The trust deed also contains information about the appointment and termination of trustees.[73] The overarching responsibility of the trustees is to administer and control trust property and ensure that the objectives for establishing the trust are achieved.[74] In addition, the trust deed must also make reference to the distribution of income to the beneficiaries. The main reason for the trust is to benefit beneficiaries, and the failure to do so will be a misnomer. Another important aspect that forms part of the trust deed is about meetings. The trust deed states the number of meetings to be held per year and the operations during such meetings, such as the minuting of discussions and resolutions taken.[75]

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[73] The death, dismissal, insolvency, declaration of unsound mind or resignation of a trustee will terminate his or her affiliation to the board as a trustee and in this case, the remaining trustees will nominate a suitable replacement.

[74] The trustees may also nominate a director from them; employ persons to manage or assist with achieving the objectives of the trust; appoint an agent to represent them for any specific purpose (this may include accountants, legal practitioners and other professionals who may be best suited for the attainment of the objectives of the trust). The trustees in terms of the trust deed may also be entitled to invest the capital amount and any such funds not required for any particular purpose.

[75] Ultimately a trust deed is an important document when it comes to the operations of a trust as it set the framework within which the trustees must act, provided that such actions or inactions are within the scope and framework as set out by Trust Properties Control Act 57 of 1988. Thus, a trust deed may provide for terms and conditions more honourous to those set out in the Act. However, it cannot leave out important statutory requirements that is ought to be included in a trust deed.

Another practical operation required to establish a trust is the opening of a bank account in terms of the Banks Act of 1990. The trust deed must also make reference to the opening and operating of the bank account. All funds received on behalf of the trust and for the benefit of the beneficiaries must be duly deposited into the banking account opened for that particular purpose. This is essential for accountability and transparency purposes. Apart from accountability, the keeping of a banking account facilitates the safekeeping of money. Thus, money received on behalf of a trust is kept better in a banking account than elsewhere.

Ordinarily, a trust deed or a trust instrument creates a trust relationship between the founder and beneficiaries. A person who forms a trust is referred to as a founder, donor or settlor of the trust.[76] The founder places assets under the control of the trustees to benefit the beneficiaries,[77] since the underlying reason for founding a trust is to benefit beneficiaries. Thus, for a trust to be valid, it must have at least one beneficiary.[78] In establishing an employee share-ownership plan, the employer will be the founder of such a scheme, whilst the employees for which the scheme is established will be the beneficiaries. In *Lupacchini NO & another v Minister of Safety and Security (*SCA), Nugent JA observed that '... A trust that is established by a trust deed is not a legal person ─ it is a legal relationship of a special kind that is described by the authors of *Honoré's South African Law of Trusts* as "a legal institution in which a person, the trustee, subject to public supervision, holds or administers property separately from his or her own, for the benefit of another person or persons or the furtherance of charitable or other purposes."[79]

In other words, although it is not a separate legal person, a trust enjoys some of the consequences of a separate legal personality in that there is a distinction between the founders of the trust and the trust property.

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[76] Davis D *et al*. *Companies and other Business Structures in South Africa* Op cit note 61.
[77] Ibid.
[78] Ibid.
[79] 2010 ZASCA 108; 2010 (6) SA 457.

In the case of *Gowar v Gowar*[80], the court stated that a trustee shall, in the performance of his duties and the exercise of his powers, act with the care, diligence and skill which can be expected of a person who manages the affairs of another. This decision affirms the statutory duty of trustees to exercise care, diligence and skills reasonably expected of a person who manages the affairs of another.[81] Furthermore, a trustee shall not by any means be exempted from acting with care, diligence and skills when administering the affairs of others.[82] Therefore, it is submitted that as long as one is administering the property of another, one is required to be mindful of their conduct in the administration of the said property. Hence, one must act with extra care and show diligence and skill of the highest degree in handling the property entrusted to their care. Failure to show proper care, skills and diligence may invite lawsuits against the trust. In extreme circumstances, the trustees may be held accountable should it be proven that they have been negligent in the handling of the trust.

In *Braun v Blann and Botha NNO & Another,* [83] the court stated that the trustee is the owner of the trust property for purposes of administration of the trust but *qua* trustee has no beneficial interests in such property. This means that although *sensu stricto* the trust property is not owned by the trustees but they are simply responsible for managing the trust property in the interest of beneficiaries, the trust property can be regarded as owned by the trustees to administer the property. It is submitted that the purpose of treating the trustees as owners of the trust property is that one can take better care of their own property compared to that of another person. It is further submitted that a person who invests in shares wants to receive a good dividend on such an investment and thus, will be careful of the decisions he/she will make regarding the investments. How much to invest, where and when to invest, and the duration of the investment are all questions that one will ask themselves before investing some funds. Similarly, when it comes to the trust property, the trustees as custodians of the trust property must be extra cautious in administering the trust property. The guiding principle in the handling of the property is

[80] Unreported judgement 149/2015) [2016] ZASCA 101 (9 June 2016).
[81] Section 9 (1) of Trust Property Control Act 57 of 1988.
[82] Section 9 (1) of Trust Property Control Act 57 of 1988.
[83] See 1984 ZASCA 19; 1984 (2) SA 850 (A) at 859D-H.

always the benefit that can be enjoyed by the beneficiaries. In other words, the trustees' actions in dealing with the trust property must benefit the beneficiaries.

The concept of separate legal personality mandates that when an individual responsible for dealing with trust property, including trust money, receives money in his/her capacity as a trustee, he or she shall deposit such money in a separate trust account at a banking institution or building society.[84] It is submitted that keeping a separate trust account is important for accountability purposes. Thus, every cent that one receives and keeps on behalf of another must be accounted for. The lack of proper exercise of accountability may result in the mismanagement of funds. The mismanagement of funds may breed theft, corruption and embezzlement as well as adversely affect the interests of the employee-shareholders in terms of an employee share-ownership scheme. If the funds allocated to employee share-ownership schemes are not properly accounted for, this may defeat the purpose of creating the share scheme. As a trustee, one is required to show forth certain character traits when it comes to dealing with the affairs of others. The fiduciary duties imposed on trustees are substantially similar to those duties directors owe to the company, as expounded below.

A trustee stands in a fiduciary position towards the beneficiaries on whose behalf they are required to manage the trust property. Thus, there are certain duties that a trustee must comply with. Firstly, a trustee is required to observe a duty of care, skills and diligence in executing his or her mandate. The extent of one's duty of care and skill largely depends substantially on the nature and essence of the organisation's business and on any other particular obligation assumed by or assigned to the particular individual who stands in the fiduciary position towards others. In general, a trustee may not be expected to have any particular business acumen, ability or intelligence.[85] Thus, it is submitted that a trustee appointed to oversee the trust fund and operations of the employee share-ownership plan must ensure that he or she manages the fund in a manner beneficial to and in the interest of the employee-shareholders.

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[84] Section 10 of Trust Property Control Act 57 of 1988.
[85] *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* 1980 (4) SA 156 (W) at 156.

Secondly, the trustees or compliance officer should always keep in mind that the primary objective of employee share-ownership plan is wealth creation and poverty alleviation. Therefore, the conduct of the compliance officer should be geared towards taking all steps in performance of their mandate to assist the employee-shareholders to yield results or 'fruits' that will improve their social and economic status. In a nutshell, the trustees must be careful and diligent in administering the trust property to ensure that the employee-shareholders receive the benefits in terms of the scheme and improvement of their well-being.

Trustees are expected to act ethically when discharging their duties. The duty of care mandates trustees to perform their duties with the utmost good faith in a judicious manner. According to Butler, trustees need to act in the best interests of all beneficiaries and members.[86] At the end of the day, the trust or the scheme (in the case of the employee share-ownership scheme) is created to provide the employee-shareholders with some form of benefit. Thus, it is important for employee-shareholders to have the opportunity to enjoy such benefits.

As long as one acts honestly in performing his/her duties, he or she cannot be held responsible for the payment of damages. To be held liable, it must be proven that a person who stands in a duty of trust towards another was grossly negligent when discharging his or her duties. The primary basis in determining the liability of a trustee is what we term 'a reasonable man test'. The question is formulated as follows: ''How could a reasonable person who finds himself in the similar shoes of the particular trustee have acted?" Although it's not cast in stone, the trustee's mandate, level of qualification and experience will guide the court in determining whether the trustee was negligent when performing his or her duties or whether the trustee discharged his or her duties diligently. It is required that each trustee exercises due care in performing his or her duties and acts in a manner as a reasonable person could have acted. Negligence will most likely be evident when a trustee is proven to have acted contrary to the manner in which a person of his or her

[86] Butler *et al* "The process of ethical decision- making in South African retirement funds" 2015 SAAJ 173.

calibre, qualifications and experience has acted.[87] It is submitted that acting negligently has severe consequences for the trust property and may seriously affect the benefits of the employee-shareholders. The maladministration of trust property may, for instance, not yield better results for the beneficiaries. In the end, the beneficiaries may be denied the benefits that accrue to them simply because of the negligent dealings of the trustees.

Another equally important duty of the trustee is the need to observe impartiality. The concept and duty of impartiality require trustees to ensure that all beneficiaries receive equal and objective treatment from the trustees. In other words, all employee-shareholders are to receive equal treatment. Any differing form of treatment should be mandated by lawful justification to avoid allegations of unethical behaviour, which in turn results in a breach of this duty. Impartiality is a cornerstone of justice and an important factor in giving effect to social justice.[88]

It is submitted that the duty of impartiality in relation to employee share-ownership plans requires much focus. Employee-shareholders find themselves in the position they are primarily because of the inequalities of the apartheid era. They were treated unequally compared to their fellow men and women of different class and/or social and ethnic groups. It is further submitted that a differing form of treatment without lawful justifications opens wounds of the past that may not have completely healed for the employee-shareholders. In addition, a differing treatment without a lawful justification will negate the purpose of employee share-ownership. Introducing a plan to reduce poverty among your employees, their dependents, and their community will not achieve the desired results if the administration of such plans causes conflict and division amongst the employee-shareholders. Therefore, the duty of impartiality calls for equal treatment and no favouritism, nepotism or corruption.

The third duty of a trustee is the need to avoid any conflict of interest in discharging one's duty as a trustee. Ensuring that there is no conflict between one's personal interest and the interest of others is employed to serve is a common law fiduciary responsibility. A

[87] Re Brazilian Rubber Plantations and Estates Ltd, available at https://discovery.nationalarchives.gov.uk/details/r/C5047423, accessed on 30 June 2020.
[88] Butler (2015) op cit note 86 at 177.

trustee appointed to oversee the employee-share ownership fund must act objectively and independently. This requires that such a trustee must be able to consider the best interests of the beneficiaries and not what is best for the trustees.[89] The trustee's duty to guard against conflict of interest was reiterated in the case of *Jowell v Bramwell-Jones and Others,* where the court stated that a trustee must usually avoid as far as possible a conflict between her personal interests and those of the beneficiaries.[90] It is thus, submitted that the interest of beneficiaries must take preference over the personal interest of a trustee in the event that there is an actual or perceived conflict of interest.

It is further submitted that persons appointed to the office of a trustee should understand that they owe a fiduciary duty towards the employer as well as the employeeshareholders. Hence it is prudent that a trustee upholds the objectives of the trust fund that is established on behalf of the employees as the beneficiaries. A proper understanding of one's duties and the rationale of such duties ensures that one is able not only to perform the required duties but also perform such duties to achieve the desired and projected results.

1.7.4 Understanding of Share Ownership

The rationale of this section is to provide an analytical discussion on the meaning of a share in the context of ESOPs. When an ESOP is introduced in a company, employees become shareholders and thus hold shares in the company in the form of "employee-shares.''

Section 1 of the Companies Act defines a "share" as one of the units into which the proprietary interest in a profit company is divided. A share issued by a company is movable property that can be transferred in the manner set out by the Companies Act or other related law.[91] In the case of *Standard Bank of South Africa Ltd v Ocean Commodities Inc,* a share was defined as comprising of a conglomerate of personal rights which permit the holder thereof to certain interests in the company, its assets and

[89] Ibid.
[90] *Jowell v Bramwell-Jones and Others* 2000 (3) SA 274 (SCA).
[91] Section 35(1) of the Companies Act 71 of 2008.

dividends.[92] This means that an employee-shareholder like any other shareholder has rights embedded in a particular class of shares, i.e. ‘’employee shares.’’ In other words, a preference shareholder may not necessarily have the same rights as an ordinary shareholder. In actual fact a preference shareholder will have priority with regards to dividends and/or return of capital.[93] On the other hand, ordinary shareholders do not have ‘preferred rights.’[94] Similarly, an employee who is not a holder of employee shares may not enjoy any rights attached to ESOPs.

a) Authorisation of Shares

The memorandum of incorporation, which is the founding document of a company, must clearly state the total amount of the share capital.[95] Share capital can be defined as the portion of a company’s equity that has been obtained by the issue of shares in the company to a shareholder, usually for cash.[96] Subsequently, authorised share capital is also known as the number of stock units (shares) that a company can issue as stated in its memorandum of incorporation. Often, share capital is not fully used by management in order to leave room for future issuance of additional shares in case the company needs to raise capital quickly.[97] This share capital is divided into shares that can be taken upon authorisation and issue, respectively. Shareholders obtain rights over shares once such shares are issued to them. In other words, an authorised share has no rights attached to it until it is issued.[98] The issue of raising capital might not necessarily be effective when ESOPs come into play. Normally a company does not implement ESOPs with the idea of raising capital. ESOPS are implemented to promote employee loyalty while assisting employees to have some form of ownership and derive benefits. Therefore, it is imperative that the company’s objectives are clear and the current shareholders take firm decisions regarding the issuing of shares for the purposes of ESOPs. This will avoid

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[92] *Standard Bank of South Africa Ltd v Ocea Commodities Inc* 1983 (1) SA 51 (C).
[93] Cassim F H I *et al*. Contemporary Company Law Op cit note 35.
[94] Ibid.
[95] Ferran E *Company law and corporate finance* (1999) Oxford University Press 279.
[96] Kirti D “Share Capital: Exploring the backbone of company law” (2018) Research Gate 7.
[97] James Chen ‘’What is Authorized Share Capital?’’ (2020) available at https://www.investopedia.com/terms/a/authorized-share-capital.asp, accessed on 31 May 2019.
[98] Section 35(4) of the Companies Act 71 of 2008.

friction, let alone possible lawsuits between the existing shareholders and the company. Therefore, one does not become the owner of shares upon authorisation of such shares. Authorisation of shares means permitting shares to be issued. Only once the authorised shares have been issued can the person or entity to whom the shares have been issued exercise rights attached to the shares so issued.[99] As previously stated, a share in a company consists of personal rights. Shareholders are entitled to enjoy this right. For example, when dividends are declared in a company, employees who are holders of shares in such a company will be entitled to share in such dividends.

Upon issuing shares to its shareholders, a company provides the shareholder with a share certificate. This share certificate is a written document that all designated signatories sign on behalf of the company, and it serves as legal proof of ownership of the shares. In other words, a share certificate issued to an employee-shareholder is the *prima facie* proof that such employee is a shareholder, entitling him or her to enjoy benefits attached to a particular share held by him or her.[100] Contents of a share certificate include the certificate number, the company's registration number and address, the name of the registered holder, the number and the description of the shares, the degree to which they are paid up and the date of the certificate.[101] A share certificate thus provides the shareholder's full name, the name of the company issuing shares, the number of shares issued and the value of each share.

b) Acquisition of Shares

Shares in a company may be acquired by a natural person or a juristic person. A juristic person is required to register with the Companies and Intellectual Property Commission

[99] Section 38 (1) of the Companies Act 71 of 2008. This provision states that '*The board of a company may resolve to issue shares of the company at any time, but only within the classes and to the extent, that the shares have been authorised by or in terms of the company's Memorandum of Incorporation, in accordance with section 36*.'

[100] *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and others* 1983 (1) SA 276 (A) at 288.

[101] Smith D *Company Law* (1999) 214.

(or an equivalent foreign agency) as a juristic person before acquiring shares in another company.[102]

To assist employees in acquiring shares, some mechanisms must be put in place to secure funds to implement ESOPs. Companies may take advantage of section 44 of the Companies Act, which permits them to extend financial assistance for the subscription of shares.[103] This means that companies will set aside funds to be used for financing ESOPs in line with the requirements of the section. This approach may work well for a financially healthy company as companies are required to satisfy, among other requirements, the solvency and liquidity tests. However, in the ailing economies of developing countries, it is difficult for companies to provide finances to employees to purchase shares. Hence, there is a need to establish mechanisms that can assist employees to participate in ESOPs without financial hurdles. In the following chapters, the thesis explores the possible mechanisms that can assist employees and companies in this regard.

The manner in which a natural person or entity secures funds for the purchase of shares is of little significance when it comes to the general acquisition of shares. However, securing funds becomes important when it comes to ESOPs, considering the objectives of establishing ESOPs. In the spectrum of economic justice, ESOPs are formed to address inherent inequalities and poverty. In establishing ESOPs, it is therefore crucial to first clearly identify the reasons for forming the scheme and assess the possible liquidity constraints of employees and the profitability of a company. This will determine the method to be used in securing funds for the scheme.

c) Securing Funds for ESOPs

(i) Purchase of Shares by Employees

Employees can obtain shares ownership in a company by directly purchasing the same from the company. This way of obtaining shares is not always easy, as the possibility of

[102] Ibid.
[103] Section 44 of the Companies Act is discussed in more detail in chapter 3.

securing ownership may be restricted by employees' liquidity constraints.[104] Low-earning employees cannot save up enough cash on their own, and usually find themselves shut out of lending markets.[105] This is because low-earning employees do not necessarily have any property to give as security in respect of their loans. In certain instances, some companies assist employees to acquire shares by selling shares on favourable terms.[106] However, due to ailing economies and collapsing markets, it is difficult for companies to sell shares to employees at a reduced price if the economy is not growing.

(ii) Share Options

A company grants a share option to its employee to buy shares from the company at a later date[107]. Generally, companies grant options to their employees as part of their

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[104] Kaarsemaker, E., Pedleton, A., and Poutsma, E., '*Employee Share Ownership Plans: A Review*' (2009) Working Paper NO.44. University of York, the York Management School, p. 6, available at http://www.york.ac.uk/management/research/workingPapers.htm,assessed on 8 June 2019.

[105] Lustig, Nora & Arias, Omar & Rigolini, Jamele. (2002). Poverty Reduction and Economic Growth: A Two-Way Causality.

[106] Kaarsemaker (2009) op cit note 104.

[107] Newman, P ''What *are Share Options*?'' Shares and Shareholders, (2020) available at https://www.informdirect.co.uk/shares/what-are-share-options/, accessed on 17 July 2019. An option is regulated by the principles of the law of contract, in particular that of offer and acceptance. Offer and acceptance is a manner of reaching a consensus between contracting parties. An offer is a declaration made by the offeror of his/her intention to be contractually bound; and the offeror formulates rights and obligations which he/she wishes to be binding on the parties (Fouche MA, et al Basic Principles of Contracts and Commercial Law, 26). An acceptance is a declaration by the offeree indicating the offeree's intention to be bound to the offeror on the terms and conditions set in the offer. (Fouche MA, et al Basic Principles of Contracts and Commercial Law, 26). A valid offer and acceptance form a legally binding contract provided that other requirements of a valid contract are met, the option being an ancillary agreement to the main agreement which must comply with the principles of offer and acceptance. An option keeps the original offer open until accepted or until the time frame set in the option lapses. Once the original offer is accepted, a valid contract is formed between the parties. Because an option is an agreement, any breach of an option will invite contractual remedies. The law governing options was well set out in the case of *Brandt v Spies* 1960 (4) SA 14 (E), where the court ruled that in an option contract, "If the main offer is invalid for some reason (such as for the absence of compliance with formalities) or illegal, the option contract will fail for lack of certainty. However, it also held in the same vein that when it comes to the issue of whether an option contract must also comply with the formalities prescribed by law for the valid formation of the substantive contract, it resolved regarding the formality of writing that, "A verbal agreement to keep open a written offer for the sale of land is a valid option contract". Thus, owing to its validity, it has all the tenets of a valid contract and is enforceable. Therefore, this ruling could be extended to a company, meaning that after entering into a share option with its employees fails to comply with the provisions of such an option contract, the employees can equally have recourse against such a company in the form of remedies.

inclusive remuneration package, which motivates employees to align between the interests of the employees and those of the company's shareholders.[108]

Share options do not confer any rights to vote or receive dividends in respect of the options to the holder thereof. Upon full purchase, the option holder will be entitled to enjoy voting and dividend rights attached to those shares.[109]

As stated earlier, the share option does not make employees shareholders, and employees only become shareholders upon exercising the options by purchasing shares. Again, issues relating to insufficient cash caused by the employee's financial constraints may hamper the process of purchasing shares.

Companies may avoid entering into the share option arrangement because of its possibility of inviting damages for breach of contract. Court cases resulting from the breach of contract impose unwanted financial burdens on the company and may also bring the company's good name into disrepute.

(iii) Donation of Shares by a Company

A company may decide to invest in share ownership plans for the benefit of its employees. This happens when a company donates shares to its employees to be held in a trust. In such a scenario, employees do not spend much on the acquisition of shares as the donation is made by the company. In practice, companies always determine their financial position before donating shares to the employees. This is in line with the solvency and liquidity requirements, as discussed later in this chapter. In terms of section 40 of the Companies Act, 2008, the directors may issue shares in return for labour or skills.

Companies that were primarily formed for the purposes of ESOPs may be willing to donate shares to employees as this is their primary business. In other words, in a country such as South Africa, where the companies are to a certain extent also struggling financially, especially during the advent of COVID-19, it is almost impossible for a

[108] Ibid.
[109] Ibid.

company to be expected to donate shares to employees to implement ESOPs. Therefore, there is a need to increase the pie. In an effort to increase the pie, developing countries such as South Africa need to revisit their social and economic policies and ensure that such policies harness and promote trade and entrepreneurship. Without taking stands in ensuring that economic growth takes place and companies are able to make good returns, donating of shares by companies to their employees is wishful thinking.

d) Financial Aspects and ESOPs

Assessed from the employee's perspective, ESOPs may be viewed as an effective way to assist them to obtain some form of ownership in the company. ESOPs can provide employees with an avenue to participate in the ownership of their company. However, as a juristic person, a company is required in terms of the law to comply with the solvency and liquidity test before extending some form of financial assistance to an employee to become an employee-shareholder. Companies are formed primarily with the objective of making a profit. Thus, any transaction within a company must be of such a nature that the company does not make a loss or is impoverished through such a transaction. Directors of a company must ensure that a transaction through which they bind the company must not place it in a financial position that is worst off when compared to the situation before the transaction took place. Therefore, to ensure that both the company's finances and shareholder's interests are protected, the South African company legislation requires companies to carry out the solvency and liquidity before they enter into certain transactions, especially where such transactions require a company to provide financial assistance for the purpose of acquiring shares in the company.[110] Although both solvency and liquidity tests are used to determine the company's financial status, the solvency ratio focuses on the company's long-term ability to pay for its liabilities. In contrast, the liquidity ratio indicates the company's ability to pay for its short-term debts.

The solvency ratio involves the assets and liabilities of the company. It entails that the company's assets must be able to cover its liabilities. Hence, when assets exceed

[110] Section 4(1) and section 44(3)(b) of the Companies Act 71 of 2008.

liabilities, a company is deemed solvent.[111] On the other hand, if the company's liabilities exceed its assets, it is insolvent. To ensure that a company remains solvent after any distributions or donations are made, an assessment should be undertaken to determine the company's financial status, prior to such an exercise. If such an assessment is negative, distributions should not be made. The balance sheet is used to calculate the solvency ratio. A healthy solvency ratio is 4:1, 4 representing the assets and 1 representing the liabilities.

The liquidity ratio, which is represented on the income statement, is used to determine the company's ability to pay for its short-term debts. A company will be deemed insolvent if it cannot pay for its debts as they become due in the ordinary course of business for twelve months.[112] Similar to the solvency ratio, the law demands that a prior assessment be undertaken regarding the company's financial status after the distribution. A healthy ratio is 2:1.

From the above discussion, it is clear that the director has a statutory obligation to ensure that the company complies with the solvency and liquidity test before any financial assistance is provided for the acquisition of the company's shares. In this instance, the question that one raises is: what happens in a situation where the solvency and liquidity test have not been complied with? Put differently, what happens in the event where the board fails to carry out the solvency and liquidity test or where after the test is conducted, the directors proceed to provide financial assistance while knowing that the test indicates that the company will not remain solvent and/or liquid after the distribution? The answer to this lies in section 44, read together with section 77 (3)(e) of the Companies Act.

In terms of section 44(6) of the Act, where the resolution or agreement is void under subsection 5, a company director will be liable to the extent set out in section 77 (3) (e)(iv) if two requirements are met. Firstly, if he or she was present at the meeting when the board approved the resolution or agreement or participated in the making of such a decision under section 74; and secondly, if he or she failed to vote against the resolution

[111] Section 4(1)(a) of the Companies Act 71 of 2008.
[112] Section 4(1)(b)(i) of the Companies Act 71 of 2008.

or agreement despite knowing that the provision of financial assistance violated this section.

Section 77 deals with the liability of directors and prescribed officers. Subsection 3(e)(iv), in particular, states that a director of a company is liable for any loss or costs incurred by the company as a direct or indirect result of the director having- (e) been present at a meeting, or taking part in making a decision in accordance with section 74, and failed to vote against- (iv) providing financial assistance to any person contemplated in section 44 for the acquisition of the company's securities, despite knowing that the provision of financial assistance was inconsistent with the provisions of section 44 or the company's Memorandum of Incorporation.

It is clear from the provisions outlined above that the directors of companies carry a heavy burden of ensuring that their actions leading to the provision of financial assistance comply with the law. In other words, the directors must ensure that the company's financial position will not be affected negatively if the latter proceeds to provide financial position to another for the acquisition of the company's shares. Directors may sympathise with employees and decide to give financial assistance to the employees while knowing that the company has not passed the solvency and liquidity test. Any such transaction will be void, and where the directors are concerned, they will be held liable in accordance with section 44(6) read together with section 77 (3)(e)(iv) of the Act.

Additional general observations can be made as far as the financing of ESOPs is concerned. Firstly, the functionality of ESOPs assumes more significance when they come about after many newly formed businesses have been faced with a financial crunch amid the current COVID-19 pandemic and has reduced jobs and slashed salaries.[113] Hence, ESOPs continue to be a strong means for business owners to retain employees as they emerge from the crisis.[114]

[113] https://www.hindustantimes.com/business-news/cred-raises-81-million-initiates-esop-buyback/story-qmbw4Fc5H4nh4zattKdkVI.html, accessed on 30 September 2021.
[114] Ibid.

Secondly, liquidation can be announced as a mechanism for making employees partners in the success of a struggling company and ensuring employees can create wealth for themselves and their families. The wealth created by the employee benefits his or her entire family. Hence, for obvious reasons, a company whose finances are on the verge of collapsing will be unable to meet the solvency and liquidity test. The directors will have no option but to invoke liquidation. But still, with liquidation and subsequent succession, employees can come on board through newly created ESOPs and derive some form of benefits for themselves and their families.

Thirdly, most employers have invested time and money in their business and therefore wish the business to continue operating profitably. At the same time, employees are also placed in a financially-well off position. Thus, when deciding on a business succession strategy, business owners should consider ESOPs. This is because an ESOP is a tax-advantaged transaction that is an alternative to a merger or acquisition.[115] ESOPs provide substantial tax advantages for the selling shareholders and the actual companies that sponsor the plans. Hence, ESOPs provide the company and the employee shareholders with tax benefits.[116] Therefore, tax benefits are one of the key advantages for companies to introduce ESOPS as both the company and the employees benefit from it, provided that the solvency and liquidity test were met in the event the company intends to provide financial assistance for the creation of such ESOPs.

Lastly, ESOPs can be used to assist employees who do not have the cash to purchase the shares. In this situation, the employees can receive the shares over time as a retirement benefit through the ESOP.[117]

The solvency and the liquidity tests are explained in more detail in the succeeding chapters with reference to South Africa, Brazil and Canada.

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[115] 'Evaluating Liquidity Options? The Advantages of an ESOP', available at https://www.schgroup.com/resource/blog-post/evaluating-liquidity-options-the-advantages-of-an-esop/, accessed on 30 September 2021.

[116] Ibid.

[117] Ibid.

e) Shareholder Agreements

The use of shareholders' agreements is quite common in South Africa. However, there has been a significant decline due to the introduction of the Companies Act, No 71 of 2008.[118] The former Companies Act[119] provided that shareholders' agreements prevailed over the provisions of the Articles of Association and Memorandum of Association of a company to the extent that any such provisions in the shareholders' agreement did not conflict with legislation. The current status quo is that a provision of a shareholder's agreement that is inconsistent with the Act or with the company's Memorandum of Incorporation (MOI) is void to the extent of such inconsistency, and this is in terms of Section 15(7) of the Companies Act of 2008.[120] The act entails that the company cannot enter into a shareholder's agreement with employees for ESOP purposes if the terms of such agreement conflict with the MOI provisions. If this happens, the shareholder's agreement will be void. For example, suppose the employee-shareholders have certain obligations towards the company in respect of the MOI, the company cannot decide to exempt employee-shareholders from such obligations, in the shareholder's agreement. Equally, through a shareholder's agreement, the company cannot exempt itself from any obligation it may have in terms of the MOI. Another issue that is usually included in a shareholder's agreement relates to the issue and sale of shares. Such provisions of issue and sale of shares in the shareholder's agreement must not be contrary to what was established in the MOI. Hence, the terms of a shareholder's agreement must find their basis in the MOI. As not all employees of a particular company may be well versed with the law and operations of the company, they may be affected negatively if the agreement that they have entered into with the company is void due to the agreement conflicting with the MOI. Therefore, it is important for companies to guide employee-shareholders on issues relating to shareholders, even though the onus also lies on the employees to obtain independent advice and assistance before signing shareholder agreements.

[118] IBA Guide on Shareholders' Agreements South Africa Edward Nathan Sonnenbergs Inc, p. 1.
[119] Companies Act (No 61 of 1973).
[120] Section 15(7) of the Companies Act 71 of 2008.

The South African Companies Act of 2008 is the main source of company law in South Africa. It contains the majority of the provisions related to shareholder rights, activism and engagement.[121] Section 1 of the Act defines the shareholder as the holder of a share issued by a company and is entered as such in the certificated or uncertificated securities register of a company.[122]

In the case of *Sammel v President Brand Gold Mining Co Ltd*,[123] it was held that by becoming a shareholder in a company, a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, as long as the decisions are made in accordance with the law, even when they adversely affect his rights as a shareholder. This is known as the principle of the supremacy of the majority, and this is paramount to the proper functioning of the companies. In companies that are not wholly owned by the employees, the chances are high that employee-shareholders will be in the minority. In such cases where employee-shareholders are in the minority, they will be bound by the decisions of the majority shareholders, to the extent that such decisions are not contrary to what the law provides.[124] Hence, the shareholder's agreement binds employee-shareholders to any decision made by the majority shareholders in the company.

Shareholder's agreements are governed and administered through the ordinary rules of the law of contract.[125] These agreements must comply with all the principles of the law of contract to ensure their validity and enforcement. Concluding a shareholder's agreement is a corporate act. One of the important requirements of a valid contract is that there must be a consensus between the parties. Thus, for shareholders' agreements to be valid and legally enforceable, the parties thereto, must have reached a consensus on the material terms and conditions of the agreement. Therefore, it is important to note that although the company law, i.e., the Companies Act, makes provision for the shareholder's agreement,

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121 Francis JA, *The Shareholder rights and activism review* 2 ed (2017) 100.
122 Section 1 of Act 71 of 2008.
123 1969 (3) SA 629 (A).
124 The key legal instrument, in this case, is the Companies Act 71 of 2008 and the MOI.
125 Stephenson's Shareholders Agreement p.49, available at https://www.stephensons.co.uk/cms/document/Shareholders_agreements.pdf, accessed on 11 March 2021.

the validity and operation of the shareholder's agreement are found in the law of contract. Therefore, if any of the parties breaches the shareholder's agreement, the aggrieved party or parties may act in terms of the law of contract.

The shareholders enter into the shareholder's agreement to organise themselves individually and collectively. As such, this agreement serves as a guiding tool on matters important to the shareholders and may impact the company's ownership. The company and the shareholders may decide what to include in the shareholder's agreement unless such aspects are provided by the law as being unlawful. The shareholder's agreement confers certain rights on the shareholders, such as certain special relationships between the shareholders and the matters relating to the protection of minority rights. As in the case of other types of contracts, a shareholder agreement entitles the aggrieved parties to seek redress for the breach of contract.[126]

When shareholders decide to terminate their agreement, it is only the agreement that ends and not their relationship as the company's shareholders.[127] In other words, if an employee-shareholder decides to terminate a shareholder agreement, it is only the shareholder agreement that is terminated, but the employee -shareholder does not lose his or her status of being a shareholder of the company. This holds true for a number of reasons. Firstly, the shareholders to the agreement were not brought into a relationship by the agreement, but by the fact that they are shareholders in a particular company. Secondly, the corporate existence and role were created through the MOI, and thus, such existence can only be ended with the dissolution of a company. This explains why the termination of the shareholders' agreement does not end the corporate existence and shareholders' relationship. It is, however, important to note that the MOI takes precedence over any shareholder agreement. Therefore, a company cannot threaten an employee-shareholder with the termination of a shareholder agreement since the termination of a shareholder's agreement cannot result in an employee losing his or her right of ownership in employee shares issued by the company.

[126] Ibid.
[127] Ibid.

The scope of what happens when a company that previously issued shares to persons with shareholder agreements in place decides to introduce employee share ownership plans is flagged by transfer restrictions. Ideally, when bringing employees into the share ownership, a company will generally be concerned with the existing owners, to ensure that they can keep control of who can acquire shares and become shareholders. Whilst there is usually no market in the shares of private companies, it will nevertheless be important to ensure that employees cannot sell or transfer their shares to any other third party. Thus, the Memorandum of Incorporation (MOI) will need to include appropriate restrictions on the ability of the employees to transfer their shares. Normally, this is dealt with by either making the employee shares non-transferrable or only transferrable with the consent of the board or majority shareholder(s).

Alternatively, or in addition to this, the MOI can set out pre-emption provisions whereby if shares are proposed to be transferred or sold, they have to be offered to the existing shareholders first. [128]

f) Shareholder Approvals

In many businesses or companies, various corporate actions require the shareholder's approval prior to adoption. This can take place in two ways. Firstly, by way of an ordinary resolution which must be supported by more than 50 per cent of the voting rights exercised on the resolution. Secondly, the shareholder may do so by special resolution, which should be supported by 75 per cent of the voting rights exercised in the resolution. However, these thresholds are adjusted in the company's constitutive documents (upwards for an ordinary resolution and up or down for a special resolution). Moreover, the SA Companies Act imposes additional approval requirements or restrictions, in peculiar instances. For example, in terms of any resolutions in the company to be passed and to approve a disposal of all or part of the assets or undertakings of a company, the

[128] Rogan H *The employee shareholder*, 2020 available at, https://www.weightmans.com/insights/the-employee-shareholder/, accessed on 09th March 2021.

resolution must be approved at a meeting. However, only the votes of disinterested shareholders will be taken into consideration.[129]

On another note, a shareholders' meeting must be called if at least 10 per cent of all voting rights entitled to vote on a matter submit a demand for a shareholders' meeting with the exception of when a court finds the demand frivolous or vexatious. Any two shareholders may propose that a resolution be submitted to the rest of the shareholders for consideration.

It should be noted that a resolution may not take place at a shareholders' meeting on a matter unless the persons present exercise in aggregate at least 25 per cent of all voting rights in terms of that matter subject to a lower or higher threshold stipulated in the constitutive documents of the company. In cases where a company may have more than two shareholders, at least three shareholders must be present.

Once a company decides to implement ESOPs, the rights of employee-shareholders may be affected. The extent to which the employee-shareholders may be affected will be determined by whether the company is owned wholly or partly through employee-shares. It is a clear-cut case if the company is wholly owned through ESOPs. This is because all employee-shareholders will fall in the same class of shares, and there will be very little effect on the rights of the employee-shareholders.

In order to adopt items that will be favourable to employee-shareholders, it would be necessary for employee-shareholders to get the buy-in of the non-employee-shareholders. Thus, it is critical to obtain 50 per cent for the ordinary resolution and 75 per cent for special resolution, respectively.

g) Protection for Making Disclosures

[129] Ibid.

Section 159[130] provides a shield by protecting shareholders who disclose information to the relevant regulators, provided that the shareholders reasonably believed in *good faith* at the time that the company or a director acted in contravention of the SA Companies Act by failing to comply with statutory obligations, engaged in conduct that endangered or harmed an individual or the environment; unfair discrimination against a person; or in contravention of all other legislation that could potentially place the company at risk.[131]

Section 159(6) states that if the person who engaged in the conduct or made the threat can show satisfactory evidence in support of another reason for engaging in the conduct or making the threat, any conduct or threat contemplated in subsection 5 is presumed to have occurred as a result of a possible or actual disclosure that a person is entitled to make, or has made.

A company may not take any action against a shareholder, or any other person as contemplated in section 159 (4) for the reason of disclosing information to a relevant regulator. Hence according to section 159(6), as quoted above, an individual is entitled to protection if he or she can prove that he or she has made a disclosure that qualifies for protection. Anyone (normally the company) that wishes to rebut this must provide evidence that the action taken by the shareholder does not warrant protection within the scope of section 159 of the Act.

Under normal circumstances where employee-shareholders find themselves as minority shareholders, they may not be willing to act against the company since they may be afraid of ill-treatment from the company and its majority shareholders. Therefore, protection guaranteed under section 159 could give employee-shareholders some form of liberty to disclose information about the company to the regulator if the company contravenes the Act by failing to comply with its statutory obligations. Employee-shareholders have a proprietary interest to protect, and thus, section 159 gives them an avenue to protect such

[130] Sec 159 of the Companies Act 71 of 2008. Subsection 2 expressly provides that ‘’Any provision of a company’s Memorandum of Incorporation or rules, or an agreement, is void to the extent that it is inconsistent with, or purports to limit, set aside or negate the effect of this section.’’ This means the company cannot take any legislative measures to take away the protection afforded to employee-shareholders in respect of section 159 of the Act.

[131] See the case of *Peter Mthandazo Moyo v Old Mutual Limited and others* Case No.: 2019/22791 para. 116.

interests. Thus, it can be summarised that this Act[132] aims to create social and economic equality amongst companies and investors by providing a stable platform for investment in which both the interest of the minority as well as the majority shareholders are taken into account. With a newly found focus on achieving economic and social equality, the Act, like its predecessor, has accommodated the need to provide an appropriate balance between the interests of all the shareholders. In order to create an equal playing field, the Act aims to prevent minority oppression by the majority or the minority from being inappropriately able to prevent the occurrence of equitable transactions to the detriment of the company and/ or majority shareholders.

h) Dilution of Equity and ESOPs?

A dilution of a share happens when a company at any point issues additional stock.[133] This results in the reduction of shareholders' ownership in the company or dilution when new shares are issued. The issuing of shares for the purposes of ESOPs may have severe consequences for existing shareholders. Issued shares have benefits attached to them, and existing shareholders may be concerned about losing out on those benefits.

The creation of ESOPs has an impact on the existing shareholders' ownership rights because it may result in dilution of the existing shareholders' ownership.[134] Therefore, before implementing any ESOP plan, it is essential for the promoters to determine how much equity should be kept aside.[135] Such a determination should be taken, bearing in mind the interest of both the existing shareholders and the employees (i.e. potential shareholders).[136] The existing shareholders may not be willing to accept the employees as co-owners and partners in sharing the wealth created.[137] In certain instances, the

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[132] Companies Act 71 of 2008.
[133] https://pocketsense.com/dilution-occur-shares-granted-exercised-2991.html, accessed on 08 May 2021.
[134] How much Equity should be kept aside for ESOPs?, available at www.esopdirect.com › blogs › how-much-equity-should, accessed on 30 September 2021.
[135] Ibid.
[136] Ibid.
[137] Ibid.

existing shareholders may be of the view that they have invested a great deal in the company and may see employees as a threat to their wealth. In other instances, the existing shareholders may be more welcoming to the idea of getting employees on board as shareholders, especially in instances where the company is facing liquidity problems, since an ESOP can help with boosting the company's finances. Hence, the company must properly look at the interest of the existing shareholders and that of the employees, the existing equity base, the objectives of the plan and the proposed number of employees to be covered by the plan.[138] If a large number of employees are to be covered by the plan, more shares will have to be issued and taken up; hence there will be higher dilution.[139] Furthermore, considering the objectives of the plan is important. For example, if the company is responding to the national call to assist the government in addressing poverty and inequality, there is a high likelihood that more employees will get shares from the ESOP Plan, with a higher risk of dilution. Regardless of the objectives of the ESOP Plan, a well-designed and properly implemented ESOP Plan will minimise the high risk of dilution.

Furthermore, there are two types of damages that shareholders may suffer if new shares are issued but not offered to the existing shareholders. Shareholders' voting power is diluted, or their investment within the company is reduced.[140]

The law may protect against this risk by providing peremptory pre-emptive rights to all its existing shareholders to buy issued shares. This may be time-consuming to shareholders as the shares must be offered first to the existing stockholders, which may highly hinder the ability of the corporation to quickly obtain new financial resources when market conditions are favourable.[141]

A pre-emptive right to purchase shares is another way of protecting shareholders in cases where new shares are issued. In this instance, the shareholders interested in avoiding the dilution of their participation can acquire pro-rata. This protection is only successful to

[138] Ibid.
[139] Ibid.
[140] Ventoruzzo M, Issuing New Shares and Pre-emptive Rights: A Comparative Analysis, (2013) 12 *Rich. J. Global L & Bus.* 517.
[141] Ibid.

the extent that shareholders are financially stable and willing to buy the new shares, but no dilution will occur if they do.

In South Africa, the board of directors of the company may have the right to issue the company's shares by means of an ordinary resolution of the board, as long as the shares have been authorised by the company's MOI. Pre-emptive rights refers to the protection offered to the existing shareholders. When that pre-emptive right is granted on an issue of shares to existing shareholders, then third parties or existing shareholders have no right to acquire additional shares or dilute the existing shareholders without first offering the existing shareholders to maintain their equity percentage shareholding.

Section 39(2) of the Companies Act provides for the pre-emptive rights on an issue of shares. [142] This section caters for both private companies and personal liability companies. However, the MOI of a company may restrict, negate or limit the pre-emption right contained in section 39(2) with respect to any, and all classes of shares.

1.7.5 Various ESOP Models

There are various Employee share-ownership plans that a company may adopt in furtherance of its objectives, the common objective being employee incentives. Incentives provide an avenue through which firms can encourage their employees to improve their productivity.[143]

Companies must identify the factors such as the risk associated with a particular share plan, its liquidity constraints, the size of the organisation and the number of employees it seeks to benefit from a particular ESOP model.

a) Phantom Share Schemes

[142] Section 39(2) of the Companies Act 71 of 2008.
[143] Daniel C O 'Effects of Incentives on Employees Productivity (2019) 4(1) *International Journal of Business Marketing and Management* 41.

According to the phantom share schemes, no actual shares are issued to the employees. Units are issued to employees, and since there is no issuing of actual shares, the units do not entitle the "employee-shareholders" to rights in respect of actual shares. The "shareholders" are entitled to receive dividends declared in terms of an actual share.[144]

In phantom share schemes, a company promises to pay an employee a bonus at a particular time in the future or when an employee achieves a specified goal.[145] In terms of this form of share scheme, the company does not issue real shares, and therefore, the issue of diluting existing shares does not arise. The existing shareholders may be willing to accommodate this share scheme as there is no real threat to their ownership of shares. The company may equally be willing to issue this type of shares as this will not affect the company's financial situation at the time of "issuing" shares. Hence the "issuing" of units do not have an actual impact on the company's finances.

Employees may not be interested in phantom shares as they do not receive actual shares, and as such, they cannot exercise any rights attached to various classes of shares.[146]

The phantom share scheme offers certain advantages to the existing shareholders. In a phantom share scheme, there is no dilution of the company's ownership.[147] Furthermore, in this form of share scheme, employees do not get the opportunity to participate in the company's management.[148] Lastly, there is no additional cost to be borne by the company in implementing this type of a share scheme.[149] This type of share scheme is not very useful for the purposes of using ESOPs to fight poverty. ESOPs can be extremely useful in addressing the attendant inequalities and poverty if it gives employees some form of ownership and the opportunity to participate in the management and decision-making of

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[144] Butler E 'Employee Share Incentive Schemes – The taxation of the old and the "new" Technical report submitted in fulfilment of the requirements for the degree H. Dip (Taxation) in the Department of Law University of Cape Town (2005).

[145] Tannebaum Helpern Syracuse & Hirshtritt "Phantom Equity Plans: A flexible Alternative to Retain and Motivate Key Employees'', available at http://www.thsh.com/publications/phatom-equity-plans-a-flexible-alternative-to-retain-and-motivate-key-employees, accessed on 14 August 2020.

[146] Butler, (2005) op cit note 134 at 144-9+.

[147] Phantom Stock or ESOP: Which is better?, available at https://eqvista.com/phantom-stock/phantom-stock-or-esop, accessed on 10 November 2021.

[148] Ibid.

[149] Ibid.

the company. Hence, it may safeguard the interest of the company. Phantom shares do not offer much help to the employees.

b) Deferred Implementation Option Plan

This form of share scheme relates to a situation where a contract is entered into between the employer company or the share trust and selected employees. The latter agrees to sell shares to selected employees.[150] The payment and delivery of the shares to the selected employees are deferred over a given period, usually three to ten years. The employee only receives dividends and other associated benefits after paying for subscription and delivery of the shares.[151] Ideally, option schemes can have far-reaching effects on both the company and its employees.

Generally, when a company utilises a share scheme, it is concerned with recruiting, retaining and motivating its employees as well as nurturing employee loyalty and engagement. Furthermore, by implementing a tax advantageous share option scheme for its employees, companies can benefit from incentivising their workforce tax-efficiently.[152]

Accordingly, this minimises the overall cost to the company of providing a total remuneration package to its workforce. Of course, this should be advantageous since running costs are channelled better to increase productivity. Additionally, by issuing share options, companies can often avoid cash flow issues associated with paying cash bonuses. Sometimes employees are not at par with their employers and have very little or no understanding of shareholder agreements or even who the shareholders are. Thus, by granting share options to employees, companies can align the interests of the employees with the shareholder without having to provide the employee with dividends or voting rights until the option is exercised and shares are acquired.[153]

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[150] Ibid.
[151] Ibid.
[152] Skinner P Nisbet J et al. 2016. *Share Options*. United Kingdom: Harpermcleod. available at: https://www.harpermacleod.co.uk/media/521523/share_options.pdf, accessed on 09 March 2021.
[153] Ibid.

Furthermore, share schemes can also be quite advantageous to the employees. Articles such as cash bonuses and wages are taxable. Thus, where an employee qualifies to participate in a tax profitable share option, such as an EMI, their option may not be subject to any income tax on grant or on exercise of the reward, in some cases. Moreover, in circumstances where a share option is granted, employees can choose not to exercise their option (and therefore not pay the exercise price) if the value of the shares decreases. This is very lucrative in the long-run and can significantly aid in alleviating the financial burden of employees.

According to Skinner,[154] if employees realise that by increasing the company's value, they increase their wealth, this can be a powerful motivator and can be mutually beneficial for the company and the employee. Generally, the participation in company share schemes gives the potential for employees to make significant financial gains, which they are unlikely afforded through the sole receipt of their normal wage.

Most share scheme arrangements involve the issue (directly or indirectly) of shares. Ideally, while equity dilution is inevitable, it can be managed. Some companies are disincentivised from operating employee share options due to the legal and ongoing administrative and accountancy costs. However, the author is happy to discuss ways to manage the cost. Furthermore, the employment of value shares can confound a company’s structure. However, often an employee cannot sell the shares prior to an exit to realise cash. Generally, depending on the structure of the options, employees may have to pay for their shares before selling them.

Most shares schemes contain good and bad leaver provisions, which means they can lapse on termination of employment. However, this may mean that employees feel obliged to stay with a company longer than they would have liked in order to receive their award and/or not forfeit any tax advantages they may otherwise receive. Similarly, share options are usually the only effective incentivisation tools where the price of a share has

[154] Ibid.

increased. Employees may dislike the idea that their future finances may depend on the company's success.[155]

c) Broad-Based Share Ownership

The Broad-based share ownership mostly finds its basis in legislation or policy geared towards enabling the black people, especially those from the previously disadvantaged sections of the community, to share in the ownership and resources of their company.[156]

A Broad-Based Ownership Scheme refers to a communal ownership scheme, which is constituted to enable the participation of specified natural persons in the benefits flowing from the ownership by that scheme or by its fiduciaries of an equity interest in an entity, which could be in the form of a community or group of enterprises. A Broad-Based Ownership Scheme may be created in the form of a Trust.[157] ESOPs help to improve productivity by enhancing worker incentives and aligning them with shareholders' values. Furthermore, the said share option assists with conserving cash. Firms may seek to conserve cash by offering stock to employees in exchange for a cut in wages.[158] Conversely, stock options promote decisions aimed at increasing short-term share value as opposed to long-term business success. Stock option plans can also excessively dilute stock ownership value and voting power.[159]

At face value, the broad-based share schemes seem to be very lucrative in that employees are given an opportunity to share in the ownership and management of the company. However, despite the plausibility of ESOPs promoting economic growth and development as well as reducing poverty, as stated above, it is difficult to implement ESOPs in an economy that is not growing. All stakeholders[160], including governments,

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[155] Ibid.

[156] In the South African context, the broad-based share ownership finds its basis in terms of the Economic Empowerment Act of 2003 read together with policies created in such regard.

[157] https://www.bbbeecommission.co.za/wp-content/uploads/2019/04/Final-brochure-on-Trusts-29Nov18_1.pdf, accessed on 05 August 2020.

[158] Atanassov & Kim (2009) for evidence in support of the worker-management hypothesis in the context of corporate restructuring around the world.

[159] http://www.hrconsultant.com/articles-white-papers/broad_based.html, accessed on 05 August 2020.

[160] King IV Report on Corporate Governance for South Africa (published in 2016) defined the stakeholder as *''those groups of individuals that can reasonably be expected to be significantly affected by an*

need to play an active part in growing the pie in order to promote the expansion of ownership, growth and development.

During the UN Conference on trade and development, it was postulated that the key policy tools to be advocated for in addressing poverty in developing countries are competition law, and policy interventions.[161] In order to encourage development, governments need to remove barriers to free trade and amend laws that encourage anti-competitive business practices.

1.8 Theoretical Framework

Chapter 2 provides a detailed analysis of binary economics as it applies to the study. Research of this nature requires the study and understanding of social and economic issues that may enhance or hamper the country's economic development. Thus, the author dwells on the schools of law and economics by focusing on the theories of justice underpinning these theories. Ideally, the theory of economic justice was used to investigate the viability of ESOPs on the basis that it will help to reduce poverty substantially and achieve equal distribution of income and wealth. Economic justice, which comprises of participative, distributive and social justice, is concerned with both the individual and the social order. Distributive justice concentrates on fairly distributing society's benefits and encumbrances; whereas redistributive justice refers to the just imposition of penalties and punishments.

To address socio-economic injustices, it is plausible to adopt legal policies that aim to reform the society's economic order to achieve an equitable, fair, and just distribution of resources and benefits.[162] It is noteworthy that advancing shares to employees may not be a clear-cut mechanism for reducing poverty. It must be well thought out to ascertain

organisation's business activities, output or outcomes, or whose actions can reasonably be expected to significantly affect the ability of the organisation to create value over time.''

[161] Qaqaya H & Lipimile G 'The effects of anti-competitive business practices on developing countries and their development prospects' United Nations Conference on Trade and Development.

[162] Warikandwa T V & Osode P C 'Regulating Against Business Fronting to Advance Black Economic Empowerment in Zimbabwe: Lessons from South Africa' (2017) 20(1) *Potchefstroom Law Journal* 9.

whether the principles of a free market or a mixed economy can be employed to implement policies aimed at addressing poverty.[163]

1.9 Literature Review

Morgan states that economic development can assist with attracting private investment to expand the tax base. Additionally, it can increase employment opportunities and personal incomes. More importantly, economic development has a greater prospect of increasing wealth in a community.[164] Economic growth and wealth creation describe a situation of prosperity, while prosperity means that the physical, emotional and psychological needs of people on all levels, are being abundantly met.[165]

The concept of economic development is not easy to define. However, the various objectives that such an economic development programme aims to achieve can be used as a tool to describe the concept. In most instances, economic development is centred around the themes of employment and wealth creation and improved quality of life.[166] Similarly, economic development may be broadly described as a process used to influence the growth and reformation of the economy to augment the wellbeing of a community. In the same vein, Friedman and Bhengu opine that the possible solutions to poverty alleviation call for a balanced approach.[167] On the one hand, there is a need for long-term solutions such as micro-enterprise, formal sector job-creation, and improved education.[168] Equally so, on the other hand, specific poverty alleviation strategies are necessary if South Africa wishes to meet its development goals, which will ensure that all citizens live above the poverty line.[169] Small, medium, micro enterprises (SMMEs) are seen as a vehicle to address South Africa's problem of high unemployment because of

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[163] Ibid.

[164] Morgan J Q *Economic Development Handbook* 3 ed (2009) 29.

[165] Barber H D 'Importance of Entrepreneurship to Economic Growth, Job Creation and Wealth Creation-Canadian Speaker.' (2007) 33 (1) *Canada-United States Law Journal* 35.

[166] Holman D Jason C *et al*., 2018. *The International Economic Development Council's Economic Development Reference Guide*. Washington DC: The International Economic Development Council.

[167] Friedman I & Bhengu L 2008 Op cit at note 8.

[168] Ibid. SMMEs have the ability to play a significant role in the creation of jobs, the reduction of inequity, and the alleviation of poverty. (See Peters, R & Naicker V., ''Small medium micro enterprise business goals and government support: A South African case study'' (2013) 44(4) *S.Afr.J.Bus.Manage* 14.

[169] Ibid.

their high labour-absorptive potential[170]. Furthermore, the SMME activates domestic competition by creating market niches in which they develop until they locate a new niche in reaction to demand changes, as well as allowing them to be internationally competitive due to their adaptability.[171] Importantly, the SMME can address disparities left over from the apartheid era, such as patterns of economic ownership and limited career options for Black employees.[172]

In South Africa, the Companies Act was drafted in a manner to strive towards promoting economic development. The Act has removed cumbersome incorporation procedures, and introduced innovative ways such as business rescue to 'revive' and restructure ailing companies. [173] Business rescue proceedings are implemented to rescue failing companies in a manner that considers the interests of all affected stakeholders. [174] According to Cassim, FHI *et al,* the economy, in general, and business activity, in particular, are both influenced by company law.[175] This means that company laws of any particular jurisdiction, including South Africa, must be drafted in a manner that positively impacts the country's developmental goals. It must promote the flexible and easier establishment of companies, promote easier operations and prove to be friendly in ''resuscitating'' attempts of failing companies. In South Africa, the business rescue process was introduced because the judicial management process provided under chapter XV of the 1973 Act was failing the local economy as only a few if any, judicial management orders resulted in the saving of companies experiencing financial difficulties.[176] The corporate principles of issue and authorisation of shares[177], financial assistance for the acquisition of shares[178], and share repurchases[179] are some of the key aspects under the company law of South Africa that influence the introduction of ESOPs

[170] Peters R & Naicker V ''Small medium micro enterprise business goals and government support: A South African case study'' *S.Afr.J.Bus.Manage* (2013) 44(4) 15.
[171] Ibid.
[172] Ibid.
[173] Mongalo T 'An overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) *Acta Juridica*. Also, see Delport Henochsberg on the Companies Act 443.
[174] Delport Henochsberg (2015) 447.
[175] Cassim F H I *et al.,* Contemporary Company Law Op cit note 35.
[176] *Richter v Absa Bank Limited* (20181/2014) [2015] ZASCA 100; 2015 (5) SA 57 (SCA) (1 June 2015).
[177] Cassim F H I *et al.*, Contemporary Company Law Op cit note 35 at 221.
[178] Ibid. 308-310.
[179] Ibid. 298.

in one way or the other. The debate regarding the soundness of companies purchasing their own shares has been going on in many jurisdictions, and South Africa has not been exempted from this for many decades. According to Cilliers *et al* the prohibition of financial assistance for the purchase or subscription of own shares as contained in section 38 of Companies Act 61 of 1973 was cast in extremely wide terms.[180] This suggests that in terms of the 1973 Act, it was virtually impossible for companies to offer financial assistance in connection with the repurchasing of their shares. However, Cassim FHI *et al*, in interpreting the provisions of the 2008 Companies Act, observed that the Companies Act has now unequivocally embraced the modern solvency and liquidity approach, resulting in the complete abandonment of the capital maintenance rule.[181] Companies in South Africa can thus exercise their powers to repurchase shares according to the law. The question of whether these corporate law principles successfully promote the implementation of ESOPs requires a robust debate, and this thesis seeks to achieve this in the succeeding chapters.

According to Mazibuko, [182] an ESOP is an arrangement in which the employees are granted an opportunity to hold rights in the company's equity and have influence over the decisions made by the company. Therefore, the primary rationale for ESOPs could relate to the employees' right to purchase shares in the company with the company's help. ESOPS form part of a wider approach to expand capital ownership, broader prosperity and economic justice, commonly referred to as binary economics.[183] Ashford postulates that once poor and working people have the same ability as wealthy people to acquire capital for profit, they will become more prosperous as a result of their capital ownership. In addition, creditworthy companies will more profitably employ their productive capacity, and the economy will grow quickly.*[184]*

If the above formulation is correct, share ownership would provide employee-shareholders with income to take care of themselves. Moreover, the companies'

[180] Cilliers, H S *et al.*, *Corporate Law* 3 ed (2000) 329.
[181] Cassim F H I *et al.*, Contemporary Company Law Op cit note 35 at 11.
[182] Mazibuko (2003) op cit note 38.
[183] Ashford R 'Binary Economics: The Economic Theory that Gave Rise to ESOPs.' (2017) *College of Law-Faculty Scholarship*. 6, accessed on 21 February 2021.
[184] Ibid.

productive capacity could influence economic growth and the development of South Africa.

Employees can partake in the financial benefits of a company in various forms:

Firstly, individual employee ownership: This allows employees to own shares or stock options in a company in which they are employed. In such an instance, shares may be donated or sold to the employees at cheaper and affordable prices, considering the market value and the company requirements.

Secondly, employee stock ownership plans: This allows employees to collectively share in ownership, where shares are acquired through an intermediary entity, financed by the share of profits allocated to employees, apart from their salaries.

Thirdly profit sharing: This is where employees receive a share of the profits that the entity makes in addition to their fixed remuneration. Hence, employees may enjoy immediate or deferred benefits.[185]

Kaarsemaker opines that employee ownership affects the morale and the attitude of the employees positively as it provides employees with intrinsic satisfaction (i.e. it brings about behavioural change), extrinsic satisfaction (i.e. financially rewarding), and instrumental satisfaction (i.e. employees participate in decision-making and, thus, facilitate desired outcomes).[186] Moreover, Sen Gupta believes that introducing employee share-ownership schemes in an organisation is often accompanied by greater participation in decision-making.[187] Employees feel part and parcel of the organisation the moment they are involved in the decision-making process of the company they work for. Thus, they work towards increasing the company's turnover and profits.[188]

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[185]Lowitzsch J, Iraj H et al. The Promotion of Employee Ownership and Participation (2014) The Inter-University Centre for European Commission's Dg Markt. available at http://eprints.staffs.ac.uk/2616, accessed on 28 October 2021.

[186] Kaarsemaker (2009) op cit note 104.

[187] Sengupta S Whitfield K & McNabb B Employee share ownership and performance: golden path or golden handcuffs? (2007) 18 (8) *The International Journal of Human Resource Management* 1507.

[188] Kaarsemker (2009) Op cit note 104.

Accordingly, Pedleton *et al* believe that employee share ownership schemes promote greater organisational effort and the personal effort of the employee while reducing the propensity to quit.[189] In other words, the employee feels valued as part and parcel of the organisation and will go an extra mile to maximise the company's profits, seeing that he or she will share in the profits made by the company in the form of dividends. In the same vein, Mazibuko *et al* are of the opinion that it is easy and inexpensive to formulate and implement employee share ownership schemes.[190] Although this contention can be true, the formulation and administration of ESOPs are largely informed by the legislation and regulatory framework prevailing in a particular country.

Barnes *et al* believe that the employees can gain extra financial interest in the company they are employed through employee share ownership schemes.[191] Apart from aiming to alleviate poverty and reduce the inequality gap between the rich and poor, employee share-ownership schemes are believed to have the capability of reducing industrial disharmony as they introduce common interests between management and employees (i.e. meaning participation to maximise profits).[192] Mazibuko states that the disadvantage in implementing ESOPs is that it may become cumbersome to manage and oversee employees in the workplace. As such, employees may feel important and will refuse to subject themselves to any supervision of those in authority as they will also be shareholders.[193] Furthermore, employee share ownership promotes employee rights to have greater involvement in the decision-making process, leading to a loss of managerial authority.[194]

The primary aim of introducing and implementing employee share ownership schemes in a company is associated generally with reducing poverty levels and increasing the income and wealth of the employees concerned. *Tazoacha* views poverty as the absence of peace in an individual resulting from hunger, the lack of basic human rights and medical

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[189] Pendleton A Wilson N & Wright M 'The perception and effects of share ownership: Empirical evidence from employee buy-outs. (1998) *36*(1), *British Journal of Industrial Relations*, 99-123.
[190] Mazibuko (2003) op cit note 38.
[191] Barnes, A Josev T Marshall J L S Mitchell R Ramsay I & Rider C Employee share ownership schemes: Two case studies. (2006) *Corporate Governance and Workplace Partnerships Project*.
[192] Ibid.
[193] Mazibuko (2003) op cit note 38 at 33.
[194] Ibid.

care. She further asserts that poverty is one of the most retarding and damaging forces in human life.[195]

Phipps views poverty in terms of the absolute approach, which means that you have less than an objectively defined absolute minimum. In contrast, the relative approach to poverty means having less than others in society. The subjectivist approach refers to poverty as a feeling that you do not have enough to get along.[196]

Chris Goulden *et al.* maintain that poverty is not a static condition but changes over time as resources rise and fall, affecting the individual's needs and ability to meet them.[197] Hence poverty can be momentary, recurrent, or persistent over a longer period.[198]

The social schools of thought define poverty by referring to it in social terms. Therefore, some view the need to address poverty from the social perspective, that is, using the theories of distributive justice.[199] To this end, Mill advocates for utilitarianism, which asserts that society's moral obligation is to maximise the total amount of happiness in the

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[195] Francis T ''The causes and impact of poverty on sustainable development in Africa. In *a paper presented at the conference 'Poverty and sustainable development 'Bordeaux, France''* (2001) 22

[196]Phillips S ''The Impact of Poverty on Health: A Scan of Research Literature.'' *Ottawa, ON: Canadian Institute for Health Information*, (2003) available at https://secure.cihi.ca/free_products/CPHIImpactonPoverty_e.pdf, accessed on 10 September 2020.

[197] Chris Goulden & Conor D' Arcy. 2014. ''Definition of Poverty'' JRF Programme Paper; Anti-poverty strategies for the UK, available at https://www.jrf.org.uk/report/definition-poverty, accessed on 9 September 2020.

[198] Ibid.

[199] The World Bank report states that the outcome of poverty is insufficient access to basic necessities of life, poor living conditions and frequent bouts of illness and an early death.'' (Foster James et al., 2013. A Unified Approach to Measuring Poverty and Inequality-Theory and Practice: Streamlined Analysis with ADePT Software. Washington, DC: Worldbank. http://opemknowledge.worldbank.org/handle/10986/13731); Furthermore, according to the UN report, poverty characterised by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information (United Nations 1995 The Copenhagen Declaration and Programme of Action, New York: United Nations). Another author defines poverty as the point at which the survival of the individual and of the family became threatened (Geremek B 1994, Poverty: A history, transl. A Kolakoska, Blackwell Publishers, Oxford.) Poverty relates to the human conditions of lack of basic services such as food, housing, access to health facilities and clean water (Nkadimene K L T Molotja W Mafumo T N 2019. ''The scourge of poverty among South African Rural Women: In Defence of Social Justice'' JGIDA p.71). In attempting to address the issues of poverty, Ayala E Hage, S and Wilcox, M has written on social justice and said that it is an equitable and fair distribution of resources in society to all people irrespective of gender, age, social and political status, sexual orientation or religious background Although viewing poverty from a social perspective is in itself not wrong. However, it is improper to view property only from a social perspective in isolation from economic theories. Hence some form of balance between economic theories and social theories should be achieved when defining poverty.

world. This theory is to take away money from the rich to help the poor, and this is referred to as the re-distribution of wealth. Another theory of distributive justice propounded by Rawls is fairness. Accordingly, all opportunities available in society should benefit everyone. Nozick's theory of entitlement advocates for liberty. He believes that you are entitled to everything that is yours, and to the extent that as long as you are not hurting anyone, society is obligated to leave you alone to enjoy what is yours.

Utilitarianism and fairness require cutting the wealth of the rich to improve the well-being of the poor. Entitlement promotes one's right to just acquire and own property without external influence. Achieving the desired results or outcomes necessitates a proper understanding and correct application of each theory.

According to entrepreneurial law, poverty cannot be viewed solely from the social perspective without engaging the economic jurisprudential outlook. This becomes more evident when one deals with issues surrounding aspects of economic growth and development. One cannot address poverty without growing the economy, and growing the economy requires applying entrepreneurial theories, of which capitalism cannot be avoided. Capitalism is an economic system in which private owners own and manage property for their interests. The key characteristic of capitalism is the intention to make a profit.[200] Capitalism is known for depicting three features, namely private property, self-interest and competition.[201] In a capitalist system, people can own both tangible and intangible assets. Tangible assets may comprise of property such as houses and land, while intangible assets include stock and bonds. Furthermore, people act in seeking their benefits without necessarily regard for social issues and political pressure. However, the pursuit of interests may result in benefits for the society.[202] Companies in a capitalistic society have the freedom to move in and out of markets, promoting the joint welfare of both producers and consumers. [203]

[200] International Monetary Fund (IMF), available at www.imf.org/external/pubs/ft/fandd/2015/06/basics.htm, accessed on 13 May 2021.
[201] Ibid.
[202] Ibid.
[203] Ibid.

The Macmillan Dictionary of Modern Economics defines capitalism as a social, political, social, and economic system in terms of which private individuals own and control the majority of the property, including capital assets.[204]

Capitalism recognises the right of private parties to choose their workforce, and it also promotes fair competition in the country's economic markets.[205] In other words, private owners have the right to decide what is to be done in their employment, provided that any such conduct does not violate the labour law of a particular country. Furthermore, competition is permissible to the extent that it does not violate the legislative principles derived from the country's competition law. For instance, the Competition Act, 1998 bars trade practices from undermining a competitive economy in South Africa. All economic players in the market are expected to operate on a level playing field.

It is of paramount importance to measure poverty as this can help us keep the poor on the agenda. "A credible measure of poverty can be a powerful instrument for focusing the attention of policymakers on the living conditions of the poor."[206] In order to appropriately target interventions that aim to decrease poverty, one needs to identify the poor, as this will help ensure that resources are channelled to meet the needs of the poor. Identifying the poor is also important as it helps to monitor and evaluate projects and policy interventions that are geared towards the poor.[207]

As there is no single definition of economic development, there is no single universal policy that may be developed for successful economic development. Therefore, each state should develop a strategy or policy framework that speaks to the apartheid injustices and the current needs of the society to achieve the much-needed development.[208]

1.10 Chapter Overview

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[204] Also see Scott R 'The Political Economy' (2016) Working Paper, available at https://www.hbs.edu/ris/Publication Files/07-037.pdf, accessed on 31 May 2021.
[205] Ibid.
[206] World bank Institute ''Introduction to poverty analysis'' 2005, available at http://siteresources.worldbank.org/PGLP/Resources/PovertyManual.pdf, accessed on 31 May 2021.
[207] ibi
[208] Op cit note 20.

Chapter 1 provides the research proposal, including the problem statement, research questions, description of research methods, conceptual framework, theoretical framework and literature review.

The author explores, investigates and explains the theoretical foundation of ESOPS in **Chapter 2.** This discussion is necessitated by the need to understand the concept of ESOPs and how economic justice theories can be used to grow the economy.

The underlying objective of **Chapter 3** is the study of ESOPS from the South African perspective and how it can be used to inform the national agenda and the developmental goals of South Africa.

Chapter 4 investigates the adequacy of the South African environment for effecting ESOPs. The chapter studies various legislative instruments which can either hamper or assist companies in South Africa to introduce and effectively operate ESOPs in South Africa.

A comparative study of Brazil on the implementation of employee share-ownership as a mechanism to address and reduce poverty levels is discussed in **Chapter 5**

Chapter 6 focuses on the comparative study of Canada as a developed country on the implementation of employee share-ownership as a mechanism to address and reduce poverty levels. The comparative study in Chapters 5 and 6 aims to determine how the Corporate Law principles in the two jurisdictions compare with those of South Africa, with the result of drawing best practices that can be applied in the South African context.

Chapter 7 is the final chapter of the thesis, and the chapter discusses the findings of the research. It provides concluding remarks on the implementation of ESOPs in South Africa and whether the Corporate Law rules of South Africa foster or hinder the effecting of ESOPs in South Africa. The resulting aim is to determine whether ESOPs can be employed to reduce poverty in South Africa.

CHAPTER TWO

THE THEORY OF BINARY ECONOMICS AND EMPLOYEE-SHARE PLANS

2.1 Introduction

According to the World Bank, poverty relates to the deprivation of an individual's well-being. This comprises low levels of income and the difficulty associated with acquiring the basic goods and services required for dignified survival.[209] Low levels of health and education, limited access to clean water and sanitation, insufficient physical security, a lack of (political) voice, and insufficient capacity and chance to improve one's life are examples of poverty.[210]

The principles of economic development are used to combat poverty. Therefore, the primary objective of economic development is to create the wealth of a nation[211] and distribute this wealth for the benefit of all participants involved in the process of wealth creation. Economics analyses how society seeks to allocate its limited resources to achieve economic growth.[212] Adam Smith described economics as the science of wealth[213] and Ricardo went one step further and attached distribution to the concept of wealth.[214] On the other hand, Mills defined economics as the law that governs mankind in the production of wealth.[215]

The aforementioned descriptions of economics help one to make few observations regarding the concept of economics. The first observation relates to wealth. Wealth is considered as very important for a number of reasons. It gives people a cushion if they lose their jobs or fall on hard times, and it can also provide a source of income through, for example dividends on shares, and it also allows people to make once-off or large-

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[209] World Bank. *"World Development Report 2000/2001: Attacking Poverty",* Washington, DC: World Bank, (2004) available at http://openknowledge.worldbank.org/handle/10986/11856, accessed on 30 May 2020.
[210] Ibid.
[211] Adam Smith is regarded as the mastermind behind the classical school of economics. Other economists such as David Ricardo, John Stuart Mill and Robert Maltus has built on the works of Smith.
[212] Ibid.
[213] Ibid.
[214] Ibid.
[215] Ibid.

scale investments, such as in property.[216] The second observation has to do with wealth distribution, and the third relates to the production of wealth.

Now that the essential features of economics and economic development have been outlined, the next section of the chapter seeks to analyse the principles of binary economics and how it operates in the context of ESOPs.

2.2 The Theory of Binary Economics

Binary economics got its name from the assumption that capital and labour are binary factors of production.[217] In other words, both capital[218] and labour productivity are essential factors of production. Although capital and labour cooperate, 'each does its work, has its productive capacity, and demonstrates its independent productiveness.[219]

According to Kurland,[220] for binary economics to be achieved, broad-based affluence and economic freedom, as opposed to financial insecurity and economic dependency for the masses in society, would be made possible through the extensive ownership of constantly improved capital assets. This also includes system changes that are added to produce more consumable goods with less and less human input and resources. From the onset, it is important to state that binary justice provides a new description of poverty in an industrial economy and suggests a new approach for making all people self-sufficient without taking property from the well-off. Thus, the redistribution of resources is rightly rejected to ensure economic justice. The best argument advanced in support of this claim

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[216] Keeley B, 'What are income and wealth?', in *income inequality:* The Gap between Rich and Poor, OECD Publishing, Paris, available at https://www.oecd-library.org/docserver/9782642460103-en.pdf?, accessed on 10 July 2021.

[217] Ashford R, ''Binary Economics and the case for Broader Ownership'', (2008) available at https://ssrn.com/abstracts=8779525, accessed on 27 September 2021 11.

[218] The term capital can be used to refer to human capital and/or social capital. Human capital is a combination of accumulated knowledge and experience of economic entities…Social Capital [on the other hand] is a diverse relationship between market participants and plays an important role in the competitiveness of the economic entity and its financial sustainability.'' (Butkova O 'The definition of capital as an economic and accounting category'', available at http://doi.org/10.51.e.3sconf/20201753011, accessed on 27 September 2021.

[219] Ashford R, (2008) Op cit note 217.

[220] See Fleissner, C. Inclusive capitalism is based on binary economics and positive international human rights in the age of artificial intelligence. (2018) 17 *Washing University Global Studies. Law Review* 201.

is that despite the visceral reaction we have to poverty, if we truly wish to establish equality and keep aristocracy minimised, we must allow the market to distribute wealth as it will. This then means that one cannot distribute what they do not have.[221] Ideally, what is proposed by this theory is that the private property system should be made open to all people on market principles, and unnatural scarcity and gross distributional disparities prevailing throughout the world can be replaced with the natural, widespread abundance and freedom assured by the industrial revolution, and the distributive justice that is necessary for market efficiency.[222]

Conceptually, binary economics is to be viewed as a justice-based free-market theory or rather a theory in pursuit of economic justice. This is so in that it recognises the evolving relationship between "labour" (human input) and "capital" (non-human input) in economic growth and the production and distribution of goods and services. The changing relationship is often attributed to the ever-changing technological advancements that have promoted efficiency.[223] Thus, for the proponents of this theory, the productiveness of labour (human input) as a factor of production is of little sustenance when compared to capital (non-human input); the advanced argument is that in order to ensure an economically just society, "capital should be used to create capital".[224] Hence, binary economics is premised 'on the right to acquire capital with the earnings of capital.'[225] This refers to the approach where profitable businesses invest in items that pay for themselves in a competitive period'[226] Under normal circumstances, corporations that are profitable and wealthy individuals use their existing capital as collateral to borrow money to acquire more capital and thereafter repay the loans with the profits of the capital they acquire.[227] In other words, the existing capital affords the ownerships thereof to acquire more capital.

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[221] Truitt T *Wealth Redistribution is Not Economic Justice*, (2017) available at: https://fee.org/articles/wealth-redistribution-is-not-economic-justice/, accessed on 21 February 2021.
[222] Ibid.
[223] Ashford R ''The binary economics of Louis Kelso: A democratic private property system for growth and justice. *Curing World Poverty: The New Role of Property''* (1994) 354.
[224] Ibid.
[225] Ashford R 'Binary Economics: An Overview'' (2012), available at http://ssm.com/abstracts=928752, accessed on 27 September 2021.
[226] Ashford, Robert, "Binary Economics: The Economic Theory that Gave Rise to ESOPs" (2007). College of Law - Faculty Scholarship. 13.
[227] Ibid.

Working class people and those from poor backgrounds are severely disadvantaged when it comes to acquiring capital.[228] This is because they do not have any capital or some form of ownership that can be used in acquiring any additional capital, and thus, they may be left with no choice but to attempt to acquire capital with their current labour earnings.[229] This is the unfortunate reality for South Africa. As a result of apartheid rule, the oppressive government imposed an inferior quality of life upon the black people subjecting the latter to low-income paying jobs.[230] The mainstream economic policy requires the employees to acquire capital by using their current labour earnings. This scenario places the employees in a difficult position, making it almost impossible to acquire capital as they need to use their labour earnings to provide for their families' living expenses. Therefore, a better approach to capital acquisition is to employ a method that does not place a burden on employees to use their current labour earnings to acquire capital but rather empowers them to acquire capital using future income of capital; hence, the theory of binary economics.[231] Binary economics could thus enable the participation of poor and working class people to acquire capital with the earnings of capital.[232] Binary economics maintains that in order to promote optimal growth, development and prosperity, everyone should be empowered to acquire capital with the earnings of capital.[233]

According to Ashford, a well-established formula in sustenance to binary economics is that individuals are poor because they have not acquired the capital necessary to supplement their labour input, and they can become economically autonomous only with a private property system that enables them to acquire this capital.[234] He further argues that by socialising private capital ownership, a binary system democratises access to credit as an indispensable social means to enable everyone to acquire private capital.

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[228] Ibid.
[229] Ibid.
[230] Montle M E 'Examining the Effects of Black Tax and Socio-economic Isolation of the Black Middle-class in South Africa through the study of *Skeem Saam'* (2020) (10)(3) *African Journal of Development Studies* 238.
[231] Ashford (2008) Op cit 217.
[232] Ibid.
[233] Ibid.
[234] See generally Ashford R, 'Economics, democracy, and the distribution of capital ownership' (2011) 40 (3) *Forum for Social Economics* 368.

The aim is to build a society based on the binary principles of distributive justice by implementing asset formation policies that facilitate the accessibility of credit for non-owners. This is done while bearing in mind that capital is assumed to be significantly more productive than labour. Thus, for this reason, binary economists advocate for the diffusion of capital ownership.[235]

As already stated, binary economics rejects the notions advanced by traditional economics theories which say that the scarcity of resources is inevitable. This is rightly so in that by equipping individuals with resources or through the shared abundance of already existing resources, we can achieve not only sustainable economic growth but also the equitable distribution of future wealth and income throughout society. According to Ashford, binary economics rests on three facets that set it apart fundamentally from all preceding economic approaches, namely: "binary productiveness," "the binary property right," and "binary growth".[236]

As alluded to in Chapter 1, binary economics was first advanced by Louis Kelso, also known as the inventor of ESOPs in economics.[237] The underlying feature advanced by Kelso is that everyone must be empowered to acquire capital through the earnings of capital.[238] This is the argument that the thesis seeks to investigate: if everyone is empowered, will the country achieve some form of wealth creation and consequently poverty alleviation? An attempt to answer this question requires an analysis of capital ownership.

ESOPs are meant to provide a form of ownership to the "poor" working class people. To start with, people are dependent on their basic salaries, and they have little opportunity if at all, to acquire a form of ownership. This capital ownership, as proposed by Kelso, could be the answer. If the poor and persons from the working class are afforded an opportunity

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[235] Ibid. Governments across the world have started supporting employee ownership recognising it as a vital element of community development strategies.

[236] ''By financing the ownership of productive capacity for people with substantial unsatisfied needs and wants, participating companies may satisfy their projected credit-worthy capital requirements while simultaneously encapitalizing their employees, thereby establishing a long-run self-sustaining basis of growth.'' Ashford R, 'Binary Economics: An Overview'' (2012), available at http://ssm.com/abstracts=928752, accessed on 27 September 2021.

[237] Ashford R. (2017) Op cit note 183 at 13.

[238] Ibid at 12

to own capital, it will assist them in earning more capital through the earnings of capital so owned. For example, if employees are afforded the avenues to raise capital to finance the acquisition of shares, it will break the cycle of poverty and entitle them to have access to ownership, which can further finance the acquisition of 'further shares'. Hence, when poor and working people are provided with the opportunity to acquire capital with the earnings of capital, they will grow more prosperously by increasingly earning more spendable income for their ownership of capital.[239]

The theory of binary justice/economics pays homage to some of the classical economic theories. More specifically, the theory advanced by the avid economist and philosopher Adam Smith[240] in his thesis titled *The Wealth of Nations*. However, for the most part, Adam's theory fails to consider numerous considerations when it comes to the central role that 'capital' plays in economic justice. Thus, Kelso found it fitting to justify the increasing role of capital in production and distribution. Accordingly, labour and capital are equally fundamental or "binary" factors of production.

Capital has a robust, distributive relationship to growth, such that the more broadly capital is acquired, the more it can be profitably utilised to increase output.[241] Hence, in order to grow the economy of a developing country such as South Africa, the focus should be placed on growing capital ownership. The economic failures and financial struggles companies are currently facing in South Africa demonstrate the need to grow the economy. Thus, it is impossible for any individual or juristic person to participate in the economy through wealth creation and or distribution.[242] The more capital is acquired, the more participants who play a role in acquiring capital can benefit. Employees are directly involved in creating wealth for the company, and thus, it is prudent to say that employees should be given the opportunity to share in the company's wealth. However, whether a

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[239] Ashford R, (2006) Op cit note 226.

[240] See generally Smith, A 1791. *An Inquiry into the Nature and Causes of the Wealth of Nations: By Adam Smith,* JJ Tourneisen; and JL Legrand: Basil. p 91.

[241] Smith, A., 1791. *An Inquiry into the Nature and Causes of the Wealth of Nations: By Adam Smith,* JJ Tourneisen.

[242] In South Africa some of the businesses that either went through business rescue processes or experienced falls in their turnover include airline company Comair, The Edcon Group, Flight Centre, South African Airways, and ESCOM. This indicates that the business environment is futile enough to simply implement practices such as ESOPs with the aim of distributing resources. As it stands these resources are insufficient for distribution or are just non-existent.

company has enough wealth with which employees can participate in ESOPs is an important consideration.

It is argued that a more equitable distribution of capital acquisition, ownership, and income promotes the idea that capital can pay for itself through future revenues and makes capital employment worthwhile. Therefore, binary economists consider that the return on capital is not single-handedly related to its scarcity, the wage rate, and the interest rate, but it is also significantly related to the increasing productiveness of capital and the distribution of its ownership.[243] This is a truism when considering the grand scheme of binary economics as a theory of economics.

Thus, growth is constructively not only related to increased labour productiveness, increased capital investment, and fast-tracked technological advances, but is also positively related to the distribution of capital acquisition. Additionally, it is unique to binary economics as a fundamental economic principle. Ashford proposes that, if valid, the principle of binary growth will significantly enhance the mainstream understanding of how to economically empower poor and working people and thereby promote greater growth.[244] However, it is pivotal to realise that binary growth is not based on the behavioural premise that people will work more productively if they have an ownership stake in their employer's business. However, most advocates of binary economics accept this behavioural hypothesis, namely that broader ownership will increase labour productiveness and therefore cause growth.[245]

Furthermore, binary economics concedes that a pure synergy must exist within the market as opposed to an inevitable trade-off between economic justice and efficiency within a global free marketplace. It is fair to say that there is a directly proportional relationship between capital and economic growth. Advocates of binary economics have referred to it as a theory that proposes a solution to various economic problems.[246] It rejects pure laissez-faire assumptions in which transactions between private groups of

[243] Ashford (2017) op cit note 183.
[244] Ashford R 'Binary Economics - An Overview". (2010) College of Law - Faculty Scholarship. at p.6, available at https://surface.syr.edu/lawpub/15, accessed on 21st February 2021.
[245] Ibid.
[246] Friedman I & Bhengu L (2008) Op cit at note 8.

people are free from or almost free from any form of economic interventionism such as regulation and subsidies, binary economics is based on four pillars of a free and just global marketplace.[247]

The first pillar is that for binary economics to exist, there should be an effective means for democratising ownership of capital, including universal access to money and capital credit for financing growth and the transfer of productive assets. In South Africa, the right to own property (assets) is guaranteed under section 25 of the South African Constitution.[248] This provision forming part of an internationally revered model of how Economic, Social and Cultural rights should be enshrined in domestic laws, provides an extensive overview of what the right entails and how it can be enforced, leaving no questions as to its justiciability. This is very important within the context of economic justice and social justice. Countries with weak accountability models make 'justice' seem like a luxury and these result in citizens not being able to enforce their economic rights fully. The justiciability of these rights is often blurred, resulting in significant economic disparities.

Using South Africa as an example, section 25(1) of the South African Constitution prohibits the deprivation of property except in terms of the law of general applications. This means that all persons have the right to acquire and dispose property in any province in South Africa.[249] The mere entrenchment of the right to own property in the Bill of Rights of the Constitution offers very little sustenance through looking at the grand scheme of a free-market economic system that recognises economic justice. Human rights experts have argued about how economic rights are merely adopted as a symbolic gesture, but their recognition and application are often overlooked when compared to other rights.[250] This, of course, has a fundamental bearing on binary justice because the restoration of and universalised access to the full rights of private property is what cements binary economics as a school of thought. This is rightly so since, as previously argued in this

[247] Ibid.
[248] The Constitution of the Republic of South Africa 1996.
[249] Property is not limited to land. See Section 25(3)(b) of the Constitution of the Republic of South Africa 1996.
[250] Nakuta J "The justiciability of social, economic and cultural rights in Namibia and the role of the non-governmental organisations", in Horn, N & Bösl, A. *Human rights and the rule of law in Namibia* (2008) 95.

chapter, to alleviate economic disparities and poverty, there is a need to ensure that 'capital is used to create more capital'. This is only achievable through a broad-based system of ownership that prioritises the right to own capital. The government of South Africa can play a key role in assisting the business community to create more capital, and thus facilitate the process of poverty alleviation. One of the ways in which the government can assist with growing the capital of corporations is by eliminating or substantially reducing corporate tax on corporate income.[251] Another way in which government policies can help create and grow the capital of corporations is by reducing the cost of credit ownership.[252] This will allow corporations to get loans at cheaper repayment rates. The successful creation of capital can thus enable corporations to introduce ESOPs for the benefit of the employees.

Furthermore, binary economics recognises the limited economic power of the state. To guarantee equality within an economic context, the state's main role should be to promote justice by eliminating special privileges. Notwithstanding the influence emanating from post-colonial socio-economic reforms, the notion of substantive equality in South Africa is understood to be achievable through programmes of action aimed to ensure that previously disadvantaged persons (be it socially or economically) are provided with equitable opportunities that they were previously denied. The latter is known as 'affirmative action', which is a right as read into the South African Constitution's Bill of Rights under the equality clause. The Bill of Rights makes a specific provision for implementing affirmative action programmes. Specifically, it asserts that:

"Everyone is equal before the law and has the right to equal protection and benefit of the law", Furthermore, Section 39(1) and 39(2), respectively, assert that the right to equality includes the full and equal enjoyment of all rights and freedoms. To promote the achievement of equality, legislative and other measures designed to protect or advance

[251] Ashford R ''Why Working but Poor? The Need for Inclusive Capitalism'' Akon Law Review'' (2015) 49(2) (11)22; According to South African Revenue Services (SARS), corporate income tax refers to the tax-imposed on companies incorporated under the laws of South Africa or which are effectively managed in South Africa and derive income from within or outside South Africa. Non-resident companies, operating through a branch in South Africa are also subject to corporate income tax. In other words, its taxes are paid to the tax authority for conducting business activities in South Africa and deriving income, available at http://www.sars.gov.za/types -of-tax/corporate-income-tax/, accessed on 17 May 2021.

[252] Ibid.

persons or categories of persons disadvantaged by unfair discrimination may be taken.[253] In the case of *Sithole and Another v Sithole and Another,* the Constitutional Court of South Africa stated that the constitution requires the enactment of restitutionary measures to compensate for the harmful consequences of previous discriminatory laws and achieve substantive equality.[254]

According to Madala,[255] perhaps the framers of the constitution did not envisage affirmative action as a derogation from the right to equality or as a 'negative' right. Rather, he concedes that equality should properly be observed as being interpretive of affirmative action and as a substrate of the right to equality. Moreover, in South Africa, the legislature has proposed a number of bills targeting various public sectors of society with the specific intention of implementing affirmative action policies. Fortunately, one of those Bills that have been promulgated is the Employment Equity Act, 1998.[256] Generally, the legislature visited the need to take some action to ensure that the workplace becomes more representative at all levels of the South African population. Presumably, it reconciled a need to foster a culture of non-discrimination and diversity in every workplace. This notion is stated in the preamble of the Act, which provides that the Act aims to promote the right of equality as derived from the constitution; the elimination of unfair discrimination in employment; the mandatory implementation of employment equity to redress the unpleasant effects of discrimination; the achievement of a diverse workplace; and lastly, to encourage economic development and efficiency in the workplace.[257]

However, whether or not affirmative action is an effective means of alleviating economic barriers and is consistent with the government's objectives in reducing unemployment and, by extension, reducing poverty is self-evident. It is a step in the right direction, to say the very least.

It is a truism that affirmative action policies are needed to counter injustices such as the imposition of racist socio-economic policies by previous governments under colonialism

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[253] Madala TH ‘’Affirmative Action-A South African Perspective’’ (1999) *52*, (4), *SMUL Rev* 1539.
[254] 2021 (5) SA 34 (CC).
[255] Ibid at 1542.
[256] Employment Equity Act 55 of 1998.
[257] Ibid at preamble.

and apartheid. This is because it is the success of these policies in deliberately stunting and retarding the development of black South Africans that has led to a widening economic gap.

The equality clause forms part of a constitution within a pre-dominantly socialist state founded on social justice principles such as Ubuntu. Whereas the adverse is different, as capitalism is unconcerned about equity, this is rightly so because it is argued that inequality is essential to encourage innovation and economic development. Whether this argument holds weight requires close inspection. Perhaps, the starting point should be to consider that innovation and economic development are improbable, where ordinary citizens are not afforded the resources to compete in the market.

It is evident, especially in most economies that have very weak accountability models, that the widening gap between the rich and poor can be attributed closely to the fact that, the rich are usually in a better position to obtain resources. Thus, the state and private sector participants (such as companies that are solvent and liquid enough to implement ESOPs) must burden themselves to eliminate the overconcentration of capital amongst the elite. This, of course, is not achieved through belligerent means or through the expropriation of property without compensation. Rather, the advanced argument is that the have-nots within the society must be given equal opportunities to participate in the economy. The mechanisms employed by the state are pivoted on the idea of autonomy within the market, and it is for this reason that binary economics rejects monopolies.

Additionally, a key future of binary economics is that it aims to remove other barriers to equal participation. It is argued that this aim of binary economics has influenced the Corporate Laws of many developing countries, including South Africa, to allow various options for share acquisition. For example, the South African Companies Act requires the board of directors to issue authorised shares for adequate consideration to the company. [258] Pursuant to the definition of “consideration” in the Act, adequate consideration would include intangible assets and the provision of services and skills. This is a clear indication of removing barriers to ownership and economic participation,

[258] Section 40 (1) of the Companies Act 71 of 2008.

which is in sync with the aims of binary economics. More stringent requirements for issuing shares will make it difficult for people to participate in share ownership.

Capital (increasingly the source of economic growth) should gradually become the source of added property incomes for every person. Ideally, justice is defined as the virtue or good habit of rendering to another that which is owed to them. However, in economic dealings, there are three principles of justice that apply: the principle of equivalence (participative justice), the principle of distributive justice, and the principle of contributive justice.[259]

Edward[260] further postulates that the three principles are termed principles of economic justice because they apply strictly in the economic order. This, of course, is because there are other principles of justice. For this reason, Kelso, basing his ideal market system on the three basic principles of economic justice, maintains that binary economics is underpinned by the three interrelated principles of economic justice.[261]

(a) Participative Justice

Edward describes a classic example of the equivalence principle.[262] He argues that the principle of equivalence states that the buyer and seller in the marketplace and the worker and employer in the workplace have two binding duties on both parties. Firstly, they are to exchange things of equal value. Secondly, they are to impose equal burdens on one another. In such transactions, personal experience informs us what equal value means. He further proffers that by equal burden, of which the understanding is that the burden of the seller is to give up possession of the good or service in question. Furthermore, for the buyer, the burden is to give up possession of the money necessary to take possession of that good or service. Whereas, for the worker, the burden is performing the work required

[259] O'Boyle Edward, Principles of Economic Justice: Marketplace and Workplace Applications' (2004) 34 *Forum for Social Economics* 46.
[260] Ibid.
[261] Kelso L O & Kelso P H, *Democracy and economic power: Extending the ESOP revolution.* (1986) Florida: Ballinger Publishing Company.
[262] O'Boyle (2004) op cit note 259.

by the employer. Consequently, for the employer, the burden is paying the employee the wage to which they agreed.[263] Generally, this principle is to be understood as the input principle, which demands, as a fundamental human right, equal opportunity for every person to contribute to the production of society's marketable wealth, both as an employee and a fully empowered owner of productive assets.[264]

(b) Distributive Justice

Distributive justice theory states that society should allocate scarce resources to individuals with competing needs.[265] The notion of 'distributive justice' has garnered significant support and is sometimes used synonymously to refer to 'economic' and 'social' justice.[266] However, Fleischacker[267] alludes to a 'modernised' form of distributive justice, which requires the state to supply resources adequately to afford individuals with their material needs. Within the realm of economics, it is often referred to as the outtake principle, which holds that the contribution of labour to the economic process should be compensated at the market-determined rate (or "just wage") for each particular type of human contribution to the production of marketable wealth, with capital contributions compensated by the residuals (in the form of "profits" and "rentals") from the sales of marketable goods and services.

A practical legal framework established in South Africa in sustenance of the principle of 'Distributive Justice' is the so-called Broad-Based Black Economic Empowerment Act, or B-BBEE, which advocates for "the economic empowerment of all black people including women, workers, [the] youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies". Generally, the objectives as set out in section 2 of the Act are mainly to facilitate B-BBEE by, firstly, promoting economic transformation to enable the participation of black people in the economy. Upon

[263] Ibid.
[264] Ibid.
[265] Fleischacker S, *A short history of distributive justice* (2009) Harvard University Press: Massachusetts 1.
[266] Ibid.
[267] Ibid.

close inspection, it becomes evident that some of the principles set out in the Act resonate with Affirmative Action ideals. Owing to the theme of reconciling the misgivings of apartheid, the B-BBEE aims to achieve substantial change in the racial composition of ownership and management structures and the skilled occupations of existing and new enterprises. It also aims to increase the extent to which communities, workers, cooperatives, and other collective enterprises own and manage existing and new enterprises and increase their access to economic activities, infrastructure and skills training. Furthermore, the Act envisages distributive justice as being achievable only when the extent to which black women own and manage existing and new enterprises and increasing their access to economic activities, infrastructure and skills training is substantially increased. The promotion of investment programmes that lead to broad-based and meaningful participation in the economy by black people to achieve sustainable development and general prosperity are some of the principles consistent with distributive justice.[268]

However, as with most theories, the distributive theory has not been immune to criticism. Kovacevic,[269] argues that "the program has achieved little success in eradicating poverty, increasing employment or fostering economic growth. It is no doubt that the arguments advanced by the writer point to the fact that a purely 'distributive' theory of economic justice is not enough to address the underlining causes of poverty. Thus, the question remains, why is a purely 'distributive theory' inadequate?

The first answer is found within the principle of 'distributive justice', which advocates for what is observed as 'strict, or rather radical' equality. Generally, supporters of strict equality argue that inequalities tolerated by the Difference Principle are unacceptable even if they benefit the least advantaged. However, the problem faced by these advocates is to explain in a satisfactory manner why the relative position of the least advantaged is more important than their absolute position, and hence why society should be prevented from materially benefiting the least advantaged when this is possible. It

[268] Krüger L P 'The impact of black economic empowerment (BEE) on South African businesses: Focusing on ten dimensions of business performance' (2011) 15 (3) *Southern African Business Review* 207-233.
[269] Kovacevic N, 'Righting wrongs: Affirmative action in South Africa', (2007) *Harvard International Review*, Spring: 6.

would appear as though the most common explanation appeals to solidarity, which being materially equal is an important expression of the equality of persons.

(c) Social Justice

This principle was referred to by Louis Kelso and Mortimer Adler as the "principle of limitation," referring to the limitation on the exercise of private property rights such that they may not be used to harm the person or property of another or to harm the general welfare of society.[270] According to the principle of economic justice, everyone deserves equal economic, political and social rights and opportunities. In addition, this principle attempts to solve social problems flowing from a flawed economic system, resulting in unprecedented surges of poverty, social inequality and overall economic insecurity. The consequence created by the market economy system is addressed by creating social welfare policies, for example, the BEE policy that was extensively discussed previously. This welfare system has not been very effective in addressing social and economic problems in society. Despite enacting the BEEE Act and policy, most South Africans still live in poverty with limited access to basic resources. Furthermore, social justice is also used as a feedback principle that balances and restores participative and distributive justice within a market-based economic system to counter monopoly tendencies.[271] Looking at it from an African philosophical perspective, there is a jurisprudential school of thought with immense African roots and is founded on the same principles as those found in the 'social justice' theory.[272] This is the theory of 'ubuntu.' In the case *of S v Makwanyane*[273], Mokgoro J, held that metaphorically ubuntu expresses itself in *umuntu*

[270] See generally Kelso, L O & Adler M J *The Capitalist Manifesto*. New York: Randon House (1958) 23.
[271] Jimenez J Pasztor E M Chambers R M & Fujii C P 2014. *Social policy and social change: Toward the creation of social and economic justice*. California: Sage Publications. p 8.
[272] Social justice finds a very strong foundation in the African philosophy of ubuntu. This philosophy is being advanced in all sectors of government. The parliament relies on the principles of ubuntu when passing laws. The judges apply the principles of ubuntu when interpreting the law and passing judgment. The principles of ubuntu permeate through the policies implemented by the executive branch of government. The central theme of unity, support and care run through the application of ubuntu to various areas of one's life.
[273] *S v Makwanyane* 1995 3 SA 391 (CC).

ngumuntu ngabantu,[274] which when loosely translated means "a person is a person because of or through others".[275] Furthermore, the values embodied in ubuntu such as the capacity of an African culture to express compassion, reciprocity, dignity, humanity and mutuality in the interests of building and maintaining communities with justice and mutual caring, that reinforce the tenacity of social justice. This is rightly so, as the applicability of this philosophy that initially emanated as a purely African philosophy has now received tremendous coverage globally, resulting in it being implemented across various fields, including law and economics. Ideally, from a legal perspective, ubuntu (social Justice) reinforces the fundamental values of humanness, dignity and integrity, as guaranteed in the constitution. Desmond Tutu, who is regarded as a prominent advocate of ubuntu in African ontology, holds that western countries gave the world economic stand points like capitalism. In contrast, Africa has not been able to contribute that much to the economy. However, the social ethic of ubuntu has been Africa's largest contribution to the world.[276]

Additionally, as one of the factors of production is 'labour', ubuntu recognises that African organisations can build cooperation and competitive strategies by allowing teamwork based on ubuntu principles to permeate the organisation.[277] Moreover, as a people-centred philosophy, ubuntu stipulates that a person's worth depends on social, cultural and spiritual criteria. Thus, it requires a life that depends on a normative engagement with the community, a substantive appreciation of the common good and a constitutive engagement with one another in a rational and ethical community. [278]

Capitalism involves the profit incentive that encourages firms to be more efficient, cut costs and innovate new products that people want, a strategy known as 'creative deconstruction'. In contrast to capitalism, ubuntu does not promote capital growth which does not fit into a global economic model, despite its role in the social justice perspective.

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[274] Ibid at para 308.
[275] Mugumbate J & Nyanguru A 'Exploring African philosophy: The value of ubuntu in social work (2013) 3 (1) *African Journal of Social Work* 90.
[276] Tutu D No future without forgiveness: A Personal Overview of South Africa's Truth and Reconciliation Commission (2000) London: Rider Random House.
[277] Mbigi L The spirit of African leadership. (2005) 93.
[278] Ibid.

It serves to fully equip labourers in the workplace with sufficient values and work morals to improve productivity. Furthermore, it can address 'African' economic and social problems since it is, strictly speaking, African philosophy.

In the South African context, economic and social rights are well set out. Thus, they are easily justiciable in the courts, as shown in the next chapter.[279] To guarantee access to social justice, the playing field has to be levelled to afford everyone the resources necessary for them to compete within the market. This, of course, resonates with the principle of binary economics, which emphasises the idea of using 'capital to create capital'.

2.3 Conclusion

Socio-economic exclusion is one of the main causes of poverty.[280] The effects of socio-economic exclusion cause delays in the economic progress of many black people.[281] ESOPs form 'part of a broader approach to capital ownership, broader prosperity and economic justice known as binary economics.'[282] ESOPs have the ability, to a larger extent, to enable employees to acquire capital through a combination of deferred labour compensation, future earnings of capital and corporate tax deductions. However, the mainstream economic policy still hampers the full potential of ESOPs to enable participants to acquire capital with the earnings of capital.[283] Therefore, there is a need for governments to intervene and bring about changes to the mainstream economy to allow ESOPs to operate fully without any restrictions. This can be done by adopting the principles of binary economics as expounded by Kelso.

Capital and labour as factors of binary economics are essential for economic growth and development. Labour increases productivity and has the potential to increase profits in

[279] Social rights would include the right to food, water, housing and health care; while the economic right relates to the right to property and rights relating to trade and investment.
[280] Montle Op cit 230.
[281] Ibid.
[282] Ashford (2017) Op cit 217.
[283] Ibid.

the company. Increased profits afford employees the opportunity to share in the company's profits. Capital, on the other hand, boosts ownership, resulting in employees being afforded an opportunity to share in the company's ownership. It can be argued that labour provides employees with a short-term income while capital, on the other hand, allows employees to have a stake in the ownership of their company.

Binary economics has special appeal to those concerned with the economically disadvantaged people. Ideally, it does not only provide a unique explanation of the persistence of poverty; but it also offers a voluntary ownership-broadening market strategy for helping poor and working people without redistribution. The classical, neo-classical and Keynesian theories have fallen foul of Binary economics in that it has significantly exposed the inadequacies of these theories. The economic growth of the nation largely rests on the working population.[284] This makes the use of ESOPs, a more suitable method for creating and promoting wealth and development in a given country. It is, therefore, ideal to invest in the working class through ESOPs and enhance the growth and development of a particular developing country.

[284] Lanza V The Classical Approach to Capital Accumulation: Classical Theory of Economic Growth. (2012) Bachelor thesis, Umea Universitet) 18.

CHAPTER THREE

SOUTH AFRICA AND EMPLOYEE SHARE-OWNERSHIP PLANS

3.1 Introduction

South Africa, located at the foot of Africa, has a population size of 59 308 690 people. It is the second-richest country in Africa, with a GDP of 358 839 billion. However, this does not take away the fact that millions of South Africans live in poor conditions and have little access to basic resources. The World Bank, in 2019, referred to South Africa as being the most unequal country in the world. This is attributed to the little to no progress in eradicating inequalities experienced in South Africa, as many people still suffer from what the HDR terms "multidimensional poverty." Ideally, this includes social problems such as poor health, malnutrition, a lack of clean water, inadequate access to health care services and poor housing conditions. Almost more than half of all South Africans continue to live in poverty, economic growth has stagnated, and inflation remains high, while the unemployment rate continues to climb towards 30%. However, the absurdity in these statistics is questionable. South Africa is referred to as having one of the most progressive constitutions in the world, with a bill of rights that foregrounds expanded highlights of socioeconomic rights.[285]

South Africa became independent in 1994, and the country adopted a constitution, which is the country's supreme law.[286] To do away with inequality and poverty, the lawmakers introduced various sections in the constitution aimed at achieving equality [287] and economic and social development. [288] Hence, in terms of section 9, the constitution guarantees the promotion of equality and outlaws discrimination. Furthermore, the constitution provides for affirmative action with the aim to bring about transformation.

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[285] Francis D & Webster E 'Poverty and inequality in South Africa: Critical Reflections' (2019) 36 (6) *Development Southern Africa* 789.
[286] Section 2 of the Constitution of South Africa.
[287] Section 9 of the Constitution of South Africa.
[288] Section 24 (b)(iii) is of such provisions make reference to economic and social development.

This chapter, therefore, seeks to provide a study on South Africa's legislative and policy framework in respect of company law in general, but more particularly, the use of employee share-ownership schemes to achieve transformation. In particular, the chapter aims to analyse the efficacy of the corporate rules in operating ESOPs in South Africa.

3.2 Historical Legislative Treatment of ESOPs

The Employee Share-ownership Plans (ESOPs) were initially introduced in South Africa in 1987, resulting from the disinvestment of international companies such as Ford Motor Company.[289] Pick 'n Pay, Anglo American Corporation of South Africa, and Investec management are a few corporations that initially introduced ESOPS in South Africa.[290]To date, approximately 200 listed and unlisted companies have introduced the concept.[291]

At its inception, the idea of ESOPs was not entirely rejected in South Africa. However, some trade unions raised a few issues that needed to be clarified before the phenomenon could be widely implemented in companies. These issues related to the full disclosure of information relating to ESOPS, the eligibility of all employees for the consideration of ESOPs, and separation between employment and share ownership.[292] The disclosure of information, particularly in relation to the company's financial position, is important as it informs the dividends of shareholders. Hence, trade unions desired companies to disclose their information relating to their financial information should such companies introduce ESOP in South Africa. ESOPs are meant to eliminate inherent inequality and discrimination. Therefore, it is important that its introduction into a business does not discriminate between employees by favouring one individual or group over the other.

On the legislative slide, the South African company law has been governed for decades by the Companies Act 61 of 1973 until repealed on 1 May 2011. This legislation, which came into effect on 1 January 1974, brought various changes to the then South African company law regime.[293] However, this was not the first company law statute in South

[289] Mazibuko (2003) op cit note 38 at 176.
[290] Ibid.
[291] Ibid.
[292] Ibid.
[293] Cilliers H S Benade M L Henning JJ *et al*, Op cit note 180.

Africa. Various other pieces of legislation provided the legislative framework for companies, such as the Joint Stock Companies Limited Liabilities Act No 23 of 1861 and the Union Companies Act 46 of 1946.[294] The Companies Act of 1973, thus, introduced some changes such as the establishment of the company having a share capital, the abrogation of the ultra vires doctrine, and the introduction of the statutory derivative action.[295] Although these are noticeable changes in the scope of company law, the 1973 Act did not acknowledge it as being important to address the issues of economic emancipation and social freedom. At this stage, South Africa was simply looking for a piece of legislation that could close the gaps that existed in the company law regarding areas such as statutory derivative action and the establishment of the company having a share capital, as alluded to above.[296]

When the 1973 Act was applied, there was no explicit need to have conversations around transformation, economic growth and development. Furthermore, nowhere in the 1973 Act can one find concepts such as 'welfare' and 'well-being' (of South Africans). The rationale for this is somewhat clear. South Africans at the time were still living in economic slavery and political torture. No government could promise them economic and social benefits.

ESOPs, which are the key feature of this thesis, were not expressly captured under the 1973 Act. In fact, the 1973 Act proscribed companies from providing financial assistance for the purposes of acquisition of shares until Corporate Law reforms commenced starting from the third amendment of the said Act. This means that the business owners did not deem it necessary to take care of their employees through the issue of shares. It is only after attaining freedom and with the Companies Third Amendment Act[297] that a ''further category was introduced to offer shares to employees through employee share schemes''. Section 38 of the 1973 Act prohibited the granting of financial assistance to employees for the purpose of purchasing shares of a company or a holding company.

[294] South African Company Law for the 21st Century: Guidelines for Corporate Law Reform. General Notice, 1183 of 2004. The focus of this thesis however is limited to the Companies Act 61 of 1973 and the Companies Act of 71 of 2008.
[295] Ibid at 6.
[296] Ibid.
[297] Companies Amendment Act 125 of 1998.

Thus, in terms of the 1973 Act, companies couldn't finance ESOPs for the benefit of their employees. The 1973 Act not only prohibited the granting of financial assistance to buy shares of the company but also prohibited the company from repurchasing its shares. The position was, however, changed by the Companies Amendment Act, 1999. In terms of the amendment, companies were allowed to extend funds to employees to subscribe for shares.[298] Furthermore, the companies were allowed to buy back their shares. Thus section 85 of the Companies Act 61 of 1973 permits a share repurchase pursuant to a special resolution being approved by the Registrar of Companies. The said amendment brought the application of the solvency and the liquidity test into play. Thus, before a company could make funds available for repurchasing the shares so issued by it, the company could have to satisfy two requirements. These are the ability to pay its debts as they become due and payable in the ordinary course of business[299]; and the total value of the assets of the company could be able to pay for the liabilities of the company.[300] The introduction of the solvency and liquidity tests was a deviation from the capital maintenance rule. Hence, this seems to have been a much welcome intervention as far as corporate reform is concerned. This is because the solvency and liquidity tests ensure that the core business objective of a company to make a profit and protect the financial interest of the shareholders is not compromised in any manner. Although one cannot dispute that this amendment was a positive move as far as the companies are concerned, it provided no possible avenues for companies to offer financial assistance or otherwise to their employees to purchase shares.

In terms of the 1973 Act, a company was not entitled to acquire its own shares, prior to its amendment. However, the changes brought by the 1999 amendment enable a company to acquire its own shares to the extent that it is authorised to do so by the articles of association, and the share repurchase is approved by a special resolution of the members of the company.[301] The aforesaid amendment together with the amendments

[298] Section 38(2)(b) of the Companies Act 61 1973 as amended.
[299] Section 85 (4) (a) of the Companies Act 61 of 1973 as amended.
[300] Section 85 (4) (b) of the Companies Act 61 of 1973 as amended.
[301] Section 85 (1) of the 1973 Act as amended. See also Cassim FHI & Cassim R, "The capital maintenance concept and share repurchases in South African law" (2004) International Company and Commercial Law Review (ICCLR) 2.

on providing financial assistance as outlined above, brought about important developments to the South African company law as companies could now rely on these statutory provisions to facilitate ESOPs.[302]

Moreover, the language under the 1973 Act was pro-liquidation if the company was financially distressed. In other words, where the company was insolvent, and its financial statements indicated that it was not profitable, it was deemed best to invoke the provisions of section 427 by placing the company under judicial management to liquidate such a company.[303]

It is concepts such as transformation, economic growth and development that have led to the enactment of the Companies Act 71 of 2008. Therefore, it becomes apparent that clearly, there was a need for legislative and policymakers to ensure that development takes place socially, politically and economically.[304]

3.3 Suggested Methods for Effecting ESOPs in South Africa

> '*Our country needs an economy that can sustainably meet the needs of all our economic citizens-our people and their enterprises. This means access to quality work and enterprise opportunities and access to capacities and skills to make use of these opportunities. Enterprises of all types and sizes will have become adaptive, innovative and internationally competitive*.'[305]

This quotation highlights that South Africa has been faced with factors that hampered economic growth and development, particularly in the arena of company law. The

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[302] See also Cassim FHI & Cassim R, "The capital maintenance concept and share repurchases in South African law" (2004) International Company and Commercial Law Review (ICCLR) 2.

[303] Section 427 of the Companies Act 61 of 1973 as amended.

[304] South African Company Law for the 21st Century: Guidelines for Corporate Law Reform op cit note 271. Although there are many other reasons why there was a need for Corporate Law reform, such as to simplify the procedure for the formation of companies, to promote efficiency of companies and their management, to ensure high standards of corporate governance and to harmonise the South African company law with best-practice jurisdictions internationally; the key purpose of at least within the scope of this thesis was make company law an avenue for economic growth and development of the South African people.

[305] South African Company Law for the 21st Century: Guidelines for Corporate Law Reform op cit note 276 at 8.

predecessor company legislation was not necessarily concerned with the use of the company as a means to achieve economic and social benefits.[306] This lacuna in the legislative and institutional framework was among the key factors that called for company law reforms in South Africa. The reform was meant to bring South Africa to a place where people understand companies and company law as a tool to bring about economic growth and development. Hence, the 1973 Act was repealed and replaced with the 2008 Companies Act, as the process of corporate formation under the said Act was cumbersome and inflexible. As a result, this discouraged the incorporation of companies, thus contributing to the low levels of commercial activity within the economy.[307]

Considering the central theme of this thesis, which is the use of ESOPs to reduce poverty in South Africa, the question that needs to be addressed is: how can ESOPs be used in the context of the new company law regime as a means to decrease poverty levels? Put differently, how can ESOPs contribute to the realisation of the ideals expressed in the above quotation, which are economic growth and sustainable development?

In answering this question, it is indispensable to analyse the rationale and operation of ESOPs. In this analysis, three groups are considered: the employees, the company, and its response to the needs of the wider community. These groups have been identified because each of them stands to benefit from the successful implementation of an ESOP.

Firstly, ESOPs provide the employees with the opportunity to participate in the ownership of the company. As employee shareholders, employees can enjoy all rights attached to being an employee-shareholder. Employee-shareholders can benefit from their company by receiving distributions of the company's profits and selling their interests in the company, either wholly or partly. The concept of transferability of shares entitles shareholders to sell their shares at their free will, subject to applicable restrictions in the case of private companies.[308] However, the founder of a trust may, in a trust instrument, ascribe restrictions on the selling of employee shares. The right to receive dividends allows employees to meet their needs sustainably. Employee ownership has the potential

[306] Section 7(d) of the 2008 Act.
[307] Mongalo (2010) op cit note 173.
[308] Ibid.

to alleviate inequality and help create shared prosperity.[309] If ESOPs are properly administered, it may increase workers' salary and wealth, thereby broadening the overall distribution of income and wealth.[310] For example, Kumba Iron Ore, one of the companies based in South Africa, paid out R95 million to almost 6 600 employees, with each employee receiving R12 451 after tax deduction.[311] The employees, as in the case of Kumba ore, share in the dividends, bonuses or other forms of profit distribution by participating in the ownership of the company.[312]

The primary goal for which companies are formed is to make a profit. Furthermore, companies need to grow and expand. In order to achieve its goal of making a profit, it needs a loyal, productive and committed workforce. Employee share ownership boosts employee morale to work smarter and deepen their contributions to their company, as they have a sense of ownership and belonging, causing them to think and act like owners.[313] Companies owned by employees have better performance on average. Furthermore, they tend to have more stability and more survival rates.[314] If the company makes good returns, all stakeholders are dependent on the company benefits. Hence, the broader sharing of economic rewards reduces economic inequality.[315] Successful companies make meaningful and long-lasting contributions to the community where they operate. Some companies build schools for local communities, provide scholarships, and contribute to sports clubs, building houses for persons from poor backgrounds. These efforts have a lasting impact and thus contribute to the sustainable development goals of any given country. ESOPs are very useful in motivating employees to work harder, bring up new and fresh ideas to the table, work collectively and present a united front.[316]

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[309] Kruse D 'Does employee ownership improve performance? Employee ownership generally increases performance and worker outcomes' available at https://wol.iza.org/articles/does-employee-ownership-improve-performance/long accessed on 21 September 2021

[310] Ibid.

[311] R95 Million Dividend Payout to Kumba Employees, available at lhttps://www.angloamericankumba.com/media/press-releases/archive/2013/15-08-2013#:~:text=Kumba%20Iron%20Ore%E2%80%99s%20broad%20based%20employee%20share%20ownership,Envision%2C%20continues%20to%20pay%20healthy%20dividends%20to%20employees, accessed on 11 November 2021.

[312] Ibid.

[313] Ibid.

[314] Kruse D 'Does employee ownership improve performance?' (2016) Op cit note 309

[315] Ibid.

[316] Ibid.

Employees who are motivated and can work together with others are a great asset to the company. They guarantee the continued existence and success of the company for their benefit and the company' benefit.

The governments of countries bear the responsibility of providing services for their citizens.[317] A profitable company usually pumps more funds to the government through taxes. The government provides services to its citizens, and though indirectly, the society benefits from the government's resources. In addition to paying taxes, the companies also give back to the communities through social projects. In fostering growth and development, governments often finance projects aimed at promoting entrepreneurship, which is one of the key drivers of economic growth.[318] Governments can only effectively carry out their mandate of taking care of their citizens, if profitable companies meet the governments halfway. In order for a company to be profitable, it is essential to introduce ESOPs. In addition to providing financial assistance to the governments, companies may also benefit from ESOPs in the following ways set out below.

Companies contribute to the economic growth and development of South Africa.[319] For a company to play its role of driving the economy, it needs a workforce. Hence, implementing ESOPs will reduce employee turnover. Reduction in employee turnover is advantageous for the company as it saves cost, which could otherwise have been diverted to replacing employees. Reduction in employee turnover also leads to better production and customer retention as well as promotes workforce morale. [320] Furthermore, ESOPs, promote employee productivity. Employee ownership encourages employees to work harder and be more productive as they stand to benefit from increased productivity. Companies owned by employees, wholly or partly, remain competitive as the

[317] Tax payments made by individuals and companies are very essential as it is used to finance the government's expenditure. For example, the governments need to build schools, and hospitals, repair roads, pay salaries to government employees and provide grants to orphans and vulnerable groups of persons in the community.
[318] Due to the important role that entrepreneurship plays in growing the economy, it is necessary for the government to provide enabling environment for entrepreneurs to trade and in some instances, it would even be necessary for governments to provide financial assistance to entry-level entrepreneurs in order for them to succeed.
[319] Mongalo T 'The Emergence of Corporate Governance as a fundamental research topic in South Africa' (2003) 120 (1) *South African Law Journal* 175.
[320] Kokemuller N, available at yourbusiness.azcentral.com, accessed on 30 September 2021.

employees' interests are aligned with those of the company, boosting turnover for the benefit of both the company and employee shareholders. ESOPs can assist the business owner to diversify their investment portfolios on a taxed advantaged basis, and they can help facilitate transactions in ownership of a closely held business.[321] Implementing ESOPs can positively impact the lives and livelihoods of the employee-shareholders. As stated previously, employee-shareholders share in the dividends declared by the company, enabling them to meet their financial needs on a short-term basis. In the long run, employee-shareholders have ownership rights attached to the shares held in the trust on their behalf and from which they can benefit in the future.

Now that it has been established that ESOPs have the potential to positively impact employees, companies and the community, it is essential to determine how Corporate Law principles can be applied to ensure that companies have sufficient share capital to effect ESOPs in South Africa.

The language and the spirit of the 2008 Companies Act strive to ensure business continuity and economic growth and development. This is evident by the introduction of concepts such as business rescue. The purpose of business rescue is to facilitate the rehabilitation of a financially distressed company.[322]

Accordingly, the introduction of the Companies Act brought significant changes to governance with regards to employee participation in corporations. It entrenched various rights of employees to a point which extends their labour rights.[323] Thus, in terms of this development, employees are given significant rights of participation in the governance of companies as a matter of company law as opposed to industrial or labour relations law.[324] This is largely voluntary and not mandatory, and the understanding is that corporations may involve employees in the governance of the structure if such involvement does not guarantee the noticeable success of the corporations.[325]

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[321] Ackerman D 'ESOPs Corner' (2012) 15(5) Journal of Passthrough Entities 7.
[322] Section 128(1)(b) of the Companies Act 71 of 2008.
[323]Botha M ‘Responsibilities of Companies Towards Employees’ (2015) 18(2) *PER* 38.
[324] Ibid.
[325] Ibid at 11.

3.3.1 The Availability of Sufficient Share Capital to Effect ESOPs

(a) Rules Affecting the Issuing of Unissued Share Capital and ESOPs

The Companies Act of 2008 entitles employees to participate as shareholders in the company's financial affairs through the issue of shares as mandated by section 38 or through consideration for shares in terms of section 40.

According to section 38 of the Act, the board of a company has the authority to issue shares of the company at any time. In order to ensure that the issuance of shares complies with the provisions of section 38, the board must see to it that the issuance of shares takes place only within the classes and to the extent that the shares have been authorised by or in terms of the company's Memorandum of Incorporation. In terms of the 2008 Act, no shareholder approval is required for the issuance of authorised shares in terms of section 38(1).[326] This is a complete departure from the predecessor legislation, where shareholder approval was required. The approach taken in terms of the 2008 Act may be in line with its objectives of simplifying the process of forming and managing the company's operations. However, the broad powers given to the board to issue shares without the shareholders' approval may lead to lead to abuse and, if care is not taken, this can possibly lead to a situation where the board engages in conduct that unfairly disregards the interests of shareholders. Although this set of events is not desirable, if it happens that the board disregarded the interests of the shareholders in issuing shares, the shareholders may approach the court for relief.[327]

Although shares must be authorised before issue, the Act allows for the retrospective authorisation of shares. In other words, if a company has issued shares that have not been authorised or issues shares above the number of authorised shares of any particular class, the company may retroactively authorise the issuance of such shares in

[326] The approval is however required in terms of section 41(1)(a).
[327] Section 163 of 1(c) of the Companies Act 71 of 2008. In the case of *Grancy v Properties Limited v Manala* (665/12) [2013] ZASCA 57 (10 May 2013), the court applied this section stating that the court enjoys latitude in the exercise of its discretion under section 163.

accordance with section 36. Although this approach may be in line with the international trend as far as the issue of shares is concerned, it could be viewed as giving directors too much power, which could potentially be abused.

Another important development in terms of the 2008 Companies Act is the issue of shares by the board without shareholders' approval. The provisions of section 41(3) clearly illustrates that the board can issue shares without shareholder approval up to a maximum of 30% of the voting power of all shares in that class.[328] This approach was not possible under the 1973 Act.[329]

The Court has the powers to intervene where there are allegations of contravention of the law regarding issuing of shares in terms of section 38 and section 41(3). In other words, the court can set aside any transactions involving the issue of shares in terms of the aforementioned sections, where it is alleged and proven that the board has acted contrary to the law.[330] According to the principles of the law of contract, it is possible to sever the illegal part of an agreement from the legal part. But in the context of issuing shares in excess of that which is permitted legally, this would undermine the purpose of the restriction provided by section 41 (3).[331]

It is essential for the company to only issue shares that have been authorised in terms of the MOI. This is important for various reasons. Firstly, it allows transparency. All the shareholders know which classes of shares the share capital has been divided into and the extent to which such shares have been authorised for issue. No shareholder can be

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[328] Carl Stein with Geoff Everingham. The New Companies Act Unlocked. Cape Town: Siber Ink. 2011 p.14

[329] Ibid. Furthermore, in the case of *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another 2018 (3) SA 157*, the court found that in our law, the previous Companies Act provided no power for directors to issue shares. This led to the promulgation of a new Act, which now provides for that power in section 38 (1), however, that power is capped by the number of shares authorised by the MOI. Nevertheless, the court also highlighted that directors also have the power in section 36(3) to increase or decrease the authorised shares and so, in a sense, they are now able to pull themselves up by their own bootstraps. The court thus considered the obligations of the board relative to increasing the number of authorised shares of a company, and relative to the issuing of new shares in a company, as of the same. Notwithstanding the provision of the previous Act, with the advent of the new Act the powers of directors to issue shares is now constrained and within the ambit of section 76(3) of the Companies Act, 2008 which now as a consequence maintains that the exercise of the powers held by the director is subject to good faith and for a proper purpose; and it must be in the best interests of the company.

[330] Section 218. Also see *Reezen Limited v Excellerate Holdings Limited and Others* Case No 11899/2018.

[331] *Reezen Limited v Excellerate Holdings Limited and Others* Case No 11899/2018.

taken by surprise when shares are issued to shareholders. Secondly, accountability; the board is accountable to the shareholders as owners, and therefore, it is important for the board to act in compliance with the MOI.

Apart from issuing shares, the law authorises the board of directors to classify any unclassified shares into one or more existing classes of authorised shares.[332] Thus, a company that holds unclassified shares and intends to implement ESOPS can use sections 36(1)(d) and section 36 (3)(c) to classify such unclassified shares into the class of shares to be used for ESOPS. This approach can be followed where the company does not want to increase the authorised share capital. Once the shares are classified into the ESOP class of shares, certain rights will be attached to such shares, such as the right of the employee-shareholder to receive dividends, the right to vote and the right to receive information as far as the company's affairs are concerned.[333]

(b) Necessity of, and Rules Affecting, the Increase of Authorised Share Capital for ESOP Purposes

Companies are formed for various purposes. Depending on the nature, type of company that has been formed and the circumstances prevailing at a particular time, a need may arise subsequent to incorporation to increase or alter the company's authorised shares.[334] Due to the benefits that an employee-ownership can offer, such as increased productivity and better returns, companies may decide to transfer part ownership to employees. This may necessitate an increase of the authorised shares for issuing the same to the

[332] Section 36 (1) (d) and 36(3)(c) of the Companies Act 71 of 2008.
[333] Employees who have a financial stake in the company have the right to be kept abreast with all affairs within the company. This right can be exercised through the review of documents and minutes of meetings (Velasco J 'The Fundamental Rights of the Shareholder; 2006). Having access to information enables shareholders, including employee-shareholders, to make informed decisions. This is crucial because uninformed decisions can lead to employees losing dividends and profits they could have otherwise received from financially sound decisions.
[334] Authorised share capital relates to the total amount that a company can raise through issuing shares. See Haupt H & Malange J *Corporate Law for Commerce Students* (2015) 2 ed 121. Due to the benefits that an employee-ownership can offer such as increased productivity and better returns, companies may decide to transfer part ownership to employees. This may necessitate an increase in the authorised shares for issuing the same to the employees.

employees. In other instances, a company in a dire financial crisis may decide to increase its authorised shares to raise capital. Two types of companies may be incorporated in South Africa: profit companies and non-profit companies.[335]

In the South African context, a profit company refers to a state-owned company, a private company, or personal liability company.[336]

A non-profit company, also known as a company established not for gain refers to a company that has been formed for the public benefit or any of the objects as set out in item (1) of Schedule 1 of the Companies Act. Its income and property are not distributed to any its incorporators, members or directors except to the extent that this is allowed by item 3 of Schedule 1.[337]

The founding statement of a company will set out the purpose for which the company is formed. Regardless of the company's objects, the South Africa Corporate Law allows for a company to increase its authorised share capital. Hence, a company may increase its share capital either through a fresh issue of shares or by capitalising on retained earnings with a bonus issue. A company may increase the number of authorised shares of any class of shares.[338] The authority to increase or decrease the number of authorised shares is vested in the board.[339] However, the company in its MOI can decide to restrict or prohibit the company from increasing the authorised shares.[340] In other words, the shareholders may in the MOI contain a provision that expressly prohibits the board from altering the company's authorised share capital without the shareholders' approval. In terms of the latter approach, the board must first obtain the shareholders' approval before altering the company's share capital. As stated earlier in this chapter, shares must be

[335] Section 8 (1) of the Companies Act 71 of 2008. In terms of Schedule 1, the Memorandum of Incorporation of a non-profit company must set out at least one object of the company, and each such object must be either a public benefit or an object relating to one or more cultural or social activities, or communal or group interests…''
[336] Section 8(2) of the Companies Act 71 of 2008.
[337] Section 1 of the Companies Act 71 of 2008.
[338] Section 36 (3)(a) of the Companies Act 71 of 2008.
[339] Section 36 (3)(a) of the Companies Act 71 of 2008.
[340] Section 37 (3) of the Companies Act 71 of 2008.

authorised before they can be issued. However, in certain circumstances, shares that have been issued without authorisation can be retrospectively authorised.[341]

In an existing company that wishes to implement ESOPs, the need may arise to increase the authorised share capital for ESOP purposes. A company that was not initially formed for the primary purpose of dealing in ESOPs may decide to authorise and issue shares for implementing ESOPs. This could be prompted either by the company's response to corporate social responsibility where it decides to give back to its employees or by the company's renewed objectives where it intends to bring employees on board as far as ownership is concerned.[342] The company may also decide to reclassify any authorised shares that have not yet been issued. A company is permitted to increase authorised shares or reclassify authorised shares that have not yet been issued, provided that the necessary requirements are met. If the company decides to increase the authorised shares for ESOP purposes, it must amend the MOI to provide for such an increase.[343] The MOI, once amended, must be filed with the Companies and Intellectual Property Commission (CIPC).[344] A company may amend its MOI by board resolution[345], and hence there is no need to obtain a special resolution.[346] This is a complete shift from the 1973 Act, in terms of which the board needed to obtain a special resolution for amending the MOI.[347] From the shareholder's point of view, vesting the board with the power to amend the MOI could seem to be a disadvantage. This is so because the shareholders may wish to be involved in making decisions regarding the amendment of the MOI, especially where share capital is involved. However, nothing prevents shareholders from restricting the directors' powers in amending the MOI through board resolution. Hence, the shareholders can, in the MOI, state that the MOI can only be amended through a special resolution. The latter approach will obligate the board to obtain a special resolution before altering

[341] Section 38 (2) of the Companies Act 71 of 2008.
[342] There are various advantages that companies which are partly owned by employees can benefit from. For example, employee-shareholders promote productivity and thus, guaranteed increased profits and because the interests of the employee-shareholders are aligned with that of the business, the employees remain loyal to the company. An employee that shares in the ownership of the business tend to be loyal and productive and increases productivity raises turnover which is essential for the growth of the company.
[343] Section 38 of the Companies Act 71 of 2008.
[344] Section 16 of the Companies Act 71 of 2008.
[345] Section 16(4) (a) of the Companies Act 71 of 2008.
[346] Section 16 (4) (b) of the Companies Act 71 of 2008.
[347] Section 75 (1) (a)(i) of the Companies Act 61 of 1973.

the company's authorised share capital. This approach is extremely useful if the shareholders want to protect their interests. Existing shareholders may wish to guard against share dilution and therefore want to retain the power of altering the company's MOI. In the event that employees do not own the company, whether wholly or partly, the existing shareholders may be reluctant to welcome the move of implementing ESOPs as this could lead to share dilution. On the contrary, if the existing shareholders want to transfer part of the ownership to employees, they will be more willing to alter the company's share capital by taking a resolution to that effect.

(c) Share Buy-Backs and ESOPs

The issued share capital of the company is a guarantee fund that can be used to settle the claims of creditors with the result that the issued share capital cannot be reduced, nor may it be returned to shareholders except in instances where the law authorises such to happen.[348] The share capital is not a debt, but it is equity, and in the event of insolvency, the creditors have no claim for the capital contributed.[349] Thus, in terms of the *Trevor V Whitworth case*, a company was prohibited from returning capital to its members.[350] This was particularly because the creditors normally rely on the company's funds and would be affected negatively if the company exhausts its funds by returning share capital.[351] Another reason for this prohibition was to protect the company's shareholders by preventing a company from trading in its shares.[352]

The capital maintenance rule, which prohibited any transaction that may harm the creditors' interest[353] was meant to protect creditors against risks associated with a shareholder's limited liability.[354] The common law rule of capital maintenance prohibited

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[348] Cassim FHI & Cassim R ''The capital maintenance concept and share repurchases in South Africa'' (2004) 15(6) *I.C.C.L.R* 1. Capital rules in this context refer to the corporate rules that have been developed to regulate activities pertaining to the use of share capital of the company.
[349] Mongalo T *Corporate Law & Corporate Governance: A global picture of business undertakings in South Africa* (2003) 146.
[350] (1887) 1 App Cas 409
[351] Mongalo T ''Corporate Law & Corporate Governance Op cit note 349 at 146-147.
[352] Cassim F H I *et al.,* Contemporary Company Law Op cit note 35.
[353] Armour J "Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law" (2000) (63)(3) *The Modern Law Review* 5.
[354] Ibid.

companies from purchasing their own shares.[355] However, it has become more appropriate to restrict shareholder asset transfer based on solvency and liquidity ratio instead of the rules relating to capital maintenance.[356] Although the capital maintenance rule also serves its purpose of protecting creditors against the abuse of powers of the company as far as finances are concerned, its continued operation does not effectively assist economic development through the use of Corporate Law.

Hence, the principles relating to capital maintenance have undergone some changes for all companies to acquire their own shares. The Companies Amendment Act of 1999 has introduced certain amendments to the capital maintenance rules.[357] The said amendments have repealed the rules pertaining to the reduction of share capital.[358] However, as per the international trends, an exception was introduced to the capital maintenance rule, in which a company may repurchase its shares, provided that the rules set for this have been met.[359] This is where the solvency and liquidity test was introduced. To a certain extent, one can argue that the solvency and liquidity test is an exception to the capital maintenance rule. The contention is still supported by the view that the company cannot hold its own shares.[360] Hence, companies may even reduce share capital, including the acquisition of their own capital, provided there is compliance with the solvency and liquidity test.[361] It must, however, be noted that financial assistance is not limited to serve as an exception to the capital maintenance rule but it is also used in other areas of corporate finance. Hence, the new solvency and liquidity test applies to all forms of distributions.[362]

The current company law in South Africa permits companies to repurchase their shares without shareholder approval in terms of section 48 read together with section 46 of the Act. Two conditions must precede the repurchasing of shares. The resolution must

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[355] Ibid.
[356] Ibid.
[357] Beuthin R & Luiz SM Beuthin's *Basic Company Law* 3 ed (2003) 86.
[358] Ibid.
[359] Mongalo Op cit note 326. The Companies Amendment Act of 1999 repealed certain provisions of the 1973 Companies Act and allowed repurchases to take place.
[360] Ibid.
[361] Cassim F H I *et al Contemporary Company law* Op cit note 35 at 295.
[362] Ibid.

approve the distribution of the board.[363] The only time a special resolution is required for share buy-backs is when such repurchases are made by a director or prescribed officer.[364] Share buy-backs may significantly influence the company's ownership and control, and shareholders could want to be involved in decisions regarding repurchase.[365] Cassim *et al.* however, maintain that a special resolution could always be required in transactions that may result in the restricting of company capital as per section 114 of the Act. [366] Accordingly, section 48 deals with repurchases that will not significantly alter the company's capital. In contrast, section 114 requires special resolution to be applied to transactions that involve or result in the restructuring and/or change in the company's share capital.[367] At face value and to a certain extent, this contention can seem to avoid conflicts between the two sections and allow the board to act independently without obtaining permission in certain circumstances when performing share buy-backs. The problem with this contention and/or interpretation is the lack of distinction between transactions that can significantly alter the share capital of the company and 'minor transactions', which could not result in the restructuring of the company's share capital. Furthermore, before authorising the repurchasing of shares, the board should ensure that the company's financial position is not affected adversely by such distribution. In other words, in its resolution, the company, must acknowledge that it has applied the solvency and the liquidity test and the company will be able to pay its debts, and its assets will be sufficient to cover its liabilities.[368] These tests are explained in more detail under section 3.4.1 below.

A share repurchase is not only advantageous for the company, but also benefits shareholders. Upon buying back its shares, a company can return surplus funds to its shareholders, who can then make other profitable investments.[369]According to this rule,

[363] Section 46 (1)(a)(ii) of the 2008 Act.
[364] Section 48 (8) of the 2008 Act.
[365] Cassim (2004) Op cit note 325.
[366] Ibid at 8.
[367] Ibid at 8.
[368] Section 46 (1)(c) of the 2008 Act.
[369] Cassim F H I *et al*., *Contemporary Company law* Op cit note 35 at 296.

it could be impractical for a company to buy back its shares and re-issue it to implement ESOPs.

Hence, one of the justifications for allowing share repurchases is that they serve as a useful vehicle where the company has an employee share incentive scheme. It enables the company to purchase employees' shares when their employment with the company is terminated.[370] Furthermore, share repurchases can assist the company to maintain a healthy or desirable debt-equity ratio.[371]

Applying the principles of a share repurchase is extremely convenient for a company that has introduced or seeks to introduce an ESOP as it enables the company to purchase employees' shares when they leave their employment.[372] The application of this corporate principle means that employees enter into an agreement with the company in terms of ESOPs, whereby the company reserves the right to repurchase the shares if the employee leaves employment.

(d) Mandatory Offer Rules and Implementation of ESOPs Through Empowerment Deals

The mandatory rule is premised on the protection of minority shareholders.[373] Minority shareholders must not be forced to remain with a company where the control of the company changes[374].Therefore, they must be allowed to decide what happens upon a takeover. Hence the Companies Act of 2008, in particular section 123, sets out the procedural and substantive mandatory rules as follows:

Firstly, a regulated company may re-acquire any of its voting securities in terms of section 48 or a scheme arrangement as per section 114.[375] Alternatively, a person acting alone may acquire a beneficial interest in voting rights attached to any securities issued by a regulated company. To comply with this requirement, two or more related or inter-related

[370] Ibid at 294.
[371] Ibid.
[372] Ibid at 296.
[373] Nkoane P 'South African Mandatory Offers Regime: Assessing Minorities' Leverages to Seek Recourse and Equal Treatment in Takeover Bids' (2020) 2 *ELR* 43.
[374] Smit A L *Compulsory Acquisition of minority shareholding: A critical analysis* (LLM Thesis) 1.
[375] Section 123 (2) (a) (i) of the Companies Act 71 of 2008.

persons who are acting in concert must also acquire a beneficial interest in voting rights attached to any securities issued by a regulated company.[376]

Secondly, the person or persons contemplated in paragraph (a)(ii) of the Act must, as a result of the acquisition together with any securities already held, be able to exercise at least the prescribed percentage of all rights attached to the securities of that company.[377]

Thirdly, the person or person referred to in the above rules must, within one business day after the date of an acquisition contemplated in subsection (2), give notice in the prescribed manner to the holders of the remaining securities. The said notice must provide a statement indicating that they are in a position to exercise at least the prescribed percentage of all the voting rights pertaining to the securities of that regulated company and an offer to acquire the remaining securities on the terms set in accordance with the provisions of the Act and the Takeover Regulations. [378]

Fourthly, the person or persons as stated in the above rules must deliver a written offer, which must comply with the Takeover Regulations. This offer must be given to the holders of the remaining securities of that company to acquire those securities in terms of section 3 (b) of the Act.[379]

Lastly, the Minister may prescribe a percentage of not more than 35 percent of the voting securities of a company.[380]

The purpose of the mandatory offer rule is to ensure fair and equal treatment of all holders of relevant securities when the transference of the company control is in the offering. [381] The rationale is to avoid the possible ill and unfair treatment of minority shareholders during the takeover.[382] In certain situations, the minority must approach the court to enforce and enjoy their rights. The intention announcement is provided in the rules that somehow warrant the equal treatment of affected security holders. This is pursuant to the

[376] Section 123 (2) (a) (ii) of the Companies Act 71 of 2008.
[377] Section 123 (2) (c) of the Companies Act 71 of 2008.
[378] Section 123 (3) (b) of the Companies Act 71 of 2008.
[379] Section 123 (5) of the Companies Act 71 of 2008.
[380] Ibid.
[381] Nkoane (2020) Op cit 349.
[382] Ibid.

fact that when a firm announces its intention, it is required to fulfil its takeover vows.[383] The mandatory offer further serves other important purposes, such as ensuring that the minority shareholders are not forced to remain in the company where there has been a substantial change of control.[384]

The move of the mandatory rule requirement in terms of the 2008 Act was to bring South Africa in line with the international approaches of having a statutory merger procedure that is court-free, to a larger extent.[385] Therefore, as outlined above the rule does not rely on court interventions to guarantee a successful merger. The parties themselves can ensure the success of the merger through compliance with the statutory rules pertaining to mandatory offers.

An important aspect of the mandatory rules relates to the payment in consideration. The payment of shares in consideration makes it easier to sell and transfer shares. The mandatory offer rule in terms of the South African company law does not explicitly refer to the payment in consideration. The company laws of other jurisdictions expressly include a statutory provision to allow payment in consideration of a mandatory offer . Even though section 123 of the Companies Act does not explicitly make reference to the concept of 'payment in consideration', nothing precludes the payment of cash consideration.[386] However, one could have expected the South African Corporate Law reform to make reference to payment in consideration of terms of the mandatory offer rule. However, the fact that South African Corporate Law has moved away from the capital maintenance rule indicates that adequate consideration can also be accepted as payment for shares. Adequate consideration requires compliance with the liquidity and solvency tests.[387] These tests were discussed extensively in the previous section. Therefore, explaining them in this section is unnecessary, other than reiterating their importance before consideration is made and accepted. Mergers and acquisitions play

[383] Ibid.
[384] Ibid.
[385] Davids E Norwitz T & Yuill D, 'A microscopic analysis of the new merger and amalgamation provision in the Companies Act 71 of 2008'' 341.
[386] Ibid at 345.
[387] Ibid.

an essential role in ensuring the efficient allocation of society's resources.[388] For this reason, the concerned parties, especially the controlling shareholder, must ensure that they follow the statutory requirements for the process to yield positive results for all the affected parties.

The concept of fair value has not been expressly included in the mandatory offer rule. To sufficiently protect the rights of the minority shareholders, it would be prudent if they had the statutory right to demand a fair value in their shares subject to the mandatory offer.

Several arguments have been advanced against the mandatory offer rule. The mandatory offer makes the financing of shares somehow costly and makes it difficult to achieve the aims of black economic empowerment. However, it is important to note that the black economic empowerment movement in its current form cannot effectively assist South Africa in achieving the aims of poverty reduction, as was indicated in Chapters 1 and 2 of the present study. The Mandatory offer rule, together with other Corporate Law reforms such as the oppression remedy and statutory derivative action, can be used to achieve the desired result. Another drawback that is introduced by the mandatory offer is that it does not protect minority shareholders as the offeror could reduce the price of the shares to enable him/her to afford the payment of such shares on offer. However, this view can be contended. In accepting the offer, the offeree can take various facts into account, such as the market value of the offered shares. Although the detailed analysis of the mandatory offer rule falls beyond the scope of this thesis, making amendments to the provisions of section 123 may be desirable to the extent that it helps to facilitate effecting ESOPs.

In a company where the ownership control changes and the employee's shareholders find themselves to be the minority, they may be affected by the mandatory offer. This may especially happen when the majority offeror offers for the payment of shares in an amount less than their value.

[388] Ibid at 337.

3.4 Financial Assistance to Implement ESOPs

3.4.1 Compliance with Financial Assistance Requirements

There is an understanding that any person that intends to invest in shares of a company must do so from his or her resources.[389] Individuals can therefore not rely on the company's resources in their efforts to acquire shares in that very company.[390] However, the law permits companies to give financial assistance to individuals to acquire shares in the company. To this end, the Companies Act of 2008, in terms of section 44, regulates the process of granting financial assistance for the subscription of shares. Section 44 does not provide a concise definition of financial assistance. However, it guides by stating that "financial assistance does not include lending money in the ordinary course of business by a company whose primary business is the lending of money".[391] From the definition provided under section 45, financial assistance refers to the lending of money, guaranteeing a loan or other obligations, and securing any debt or obligation.[392]

A company must comply with various financial assistance requirements before providing financial assistance to employees for subscription of shares. Firstly, the purported financial assistance must be pursuant to an employee share ownership scheme that satisfies the requirements of section 97 or as a result of a special resolution of the shareholders.[393] When it comes to the special resolution authorising the board to

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[389] Mongalo, Op cit note 349 at 133.

[390] Ibid. This prohibition was expressly provided in section 38 of the 1973 Act,but was subsequently repealed in the 1999 by the Companies Amendment Act. Also see the case of *Trevor v Whitworth* (1887) 12 App Cas 409)).

[391] Section 44(1) of the Companies Act 71 of 2008.

[392] Section 45 (1) of the Companies Act 71 of 2008.

[393] Section 44 (3) (a)(i) and (ii) of the 2008 Act. Section 97(1) sets out the standards for qualifying employees shares as follows: a company is required to appoint a compliance officer for the scheme who reports to the directors of the company, and the company must pronounce itself in the financial statements as to the number of specified shares that the company has allocated during the financial year in terms of its employee share scheme. In addition, a compliance officer is required to perform administrative duties.[393] The compliance officer is responsible for the administration of the scheme.[393] In other words, the compliance officer is responsible for all the paperwork and ensures that the decisions taken by the board in terms of ESOPs are implemented. As was outlined in chapter 1, section 1 of the Companies Act provides that an "employee share ownership scheme" has a meaning as set out in section 95(1)(c) of the Companies Act. In terms of section 95(1)(c), an employee share ownership means:
"*a scheme established by a company, whether by means of a trust or otherwise for the purpose of offering participation therein solely to employees, officers and other persons closely involved in the*

administer the granting of financial assistance for the acquisition of shares in the company, it is unclear as to whether the resolution must clearly and with specificity outline the category or categories of individuals to whom the financial assistance should be given for the purpose as outline in the Act.[394] Hence, there are two possible interpretations in terms of which the resolution must be drafted. The first interpretation is where the category or categories of potential recipients are widely framed to give greater discretion to the board of directors to determine whether to provide financial assistance or not.[395] The second interpretation could be where the special resolution concisely and with specificity sets out the category or categories of individuals to who financial assistance should be given. The second interpretation could be the most preferred one as it still gives the shareholders the right to control and decide what happens to their share capital and who can become part-owners in the company. However, there is no clear indication in the Act that the special resolution must set out the category or categories of recipients of financial assistance with specificity.

The second requirement relates to the solvency and liquidity tests. The solvency and the liquidity requirements for granting financial assistance to employees for subscription of shares as introduced in terms of the amendments to the 1973 Act[396] continue to feature in the Companies Act of 2008.

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business of the company or subsidiary of the company, either by means of the issue of shares in the company; or by the grant of options for shares in the company". Hence ESOP may be established through the use of a compliance officer or by means of trust established for that particular purpose. There is however nothing in the Act that prohibits companies from establishing both a trust and appointing a compliance officer to ensure adequate operation of the ESOP. Furthermore, it is important to note that financial assistance may be granted subsequent to a special resolution. To be effective, such a resolution should have been adopted within the previous two years that approved such assistance as required by section 44 (3) of the 2008 Act. Furthermore, the approval of the financial assistance should have been for a specific recipient or generally for a category of potential recipients (section 44 (3) of the 2008 Act). This entails that shareholders can decide through a special resolution that the company offers financial assistance to all employees employed by the company or employees at a particular level or rank. In order to comply with the corporate social responsibility and with the aim to give back to the committee, shareholders may take a move towards approving the offer of financial assistance to the company's employees. However, in the economy that is crippling, such as in the South Africa situation, this approach could be wishful thinking, unless of course measures are taken to grow the share capital of the company.

394 Cassim FHI et al., *Contemporary Company law* Op cit note 35 at 329.

395 Ibid.

396 Section 38(2)(b) of the Companies Act 71 of 2008.

The 2008 Act recognises the role that the companies play in the economic development of South Africa. Therefore, the insertion of the solvency and liquidity test in section 4 (1) of the Companies Act 71 of 2008 aims to promote a company's financial viability.[397] The solvency and the liquidity test replaced the capital maintenance rule that existed under the 1973 Act prior to its amendment.

According to section 4(1) of the Act, a company is assessed to satisfy the solvency and liquidity test at any time if, taking into account all reasonably foreseeable financial circumstances of the company at that time: (a) the company's assets, or, if the company is a member of a group of companies, the aggregate assets of the group of companies, equal or exceed the company's liabilities, or, if the company is a member of a group of companies, the company's total liabilities, as fairly valued; and (b) secondly, it appears that the company will be able to pay its debts as they become due in the ordinary course of business for 12 months after the date on which the test is considered.

In addition to section 4(1), section 44 (3) (b) obliges the board to inquire into the financial affairs of the company to determine whether the company would, after assisting, be in a position to satisfy the solvency and the liquidity test. The liquidity test refers to the company's ability to pay its debts when it becomes due and payable.

Several observations can be made as far as the financial assistance requirements are concerned. Firstly, the Act under section 4 states that the company must satisfy the solvency and liquidity tests. The rationale for subjecting the company to meet the solvency and liquidity tests may be founded on the board's effort to safeguard and protect the interests of creditors and minority shareholders of the company. [398] However, the Act fails to indicate who must be satisfied that the company has complied with the solvency and liquidity test. Reading section 4 (1), one can thus assume that this is an objective test. On the contrary, considering that the board of directors are vested with the powers to take administrative decisions in a company, they are the ones to be satisfied that the

[397] Bidie S "The nature and extent of the obligation imposed on the board of directors of a company in respect of the solvency and liquidity test under section 4 of the companies act 71 of 2008 (2019) (5) (1) *JCCL & P* 60.

[398] Cassim F H I *et al., Contemporary Company law* Op cit note 35.

company has complied with the solvency and liquidity tests. The latter thus, presupposes that as long as the board is satisfied, no matter how unreasonable that satisfaction may be, the requirement is met. Regardless of whether the test is subjective or objective or combination, what is of essence is that the board makes a proper inquiry and writing the provisions of section 4 of 2008 in its current form does not give proper guidance on how such an inquiry could be effectively done.[399]Another observation made is that the Act fails to define the word debt. Therefore, we need to lean towards common law for the proper definition of a 'debt.' In the case of *Barnett & others V Minister of Land,* the court said that the term debt refers to an obligation to do something.[400]

In analysing the concept of 'debt as they become due', the Court, in the case of *Truter and Another v Deysel,* held that the phrase refers to an owed and payable debt, including a delictual debt. The court went on to state that when a creditor obtains a cause of action to recover the debt, then such debt becomes debt and payable. The creditor is, thus, required to set out the complete facts upon which he or she relies on to succeed in his or her claim against the debtor. [401]

The solvency test refers to the ability of the company to use its assets to pay for its liabilities immediately after providing financial assistance to employees for the subscription of shares. This exercise requires forecasting balance sheet items to make a decision. The balance sheet is divided into two parts. The first part of the balance sheet

[399] Ibid at 274. Section 4 simply requires that the enquiry must be based on financial information and consider the fair valuation of the company's assets and liabilities.

[400] 2007 (6) SA 313 (SCA), para 19.

[401] 2006 (4) SA 168 (SCA) (17 March 2006). Before the creditor can claim performance from the debtor, it is essential that the creditor has performed his obligation where the commercial transaction requires a reciprocal performance or where the performance of the debtor is dependent on the creditor's performance. In sum, a debt must be claimable by the creditor and payable by the debtor.[401] (See the case of Truter and Another v Deysel 2006 (4) SA 168 (SCA) 17 March 2006).
When a company enters into a commercial transaction with another party, the normal principles of the law of contract apply, for example, when purchasing an item from another involves the contract of sale. In such an example the company being the buyer will be required to pay the purchase price to obtain the *merx* being sold. Where the company is leasing a property from another party, the company will be required to pay the rental amount as agreed in terms of the lease agreement. Hence, in terms of both the above examples, the performance of the financial obligation of the company will be dependent on the terms as contained in the contract to which the company is a parto.

provides a list of items of value owned by the business, whilst the second part indicates the liabilities, that is, the list of sources used to finance the acquisition of assets.[402]

The duty of the board in terms of section 4 (1), as outlined above, is two-fold. Firstly, the board must carry out valuations of the assets and measure the liabilities. This exercise is necessitated by the board's mandate to make an informed decision as to whether the company will be able to finance its liabilities after the proposed financial assistance is extended to employees for them to subscribe to shares. The ratio of 2:1, as stated in Chapter 1, is deemed to be a healthy solvency ratio. Secondly, the board is required to evaluate the company's cash flow to determine whether it will have enough cash or other current assets that can be easily converted into cash to pay for its short-term debts. The compliance with the solvency and liquidity requirements necessitates that the board of directors possess the skills and competencies that will enable them to discharge their statutory obligations in terms of the said Act. Since the directors' duties in terms of section 4(1) involve studying financial statements and accounting books, it would be prudent if the persons on the board has some financial knowledge.[403]

The authority to provide financial assistance for the subscription of shares is vested with the board, except to the extent that the MOI of the company provides otherwise.[404] This

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[402] Velez-Pareja I, "Forecasting Financial Statements with No Plugs and No Circularity" (2012), available at http://www.michaelmonas.gr/images/Mixalhs/resources/SSRN-id411129.pdf, accessed on 10 June 2021. It is undisputed that a debt relates to the commercial transactions of a company, considering the principle of separate legal personality as it applies to companies and given the words 'ordinary course of business'.[402] (See Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others, case no 1423/2018 [2020] ZASCA 83 (03 July 2020). Only authorised persons can enter into transactions that bind the company. Consequently, any claim based on an alleged debt of a company can only be successful if such debt was created as a result of the conduct of an authorised person of the company. Since the board of directors has the obligation to ensure compliance with the financial assistance requirements as set out above, it is imperative that their conduct does not fall short of that which is expected from a reasonable board in the exercise of such functions. Section 76(3) of the Act mandates directors to act 'in good faith and for the proper purpose, in the best interests of the company and with the degree of care, skills and diligence that may be reasonably expected of a person' performing the particular task as a director.[402] Once the board of directors acts in a manner that falls short of what is required from them, the directors may be liable as provided for in terms of section 77 (2) of the Act.

[403] The function of interpreting and analysing financial statements can also be done by other persons as may be designated by the board.

[404] Section 44(2) of the Companies Act 71 of 2008.

legislative authority given to the board to authorise the granting of financial assistance is not absolute and can be limited or removed in terms of the MOI.[405]

The very nature of share capital denotes that it is the capital that the company obtains through the issue of shares to its shareholders. Thus, various types of shares issued to shareholders make up the share capital. Hence, the solvency and liquidity test must be applied in all circumstances that pertain to the use or distribution of the company's share capital.[406] This, of course, excludes any conduct that relates to the company's ordinary business.[407] If a proper assessment is not taken in terms of the solvency and the liquidity test, the company could run into liquidity problems of inability to pay for its debts and face the difficulties of meeting its liabilities. Therefore, applying the solvency and liquidity test will extend any financial assistance to employees for the purpose of ESOPs, which will guard against possible financial hardships that the company could otherwise be faced with. It is expected that in complying with the provisions of section 4 of the 2008 Act, directors will observe their duties of 'good faith', and 'proper purpose' and will act 'in the best interests of the company'.

The solvency and the liquidity test protect both the creditors and the shareholders of the company. If the company does not comply with the solvency and the liquidity test in providing financial assistance for the acquisition of shares, the creditors may bring an application to the court for an order to compel a shareholder or former shareholder to return the consideration to the company and to order the company to reissue shares to that shareholder/s or any other order that the court deems fit.[408] The shareholders find their protection in the sense that the acquisition of shares must be authorised by a special resolution.[409]

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[405] Cassim F H I *et al*., *Contemporary Company Law* Op cit note 35 at 328.
[406] *Firstrand Bank Limited v Wayrail Investments (Pty) Ltd*, Case No: 684/2012; Judgement delivered on 20 December 2012.
[407] Ibid.
[408] Ibid.
[409] A company that proposes to acquire shares must distribute an offering circular, as per the Act, to all the shareholders holding shares of the class that it proposes to acquire, and also lodge a copy of the circular with the Registrar. Amongst other items, the circular must outline the terms and reasons for the offer. This circular will however not be required if it is dispensed within the terms of the special resolution in terms of section 85(1) or if the shares are listed on a stock exchange. The reason for imposing these conditions on

The third requirement for providing financial assistance relates to fair and reasonable terms. In other words, the board may only authorise the proposed financial assistance if 'it is satisfied that the terms under which the assistance is proposed to be given are fair and reasonable to the company'.[410] According to Cassim, this requirement makes the Act tougher to negotiate than section 38 of the 1973 Act. This is because, in terms of the 2006 amendment to the 1973 Act, the two requirements, namely, the special resolution and the solvency and liquidity test, were sufficient for the board to approve financial assistance, irrespective of whether the assistance given was fair and reasonable to the company.[411] The approach taken under the 2008 Act on requiring assistance is fair and reasonable and is the right move as this approach could protect the financial interest of the company. However, what is regrettable is that the Act does not indicate clearly what fair and reasonable is related to.

The last requirement for the granting of financial assistance places an obligation on the board of directors to ensure that any requirements or limits imposed by the company's Memorandum of Incorporation on the provision of financial assistance have been met.[412] This means that the company's MOI may expressly prescribe certain conditions to be met before granting financial assistance is approved by the board.

3.4.2 The 'Adequacy of Consideration' Requirement and Methods of Financing the ESOP Transaction

(a) Provision of Services as Consideration for the Purchase of Shares

According to the South African company law, the company's board may issue authorised shares only in respect of three instances. In the first instance, the board may issue authorised shares for adequate consideration to the company.[413] The board must

the company that intends to acquire shares is simply to protect the interests of the existing shareholders in the company.

[410] Cassim F H I et al., *Contemporary Company law* Op cit note 35 at 330.

[411] Ibid.

[412] Section 44(4) of the Companies Act 71 of 2008.

[413] Section 40 (1)(a) of the Companies Act 71 of 2008.

determine this adequate consideration, as such. Secondly, the board may also issue authorised shares in terms of conversion rights associated with previously issued securities of the company.[414] Lastly, the authorised shares may be issued as a capitalisation share as contemplated in section 47.[415] Ideally, a consideration in this regard means anything of value given and accepted in exchange for any property, service, act, omission or forbearance or any other thing of value.[416] Thus, it includes money, securities, labour, negotiable instrument, property promise, assurance, or agreement, irrespective of its intrinsic value or whether it is transferred directly or indirectly.[417] The understanding of consideration is important as consideration is required in ‘’exchange’’ of share ownership.

However, modern corporate law and practice do not necessarily limit the company to provide financial assistance to the less fortunate to purchase of shares from a company. For example, permitting them to pay for their shares with a promissory note to the company.

The board of directors is required to issue shares for adequate consideration.[418] However, the Companies Act does not provide a definition of the term adequate consideration.[419] In certain circumstances, the board may be justified in issuing shares of the company without immediately receiving consideration, in respect of the shares so issued by the company.[420] An example of this is an agreement between the company and the subscribing party to the effect that the latter provides services in the future to the company.[421]

Ordinarily, the adequacy of the consideration cannot be challenged unless it is done in terms of section 76 and section 77 (2) of the Act.[422] Section 76 provides for corporate

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[414] Section 40 (1)(b) of the Companies Act 71 of 2008.
[415] Section 40 (1)(c) of the Companies Act 71 of 2008.
[416] Botha (2015) op cit note 41.
[417] Ibid.
[418] Section 40 (1)(a) of the Companies Act 71 of 2008.
[419] Des Kruger Brian Dickinson Issuing Shares in Exchange for a Negotiable Instrument or for Future Services the Tax Dimension.
[420] Ibid.
[421] Ibid.
[422] Delport P, *New Entrepreneurial Law* (2014) 57.

functions of directors and sets out what is acceptable from a director in the performance of his/her duties. One of the duties of a director that is of importance as far as determining the adequacy of the consideration is concerned is the duty to act in the company's best interest. This entails that when the board accepts the consideration as being adequate, the question is whether such action and the consequences thereof will be in the company's best interests. Put differently, one could ask whether or not the company would be better off if such a consideration has not been accepted as adequate. Since consideration has to do with commercial transactions, the impact on the company must be measured or determined in financial or monetary terms. Section 77 (2) solidifies this view by holding that a director may be held liable for any loss, damage or costs sustained by the company as a result of his/her action. The company suffers loss or damage in monetary terms. Therefore, the yardstick used in this instance could determine whether the board's action in accepting the consideration affected the company in monetary or financial terms.

The prospective shareholders of the company in terms of ESOPs are persons employed by the company. In other words, these are individuals tied to the company through an employment contract and receiving salaries as per the terms of the said contract. Although such employees want to subscribe to shares in the company to derive some form of benefits, they may lack the necessary funds to purchase those shares. One of the ways in which such employees can finance the subscription of shares is through the provision of services. In other words, the employees can take up shares in exchange for future services provision.

South Africa could take advantage of the company law reforms to enable companies to accept services as adequate consideration. This position could help employees to take up shares in the company with the understanding that they will offer their services to the company in exchange for the shares so received. This sort of arrangement will take away the financial hurdles that the employees face in securing funds, which could otherwise be needed to purchase shares. However, it would be very difficult for the company to raise enough capital to issue shares to employees in exchange for their services, especially in a developing country. Therefore, for companies to take maximum benefit of 'services as

adequate consideration for shares', they must look at other avenues to raise sufficient capital for the employees' benefit.

3.5 Conclusion

The South African Corporate Law follows international trends and has repealed the capital maintenance rule. This rule prevented the company from acquiring its shares. The rationale for this was to protect the interest of the company and its stakeholders, i.e., the shareholders and the creditors. Hence, the law provides flexibility and allows the company to acquire its shares.[423] Furthermore, the current Corporate Law also permits companies to provide financial assistance to employees to acquire shares in their company.[424] This is a much-welcomed approach as it ensures that employees who could not be able to acquire shares in the company due to their inability to finance such shares, can now acquire shares through the financial assistance provided by the company. However, it must be noted that the company must comply with the financial assistance requirements[425]. Hence, to a certain extent, although the capital maintenance rule has been replaced in other laws, the objectives that it intends to serve, i.e., to protect the company, its shareholders and creditors are still relevant and taken care of in terms of the current law.

It is regrettable that there are still gaps in the law as far as capital rules are concerned. Section 4 of the Act does not provide proper guidance as to how the board must inquire into the financial health of the company, using the solvency and the liquidity test. The question that remains is: it enough for the board to be satisfied if the company has complied with the solvency and liquidity tests prior to distribution? Furthermore, the Act does not indicate what fair and reasonable relate to in the provision of financial assistance for the acquisition of shares is concerned.

[423] Section 46 and 48 of the Companies Act 71 of 2008.
[424] Section 44 of the Companies Act 71 of 2008.
[425] Section 44 of the Companies Act 71 of 2008.

The Corporate Law Reform in South Africa seems to have fostered business growth and economic development. The modern Corporate Laws of South Africa empower companies to authorise and issue shares to employees. Furthermore, the mandatory requirements as contained in section 44 and 45 of the Act provides employees with a wider opportunity to acquire shares in the company. Firstly, employees can receive financial assistance from the company for the purposes of ESOPS, provided that the company complies with the solvency and liquidity requirements and the administrative requirements set out in section 97. Furthermore, the rules relating to increasing share capital allow companies to adjust their share capital to accommodate ESOPs. The Corporate Law rules in South Africa demonstrate that effecting ESOPs in South Africa can become easier if companies follow these rules meticulously. For example, rules on issuing unissued shares and those on increasing share capital can enable companies to effect ESOPs. Not only are companies able to issue unissued shares, but they can also repurchase shares to facilitate effecting ESOPs in South Africa.

CHAPTER FOUR

SOUTH AFRICA'S ENVIRONMENT FOR ESOPS AND RELATED REGULATORY INSTRUMENTS

4.1 Introduction

The South African company law allows companies to grant employees opportunities to participate in the economy, on a voluntary basis. In other words, employers are not mandated by legislative means to grant shares to employees through the concept of ESOPs, and it is rather an encouraged mode of process. The question is whether employers are willing to grant an opportunity to employees to participate in the company's shareholding. The employer may be unwilling to set up and operate ESOPs for various reasons, such as the dilution of share ownership, administration costs involved, and share price volatility. Another question worth considering is: even if they are willing to introduce ESOPs, are employers able to carry the cost of establishing and managing ESOPs in the current economic landscape? As previously alluded to, in an economy that is not growing, it is almost impossible for employers to introduce ESOPs. All key players, including the government, have a key role in assisting with growing the economy. Allowing free trade and advancing the principles of capitalism can help to promote the implementation of ESOPs in companies.

An ESOP can be used as a mechanism to empower employees. It facilitates the holding of shares in a company for the benefit of *bona fide* employees or former employees of the company.

South Africa has undergone social and economic changes, and this has resulted in ESOPs becoming a crucial issue that concerns the demands made by the employees for economic inclusion and shared ownership. Employees can enjoy benefits in the company in various forms. However, a move has been made towards financial rather than

democratic forms of employee involvement, including employee shares ownership and profit-related pay schemes.[426]

The scope of this thesis, as outlined in the preceding chapters, is to find a way through which ESOPs can be used to reduce poverty. However, although ESOPs appear to assist with attaining the long-term development goals of South Africa, such schemes should not be enjoyed in isolation from all other forms of employee participation. For example, it is not enough that the employees only receive dividends from their employer's company. Such employees must also have a voice in the company in the form of voting rights etc. In other words, employees must have a right (though such may be limited if reasonable and justifiable) to determine the company's strategic direction, particularly because their financial interest is at stake.

The Companies Act, in its purpose provision *inter alia* commits to promoting compliance with the Bill of Rights in the application of company law.[427] In the African setting, this is a new way of thinking. The law that aims to ensure compliance with the constitution and promotion of human rights needs to be applauded. After all, enacted legislation should adhere to the constitutional law principles and uphold, protect and promote human rights. However, this aim of the Companies Act that seeks to encourage compliance with the Bill of Rights - is it simply wishful thinking or is this commitment noticeable in its application in South Africa?

What seems to be an outstanding feature and purpose of the current Companies Act is, amongst others, to reaffirm the concept of the company as a means of achieving economic and social benefit.[428] It is submitted that this is the first step of the pivotal role played by corporations to assist the government in promoting the economic stability of South Africa. Furthermore, the Act further seeks to encourage active participation in economic organisations and management productivity.[429] It is submitted that active participation in the economic organisation is very important for companies as they remain

[426] Ibid.
[427] Section 7(a) of the Companies Act 71 of 2008.
[428] Section 7(d) of the Companies Act 71 of 2008.
[429] Section 7(f) of the Companies Act 71 of 2008.

a key partner alongside the government to assist with promoting the welfare of the people living within the communities where they operate.

The applicability of the Bill of Rights to corporations extends beyond the mere fact of imposing obligations on corporations: it changes to a greater extent the very nature of how corporations must now operate with respect to their commercial undertakings. Gwanyanya suggests that the Companies Act places an obligation on companies to ensure that their activities and actions align with the spirit and objects of the South African Constitution and the Companies Act.[430] Furthermore, Botha builds on this argument and states that the interests of various stakeholder groups in the context of the corporation as a social institution should also be enhanced and protected.[431] It is submitted that in the past, employees were simply viewed as working for their employer, and their provision of services was solely met by payment of a salary. The well-being of an employee and their participation in the financial affairs of their employer's business activities was of little significance. However, this seems to have changed, especially in the first world countries where employees started gaining recognition as stakeholders with a voice.

South Africa has not been silent on the aspects of development and growth. The South African government has come up with initiatives and policies to move the country towards greener pastures, where milk and honey are not only a "hope" but a reality enjoyed by its subjects. One of such milestones was the creation of the national department of tourism in 2009. The gazetting of the tourism sector codes took place in 2007, giving the codes legal status.[432] Prior to this development, an empowerment charter for tourism was introduced with the appointment of the tourism BEE charter council. [433] The government, through its tourism department, has set targets such as achieving an overall level of senior management participation by black people of 43% within five years. Another commitment was attaining the participation of black people in middle management positions of 63%

[430] Gwanyanya M 'The South African Companies Act and the realisation of corporate human rights responsibilities' (2015) (18)(1) *PER* 3103.
[431] Botha (2015) op cit note 41.
[432] Department of Tourism: Republic of South Africa Tourism B BBEE Sector code guide, available at https://www.tourism.gov.za/AboutNDT/Publications/Tourism%20B-BBEE%20Easy%20Guide.pdf, accessed on 31 August 2021.
[433] Ibid.

and 75% for the two five-year milestones of 31 December 2012 and 2017, respectively.[434] Today in 2021, and looking at the statistics, can we say their commitments were achieved? Has the tourism sector seen much transformation and achieved the objectives of black participation in areas of influence? The answer is sadly no. The South African government has introduced various initiatives to transform the tourism sector. Examples of such initiatives include the Tourism Enterprise Programme, the establishment of tourism business incubators and the efforts to cultivate certain tourism niches in which black entrepreneurs can find opportunities.[435] The puzzling question is whether the black people, the majority of whom are victims of poverty and inequality, have the means to access and successfully participate in this industry?.[436] Legislative and policy frameworks are key in ensuring the proper participation of black people in the tourism industry.[437]

4.2 The Influence of Labour Law on ESOPs

Employee share-ownership plans find their operation in Corporate Law. This is because ESOPs have to do with the issue of shares to employees. The common law principles, such as the authorisation and issue of shares as discussed in chapter 3, apply equally to ESOPs. Furthermore, employees who take up shares in their company become shareholders, and logically the discussion of ESOPs must be approached from a Corporate Law point of view. Even though employees, upon taking up the shares get the status of shareholders, they remain employees of the company. Because of the employment status of those who participate in ESOPs, it is imperative to discuss the influence of labour law on ESOPs.

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[434] Ibid.

[435] Sixaba Z & Rogerson C M 'Black Economic Empowerment and South African Tourism: The Early Pioneers (2019) 8 (4) *African Journal of Hospitality, Tourism and Leisure*, available at https://www.ajhtl.com/uploads/7/1/6/3/7163688/article_62_vol_8_4__2019_uj.pdf, accessed on 3 July 2021

[436] Magi L M 'Tourism based Black Economic Empowerment (BEE): Initiatives for local community development' (2010) 2 (2) *The Journal of Humanities and Social Sciences* 122.

[437] Ibid.

4.2.1 Labour Relations Act

The notion of industrial democracy and transformation of the workplace are central issues in the South African labour law. [438] During the apartheid era, black people were employees, and white people were employers. The apartheid laws aimed to discriminate against the governed. Thus, such laws violated the human rights of persons as employees who were, to a larger extent, regarded as slaves and, as such, could not be entitled to enforce and enjoy their human rights. However, with the introduction of the Labour Relations Act, issues relating to discrimination and unfair labour practise has been abolished.

The Labour Relations Act[439] (LRA) is the primary piece of labour legislation that governs employment relations and labour law in South Africa. The enactment of the Labour Relations Act brought major changes in South Africa's statutory industrial relations system. Following the transition to political democracy, the LRA encapsulates the government's objectives to democratise and reconstruct the economy and society in the arena of labour relations. [440]

Labour law governs the relationship between the employees and their employers. Such laws set out the basic characteristics of the employment relations, though this is further amplified in the employment contract. Even though employee-shareholders have a financial stake in the company, they remain employees, and are consequently bound by labour law. Employees are the primary group of people who directly stand to benefit from ESOPs.[441] However, as the concept of ESOPs dictates that one must be an employee to be entitled to enjoy the direct benefits of an ESOP. If the employee loses his or her employment, it will mean the end of their right to participate in ESOPs.[442] Various factors

[438] Botha (2015) op cit note 41.
[439] Labour Relations Act 66 of 1996.
[440] Ibid.
[441] As stated in chapter 3, employees can benefit from ESOPs in various ways, such as receiving distributions of the company's profits and also by selling their interests in the company, either wholly or partly.
[442] Employment relationship may be terminated for various grounds. Hence, grounds such as misconduct, intoxication, absence without leave and breach of trust and loyalty may entitle the employer to dismiss the employee, provided that a proper procedure is followed.

may unfairly cause termination of the employment relationship. One of such factors is discrimination in the workplace. Prior to the enactment of the Labour Relations Act, the labour laws of South Africa did not protect employees against workplace discrimination adequately. Labour Relations Act affords protection to employees against unfair discrimination. Section 5 of the Act[443] states that ‘’no person may discriminate against an employee for exercising any right conferred by this Act’’. For example, employees participating in strikes would be dismissed, without such protection. After such dismissal, an employee will automatically lose out on its ‘employee-shareholder’ status. Fortunately, in terms of the current labour law dispensation, employees are protected against unfair discrimination, which could have potentially led to a dismissal.[444] Furthermore, any dismissal where the employee fails to prove a fair reason for the dismissal and follows a fair procedure in dismissing the employee is regarded as unfair dismissal.[445] Again, the labour laws that existed prior to the current labour law in South Africa did not expressly prohibit unfair dismissal. This is mainly because of the master-slave relationship as opposed to the employer-employee relationship.

Unfair dismissal has devastating consequences on the lives of the dismissed employees, as it affects not only the ex-employees’ employment status but also the right to ownership of employee-shareholders. The termination of employment results in ex-employees being forced to sell their stake in the company, especially where the affected employees are minority shareholders and do not have substantial ownership of the company’s shares. As much as the labour laws may promote ESOPs within the workplace, they may also create conflicts in a company. Employees have certain rights and obligations derived from their status as employees within the workplace.[446] Equally, as shareholders, employees are entitled to certain rights and required to perform certain obligations.[447] If not carefully attended to, employee rights and duties derived from the employment status may conflict

[443] Labour Relations Act 66 of 1995.
[444] Section 187 provides that a dismissal is automatically unfair if the employer in dismissing an employee, acts contrary to section 5. In other words, where dismissal is based on discrimination, such a dismissal is automatically unfair.
[445] Section 188 (a) and (b) of the Labour Relations Act 66 of 1995.
[446] For example, the primary right of an employee is to receive remuneration for the work done, while their obligation is to perform work.
[447] For example, employee-shareholders have a right to receive dividends, while they have the obligation to attend shareholders’ meetings and vote at such meetings as required by the law.

with the rights and duties of an employee, by virtue of being an employee-shareholder. For instance, the Labour Relations Act authorises employees to participate in the decision-making on the establishment of workplace forums.[448] On the other hand, an employee-shareholder is entitled to participate in decision making through shareholders' meetings. The question that arises is: will the employees who made decisions through workplace forums be the same employees to make decisions at shareholders' meetings? If there is a potential conflict of interest, how can this be resolved? One of the approaches to avoid the employees' employment interest conflicting with ownership interest is to prevent employee-shareholders from joining workplace forums. A similar approach is followed in companies where senior employees, for example, those at the management level, are not allowed as per workplace policy to join workplace forums.

Implementing ESOPs in terms of the labour laws that existed prior to the current Labour Relations Act, would have proven difficult. Firstly, as employees were regarded as slaves, no employer or company would be willing to introduce ESOPs and allow employees to have a stake in the company's ownership. Secondly, factors such as workplace discrimination and unfair dismissal would hamper the success and continued existence and operation of ESOPs. Although the current Labour Law, as indicated above, continued the existence of ESOPs by preventing unfair discrimination and dismissal, it may create confusion when it comes to employee-shareholders rights and duties.

4.2.2 Basic Conditions of Employment Act

Another equally important piece of legislation that deals with labour-related issues is the Basic Conditions of Employment Act (BCEA).[449] This Act was enacted to give effect to the right to fair labour practices as guaranteed in terms of the South African Constitution, that is, to provide for the regulation of basic conditions of employment and ensure compliance with International Labour Organisations (ILO) as South Africa is a member

[448] Preamble of the Labour Relations Act 66 of 1995.
[449] Basic Conditions of Employment Act 75 of 1997 as amended.

state of the ILO.[450] There are a number of provisions in the Act indicating that BCEA is beneficial to both the employer and the employee.[451] For instance, rules relating to deductions from employees' salaries and notice pay are beneficial to the employer and the employee.[452] Furthermore, the Act prescribes minimum working conditions, which create peace in the workplace and is good for both parties in the employment relationship.[453] Since employees and employers can derive some form of benefit from the provisions of the Act, it is very important for them to comply with the Act. Section 32 of this Act provides for the payment of remuneration, requiring an employer to pay an employee any remuneration in accordance with that section.[454] This is in line with the employees' common law right to be paid a salary for work done.[455] Apart from paying remuneration and other benefits relating to leave and overtime, the Act is silent on other forms of compensation. To this end, this brings about certain valuable considerations, such as whether the phenomenon of ESOPs' call for the amendment of the labour law in South Africa or has the transformation that has taken place thus far already changed labour law in that there is no need to amend labour law to transform the workplace? It is submitted that the latter school of thought can certainly not be correct. South Africans still live in poverty, even though some are salaried employees and as long as this is the case, transformation is still very much needed. However, will radically legislative changes bring about poverty reduction, bearing in mind that the South African economy has not grown as much as one could desire?

4.2.3 The Employment Equity Act 55 of 1998

The Employment Equity Act has primarily two objectives. The first objective is to promote equal opportunity and fair treatment by prohibiting unfair discrimination against all

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[450] Preamble of Basic Conditions of Employment Act 75 of 1997 as amended.
[451] *Rand Water v Johan Stoop and Another* Case no: JA 78/11.
[452] Ibid.
[453] Ibid.
[454] Also see the case of *Dr Samantha Naidoo v The Careways Group (Pty) Ltd and Another* Case no: J 945/13.
[455] Ibid.

employees.[456] Secondly, the Act aims to achieve equitable representation of black people, women and people with disabilities in all occupation categories.[457] The purpose of these objectives is to bring about transformation and introduce the previously neglected categories of persons into the mainstream labour sector. The Employment Equity Act makes it possible for black people, especially from previously disadvantaged groups of society who could not otherwise get employed.[458] As stated under section 4.4.1, an individual needs to be employed to be an employee-shareholder. In other words, the employment relationship gives the employee access to becoming an employee-shareholder. Once an individual is employed, he or she will have an opportunity to become an employee-shareholder, provided the company deals in ESOPs. Although not all companies have introduced ESOPs in South Africa, having employment is the first step towards becoming an employee-shareholder. Hence the Employment Equity Act, in its thirst to promote equal opportunity for all persons to a certain extent, reduces unemployment and contributes towards development.[459] The statutory obligation that EEA places on designated employers is to create strategies to address the under-representation of designated groups in occupations. In addition, recruiting, retaining, training, developing and promoting qualified designated groups of persons are the first steps in reducing unemployment. Secondly, persons that would otherwise find it difficult to get employment without EEA intervention now have an opportunity to own shares in

[456] BCEA section 2(a); also see du Toit *et al Labour Relations law: A Comprehensive Guide* 5 ed (2006) 35.

[457] Ibid.

[458] In the case of *Sali v National Commissioner of the South African Police Service and Others, [2014] ZACC 19* the applicant instituted an equality claim contending that the decision of the South African Police Service (SAPS) not to appoint him constituted unfair discrimination, proscribed by section 6 of the Employment Equity Act, in particular section 6 of the said Act. The applicant's claim was based on the purpose of the Equity Act which was passed to give effect to the constitutional right to equality in the workplace. (para. 4). The court in this case said that in determining unfair discrimination, it is essential to first determine whether there was a differential treatment which amounted to discrimination. As the applicant was denied appointment/recruitment to SAPS due to his age, differentiation was established and because such differential was based on the grounds listed in section 9 (3) of the Constitution, it is presumed that it amounts to unfair discrimination. This of course is unless the contrary is proved by the Respondent. This case clearly indicates that where unfair discrimination has been alleged, we first need to look at whether there is a differential treatment and if so, where it can be successfully rebutted in an attempt to dismiss any claims of unfair discrimination. Hence, the Employment Equity Act must be read in conjunction with Article 9 of the Constitution to successfully rely on and or dismiss claims of unfair discrimination.

[459] EEA places a statutory obligation on designated employers to create strategies to address under-representation of designated groups in occupations and to recruit, retain, train, develop and promote qualified designated groups of persons.

their company through ESOPs. The reduction of unemployment and provision of ownership can reduce poverty within South Africa. Although this process cannot be seen as reducing poverty overnight, it is a step in the right direction.

The responsibility to create and implement affirmative action measures rest only on designated employers and in respect of designated groups.[460] These measures are intended to remove barriers to the advancement of persons from designated groups.[461] The measures will include aspects such as appropriate training and human resource development policies. [462] To effectively implement affirmative action measures, designated employers must develop an equity plan.[463] The proper drafting and effective implementation of the equity plan will promote economic efficiency and human resource development. [464]In taking affirmative action measures, companies could take a decision to implement ESOPs.[465] Although one cannot wish away the possible costs associated with introducing and operating ESOPs, the benefits of ESOPs for various stakeholders, especially the employees, outweighs such cost.

Employment Equity Act is not without loopholes. Firstly, it is clear from reading the preamble that the purpose of EEA is to promote the constitutional right to equality[466] and eliminate unfair discrimination in employment.[467] However, EEA fails to clearly provide definitions of two of the most important concepts as far as its mandate is concerned, namely, 'unfair discrimination and employment equity'. It can be argued that the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000 curbs this lacuna by defining discrimination as

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[460] du Toit *et al Labour Relations law: A Comprehensive Guide* 5 ed (2006) 35.
[461] Ibid.
[462] Ibid.
[463] BCEA op cit note 378.
[464] du Toit et al 2006. "*Labour Relations law: A Comprehensive Guide* 5 ed (2006) 35.
[465] There are legislative requirements that companies that intend to establish ESOPs must comply with. For example, an ESOP must be administered by a compliance officer or through a trust in terms of section 97 of the Companies Act 71 of 2008.
[466] Section 9(1) of the Constitution of South Africa guarantees everyone equality before the law and the right to equal protection and benefit before the law.
[467] According to section 9(2) of the Constitution of South Africa, legislative measures are to be designed to protect or advance persons, or categories of persons disadvantaged by unfair discrimination. The Employment Equity Act is one of such legislative measures so taken in South Africa to guard against unfair discrimination while promoting affirmative action.

''any act or omission, including a policy, law, rule, practice, condition or situation which directly or indirectly-

(a) imposes burdens, obligations or disadvantaged on; or

(b) withholds benefits, opportunities or advantages from

any person on one or more of the prohibited grounds.''

Although this argument holds true to a certain extent, it would make more sense for the Employment Equity Act to include a provision that defines unfair discrimination within the ambit of labour law. Furthermore, the Employment Equity Act could have contained a provision wherein reference is made to any other legislation, including the constitution, wherein the definition of unfair discrimination is defined. The provisions relating to unfair discrimination as contained in the Promotion of Equality and Prevention of Unfair Discrimination Act and as outlined above simply provide a general definition of unfair discrimination. No express reference is made to the context of employment equity. Hence, when a dispute arises regarding unfair discrimination as far as employment equity is concerned, the courts will still be required to rely on various other pieces of legislation and other sources to define unfair discrimination in the context of employment equity.

Section 1 of EEA deals with definitions, defining some of the supposedly key terms as far as the Act is concerned. One would expect that EEA would at least define the terms discrimination and equity, even if it fails to provide definitions of unfair discrimination and employment equity. This approach taken by EEA in failing to define the terms of unfair discrimination and employment equity poses challenges in the practical application of the law. Hence, where there are allegations of unfair discrimination and breach of employment equity requirements in the workplace within the context of EEA, the courts must try and come up with workable definitions of the said terms in determining the issues brought before it.[468]

[468] Although the judiciary also has a role to play in developing the law, the best approach is for the legislature to create the law and legal principles, while the judiciary interprets and applies the law. This is what the concept of separation of powers and checks and balances requires. Section 34 of the Constitution, which deals with access to the courts, gives courts the mandate to apply the law in resolving cases brought it.

Therefore, this section has identified a fundamental flaw which is the EEA's failure to clearly define the concepts of unfair discrimination and employment equity. These definitions are important as they will provide a better application of the provisions of the Act to practical scenarios. Employment equity is essential in adequately implementing ESOPS. An Employment Equity Act that has been properly drafted and meticulously applied where possible will go a long way in addressing general issues of inequality in the workplace, but more specifically where the implementation of ESOPs is involved.

4.3 The Role of the Constitution in Fostering Economic Transformation

The notion of transformative constitutionalism describes the nature of South Africa's post-democratic Constitution. In understanding this notion, it is essential to appreciate that it comprises two distinct concepts: transformation and constitutionalism. It is essential to understand that these concepts are considered the aspirations and fundamental values of the constitution.[469] The transformative character of the constitution is recognised by the inclusion of justiciable socio-economic rights in the Bill of Rights.[470] Transformative constitutionalism envisages a meaningful improvement in the conditions of people's lives together with real change in legal culture. Therefore, the content and implementation of transformative constitutionalism cannot be considered in abstract but must be informed by actual socio-economic conditions.[471] There is a call for deliberate efforts to empower previously-excluded segments of society, especially the minority groups of society, through devices such as the protection of socio-economic rights and others aimed at attaining social justice.[472] There are five factors that could promote or retard the

Thus, the judicial powers are to be used chiefly to apply the law and not necessary to make the law, as law-making squarely falls within the ambits of the legislative branch of government.

[469] Rapatsa M "Transformative Constitutionalism in South Africa:20 Years of Democracy Mediterranean", (2014) (5) (27) *Journal of Social Sciences*, MCSER Publishing, Rome-Italy.

[470] Arendse L 'Beyond Rivonia: Transformative constitutionalism and the public education system' (2014) 29 *Southern African Public Law* 1.

[471] Brickhill J & Van Leeve Y 'Transformative Constitutionalism-Guiding light or empty slogan (2015) 5 *Acta Juridica* 141.

[472] Kibet E 'Transformative constitutionalism and the adjudication of constitutional rights in Africa' (2017) *African Human Rights Law Journal* 340.

achievement of transformative constitutionalism: access to justice, legal education, legal culture, separation of powers and reconciliation.[473]

Succinctly, constitutionalism is premised on making the constitution the supreme law and creating institutional structures to control political power in the interests of all citizens.[474] A transformative constitution also requires the government to take steps 'to advance the ideals of freedom, equality, dignity and social justice'.[475] It requires an approach to the constitution and law in general as tools committed to transforming political, social, economic and legal culture so that it radically alters existing assumptions about law, politics, economics and society in general. It relies on the values and principles underpinning constitutional supremacy.[476] A transformative constitution is not simply meant to protect the existing rights, but also to empower disadvantaged persons and contribute to the ameliorating social evils such as poverty and homelessness.[477] Being poor denies people basic resources and impacts their enjoyment of basic rights, as shown later in this chapter.

The traditional notion of constitutionalism is inadequate in meeting the peculiar needs of transitional societies emerging from traumatic pasts characterised by war, deep divisions and political repression. This is in as much as societies, constitutions, and law have to do more, including addressing past injustices and crises and inspiring hope for a better future.[478] It is submitted that South Africa has made good progress in dealing with the pain of the past and has also commenced with a future-looking agenda. However, much needs to be done to realise the 'hope for a better future'. The fact that there are still a large number of people living below the poverty line is one of the key indicators that much still needs to be done. Transformation by its very nature is a continuous process, and all state parties, together with private actors, must take proactive steps to ensure that South Africa continues to transform. All South Africans are vested with the duty to uphold the

[473] Brickhill (2015) op cit note 471.
[474] Rapatsa (2014) op cit note 469.
[475] Arendse (2014) op cit note 470.
[476] Rapatsa (2014) op cit note 469.
[477] Arendse (2014) op cit note 470.
[478] Murray, C. 2006. "The Human Rights Commission et al: what is the role of South Africa's chapter 9 institutions?"(2006) 9 (2) *Potchefstroom Electronic Law Journal* 5

constitutional provisions, and this exercise is even more important, bearing in mind the benefits of transformative constitutionalism.

4.4 BEE Programmes and ESOPS

Through its affirmative action principles, the South African government enacted various legislation to combat the adverse effects of discrimination and inequalities of the past. BBBEE is a process that seeks to strategically transform the South African economy by spreading equity holdings incorporating previously disadvantaged South Africans.[479] This involves re-organising management structures and ensuring greater participation of the majority in the economy to achieve economic justice.[480] ESOPs could be instrumental in re-organising management and ownership structures to achieve the goals of BBBEE. Therefore, this section of the chapter aims to scrutinise South African legislation that seeks to address poverty and how such legislation either hampers or aids the successful introduction and operation ESOPs.

4.4.1 National Development Plan

Upon establishing the democratic government immediately after attaining freedom, South Africa birthed a different vision, Vision 2030, to be achieved through a systematic implementation of the national development plan. The overarching role of the National Development Plan is to eliminate poverty and reduce inequality by 2030. It offers a long-term perspective as its implementation strategy illustrates that success cannot be achieved overnight. At its adoption, the proposal was for the Plan to be implemented over 17 years.[481]

Chiefly, the national development plan is founded on four broad objectives. Firstly, it sets out the goals in respect of what South Africa wishes to achieve by 2030.[482] Secondly, it

[479] Horwitz F & Jain H ''An assessment of employment equity and Broad Based Black Economic developments in South Africa'' (2011) 30(4) *Equality Diversity and Inclusion: An International Journal* 301.
[480] Ibid.
[481] Zarenda H *South Africa's National Development Plan and its implications for regional development*. (2013) Working Paper. *Stellenbosch:tralac.* 4.
[482] Ibid.

outlines the key obstacles that may hamper the nation from achieving these goals and the procedure to be followed to overcome those obstacles.[483] Thirdly, it provides a shared long-term strategic framework; and lastly, it creates a basis for making decisions about how best to utilise limited resources.[484]

To achieve the objectives of this nature, it is crucial for all stakeholders, including the private sector, the public sector and the NGOs, to play an active role and be active participants in implementing these objectives. The common understanding is that because the government is the policymaker, it is its role to ensure that such policies are properly implemented. However, this should not be the case. Although the government should be at the forefront in implementing policies, it should be the responsibility of all role-players to actively contribute to the successful implementation of such policies.

As discussed above, the plan aims to eliminate poverty, reduce inequality, and thereby guarantee all South Africans a decent standard of living. This decent standard of living can be achieved in terms of the plan if the legislative and policy framework takes the following core needs and elements into account when implementing the plan:

> *"Housing, water, electricity and sanitation; Safe and reliable public transport; Quality education and skills development; Safety and security; Quality health care; Social protection; Employment; Recreation and leisure; Clean environment; and, Adequate nutrition"*[485]

For a successful implementation of a development plan, especially in a developing country, there is a need to make a cross-reference to areas of need identified when the plan was drafted and at various intervals of implementing the plan. The principle is to ensure that the plan's implementation is geared towards meeting the identified needs.

Conceptually, the NDP has 15 chapters and outlines clear frameworks to be implemented systematically at various time intervals to achieve its aims. Chapter 2 of the NDP deals

[483] Ibid.
[484] Ibid.
[485] Ibid.

with demographic trends. It states that in order to achieve the goals of reducing poverty and inequality, it is necessary to understand the South African population.[486]

The South African rural communities must be afforded greater opportunities to participate fully in the country's economy. The common saying that 'the young people are the future of the nation' demands that the government ensure that young people are provided with better education and have access to proper food and water. These services cannot only be extended to young people, but all persons in South Africa. South Africa's demographic profile could help address poverty, lack of resources and inequality.[487]

In chapter 3 of the NDP, the focus turned towards the economy and employment. According to vision 2030, the only means of improving the living standards of South Africans is through achieving full employment, decent work and sustainable livelihoods.[488] The plan was for South Africa to create more than 11 million jobs in 20 years in order to achieve full employment.[489] Although creating jobs may contribute to poverty reduction, employment by itself may not address the root causes of poverty. This is rightly so since a person can be employed today, earn a salary and may be out of a job tomorrow without any real ownership. Attaching some form of ownership and benefits to a job will go a long way in addressing poverty. Hence, the practice of ESOPs may allow employees to receive dividends from the shares and contribute to the affairs of the company where they are employed, thus benefiting from both financial and participatory benefits. According to the NDP, South Africa needs better educational outcomes to increase employment. South Africa has done well in promoting education and ensuring that most South Africans have access to education. For example, the Department of Basic Education matric class of 2019 achieved a pass rate of 81.3%.[490] This is a high percentage and indicates that the South African government views education as a key factor that will assist with poverty

[486] NDP 2030: Chapter 2.
[487] NDP 2030: Chapter 2.
[488] NDP 2030: Chapter 3.
[489] NDP 2030: Chapter 3.
[490] South African Market Insights "South African Education Statistics", available at https://www.southafricanmi.com/education-statistics.html, accessed on 02 November 2020.

reduction. South Africa has achieved a milestone regarding its NDP's goal on employment.

Moreover, Chapter 9 of the NDP emphasises the improvement in education, training and innovation. A strong and solid education system from primary education to tertiary education is vital in addressing poverty and inequality. Progress has been made ever since 1994. For example, 32 percent of all students in 1990 were Africans, and this increased to two-thirds in 2009. Another noticeable change is the number of schools without teachers that have been reduced from 9000 to 1700.[491] Access to primary and secondary education has been expanded to include almost all age cohorts. Access to tertiary education is viewed as one of the contributing factors to poverty alleviation. In South Africa, the enrolment in higher education has almost doubled, and there is a more balanced representation of various groups in terms of its race and gender demographics.[492]

South Africa has to continuously invest in a strong network of economic infrastructure to achieve development, as indicated in chapter 4 of the NDP.[493] This calls for development in transport, energy, water resources and information and communication technology networks. In addition, promoting and ensuring equal access to basic services is vital to socio-economic development. It is noteworthy that South Africa has made progressive efforts to make water resources accessible to its people. Hence, the share of the population with safely managed drinking water rose from 60 per cent in 1996 to 75 per cent in 2016.[494]

South Africa's energy sector needs to be supported by effective policies and governance systems in order to realise vision 2030. [495] Without proper implementation and governance, any system will fail. With the growing concern of Eskom, South Africa's largest electricity provider, continuously operating at a loss and having the government

[491] Chapter 4 of NDP 2030.
[492] Ibid at note 76.
[493] NDP 2030: Chapter 4.
[494] South Africa's Voluntary National Review (Vnr) Report Empowering People and Ensuring Inclusiveness and Equality' (2019) 55.
[495] NDP 2030: Chapter 4.

pumping millions of dollars into this state-owned enterprise, the government of South Africa needs to relook at the operations of Eskom both from the legislative and institutional framework to make the entity more sustainable and to generate profit. This applies to all sectors across state-owned enterprises in South Africa. There is no use paying large sums of money to the board of directors and governance executives of companies, especially state-owned enterprises, when these companies are not creating wealth or contributing towards the country's economic development.

The plan sees the need to increase private participation and investment in the electricity sector and widen access to affordable electricity services for the poor. The Constitutional Court of South Africa was called upon to adjudicate on one's right to electricity in the case of *Joseph and Others v City of Johannesburg and Others*.[496] The court, in this case, discussed the right to receive electricity as a basic municipal service. The court stated that every local government's primary function, if not its most vital function, is to provide fundamental municipal services. The local government's fundamental mandate is to build service delivery capacity to address the basic requirements of all South Africans, regardless of whether or not they have a contractual relationship with the applicable public service provider. Although the court did not directly refer to NDP, the mere fact that aspects of the NDP, i.e. electricity, was one of the issues in the case illustrates that the government, through its local structures, is held accountable for implementing the provisions of NDPs. The line of reasoning suggests that the government as a policymaker can be held accountable for enforcing executive policies for the betterment of the South African society.

Private participation will help cast the net of ownership as ownership will no longer be concentrated in the hands of the state only. One danger with private participation is that only the wealthy will partake in this form of participation. The poor will be left out as they do not have funds or capital to enable them to participate fully. Thus, the government needs to play a role in ensuring that the black majority are somehow empowered and empowered to participate in such forms of investment.

[496] 2010 (4) SA 55 (CC) (9 October 2009).

Furthermore, water is a necessity for all South Africans to live a dignified life. Thus, in terms of the NDP, all South Africans have affordable access to sufficient, safe water resources. Thus, the country is to develop socially and economically to ensure that everyone in South Africa can enjoy this constitutionally guaranteed right.

Segregation and division have made it easier to rule under the apartheid government in South Africa. People were grouped, and their movements were limited. South Africans were denied access to resources, and they had to work long hours in bad working conditions with little or no pay. They were placed far away from their families, with little access to the society's benefits and with no ability to participate in the economy. This situation bred poverty and promoted inequality. Through its NDP and Reconstruction and Development Programme, South Africa has aimed to address the issue of segregation. Today, some black South Africans are now living and/or working in areas previously only meant for their counterparts of a different colour. Although progress has been made in dealing with segregation, much still needs to be done to integrate more black South Africa into the social and economic participation of the country's affairs.

The idea behind most national development plans, including South Africa's, is transformation. Changing patterns of ownership and the control of assets is one of the fundamental factors in transforming the economy. Various efforts have been levelled towards the transfer of ownership of assets, but this has not achieved the much-desired results, and it seems as if the employee share-ownership schemes do not play a significant role. A larger fraction of the South African population still lives in poor living conditions, stricken by hunger and lacks access to basic amenities of life. Hence, perhaps, it is necessary to put in place a clearer target and ensure that implementation and periodic review of the success of such targets takes place. Policy instruments to encourage the implementation of employee share-ownership schemes such as voluntary scorecards, procurement regulations, and development finance may partially aid in achieving the objectives of poverty reduction through the use of employee share-ownership schemes. However, a more stringent legislative move is required to achieve economic equality throughout all spheres of society, and thus, voluntarism is not desirable.

Although the NDP sets out goals for poverty reduction, economic growth, economic transformation and job creation, the private sector has a major role to play in achieving these objectives.[497] The private sector can accomplish these objectives through its corporate social responsibility.

The NDP is mainly focused on the elimination of poverty and the reduction of inequality. Thus, it is for this reason that South Africa has made progress in reducing extreme poverty through a progressive social wage programme that helped finance the provision of social assistance and free basic services. Examples include old-age pensions, child grants, primary healthcare, orphan grants, subsidised water and electricity, housing assistance, no VAT on certain food items, and more public schools declared as no-fee schools.'[498]

Generally, as a constitutional right, all persons in South Africa have a right to equitable healthcare and access to good quality health care.[499] In terms of Chapter 10 of the NDP, South Africa's vision is to achieve a life expectancy rate of at least 70 years for men and women.[500] For this vision to materialise, policies must be crafted and programmes be developed geared towards implementing the objectives of the NDP. To this end, the Reconstruction and Development Plan (RDP) formulated in 1994 by the ANC government, sets out as its objective the provision of free health services for mothers and children. It further aims to provide free primary healthcare for all and a clinic-building programme.[501]

4.4.2 Broad-Based Black Empowerment Act 53 of 2003

The Broad-Based Black Empowerment Act finds its basis in section 9(2) of the South African Constitution, which calls for the enactment of legislation aimed at remedying historical inequalities in South Africa.[502] In the case of *Minister of Finance v Afribusiness*

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[497] SAGNA 2013.
[498] South Africa's Voluntary National Review (vnr) report (2019) op cit note 494.
[499] Ibid.
[500] NDP: Chapter 10.
[501] South Africa's Voluntary National Review Op cit note 495.
[502] Horwitz (2011), Op cit note 479. The ANC government after being elected to power instituted various policies aimed at addressing the inequalities of the past and one of such policies was the BEE which later evolved into legislation. The BEE policy was introduced to address the racial inequalities that existed as a result of apartheid, in order to allow those that were previously excluded from participating in the economy of South Africa to get the opportunity to participate in the economic activities of South Africa. (Horne R,

NPC[503]*,* the court relied on Section 217(2) and (3) of the South African Constitution to foster black economic empowerment and stated that these provisions were drafted into the constitution in acknowledgement of South Africa's unfortunate history, which amongst other things, "excluded Black people from access to productive economic assets". Although the section 217 does not directly deal with BEEE in the true sense of the word, rather procurement, the aforementioned cases are relevant to the discussion of the BEEE Act as it reinforces the constitutional powers and mandate given to South Africans to ensure that economic transformation takes place, essentially, where the previously disadvantaged persons are concerned.

The South African government developed the broad-based black economic empowerment programme to redress the past imbalances.[504] The preamble of the BBBE Act thus clearly demonstrates that the apartheid laws and practices have left the majority of the South African community poor and without ownership.[505] In terms of the preamble under apartheid, race was used to control access to South Africa's productive resources and access to skills. Furthermore, in terms of the South African economy, a large portion of the community is still excluded from the ownership of assets. Hence, there is a great need to take steps to increase the effective participation of the majority of South Africans in the economy to decrease the increasing gap between the rich and poor, ultimately reducing poverty levels.[506]

Patterns of ownership and labour unrest within the South African Mining Sector 40(2) Journal for Contemporary History 28). Although it is clear that the primary objective of the BEE policy and BEEE Act is meant to provide black people with the opportunity to participate in the economy, one stands to ask the question of whether the approach taken in terms of the said policy and law was appropriate in achieving the desired result.

[503] [2022] ZACC 4. Section 217 of the Constitution deals with procurement, allowing the state and institutions to have preferential treatment with the aim of the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination.

[504] *Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa v Hidro-Tech Systems (Pty)* 2011 (1) SA 327 (CC);

[505] Share-ownership is central in fighting poverty as individuals who own shares are better off than those without share-ownership. Various advantages can be derived from employees who own shares in their company. For instance, they can share in the profits of the company, have access to dividends and ultimately benefit from the sale of their stake in the company, upon termination of their employment.

[506] Endorsing with objectives of the Broad Based Black Economic Empowerment Act, Sasol, the synthetic fuels company sold 10 percent of its shares to black people, selected from BBBEE groups and employees. This was regarded as the largest empowerment deal valued at R17.6 billion. Another empowerment transaction involved the sale of ownership stake in Holcim to AfriSam BEE consortium, valued at R7.5 million. (See Horwitz F, Jain H ''An assessment of employment equity and Broad Based Black Economic developments in South Africa'' (2011) 30(4) *Equality Diversity and Inclusion: An International Journal* 307).

The objectives of this Act are to facilitate broad-based black economic empowerment by encouraging economic transformation for black people to have a meaningful role in the economy, and achieve a considerable change in the racial makeup of ownership and management structures.[507]

It is submitted that South Africa and any other African country cannot achieve transformation without allowing people from all backgrounds and races to participate in the economy. Previously excluded from owning shares and receiving benefits, the majority of the black people must be given the opportunity to participate and contribute positively to the development of South Africa's economy. Allowing people to participate in the economy will not only assist with poverty alleviation but will also help to restore the dignity of the people once lost.

It is submitted that although there is a need to fight towards achieving a substantial change in the racial composition of ownership and management structure, this should be done with caution to avoid following the same route taken by those under apartheid rule. This will not only impact South Africa's economy, but can also negatively hamper the political stability, which the government, fought to establish, after attaining freedom. Hence to achieve the deep call for economic transformation and change in the racial composition of ownership, South Africa will need to perform a balancing act. Any preferential treatment should be based on a justifiable ground to meet a specifically just and lawful result, with concerted efforts to avoid favouritism, nepotism and racial discrimination.

It is further submitted that adhering to affirmative action demands that the government actively takes initiatives that will provide opportunities for economic growth and development and emancipation from economic slavery. In other words, affirmative action policies and practices should be enacted and implemented to deal with the inequality that was caused by the past. However, careful thought is needed to ensure that the practice does not repeat the past. The idea behind affirmative action is not to get even with those

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From both these empowerment transactions it is clear that there is a correlation between BBBEE and ESOPs.

[507] Broad-Based Black Empowerment Act 53 of 2003.

who caused pain in the past, but to bring about economic equality. When applying affirmative action, the question that one needs to ask is whether a particular policy such as ESOPs will assist to close the inequality gap between the rich and poor or will it fuel the idea of simply taking from the rich and giving to the poor unjustly.

One of the features of black economic empowerment in South Africa relates to employment equity. The BEE policy in South Africa seeks to advocate for employment equity, stressing the need for the previously disadvantaged groups of persons to get equal employment opportunities.[508] Providing equal employment opportunities is an essential characteristic in addressing issues of poverty. However, ensuring that previously disadvantaged persons have access to equal employment opportunities is not a simple practice of advertising and hiring persons from the said group or class. Due to the apartheid injustices of the past, most persons from the previously disadvantaged groups may not have formal education and training, thus, they are unable to perform the jobs they may be hired for. In the long run, this may result in poor service delivery affecting the country's economic development. The employment equity policies must therefore be set on a framework that allows adequate training and continuous education of the previously disadvantaged persons so that they can contribute to the country's economic development. If care is not taken, the implementation of employment equity policies may provide little benefit and more harm to service delivery and economic development.

Investment is not a once-off activity. It requires a constant and continuous effort of channelling activities and resources towards a particular direction to achieve the much-wanted results, in this case, economic growth and poverty reduction. Will enabling the employees to own shares in their employer's company result in sustainable development and general prosperity, or is it just a myth?

Section 12 of the Act [509] mandates the Minister of Trade and Industry to promote a transformation charter for a particular sector of the economy, provided that such a charter has been developed by the major stakeholders in that sector and advances the objectives

[508] Shava E, 'Black Economic Empowerment in South Africa: Challenges and Prospects' (2016) 8 *Journal of Economics and Behavioural Studies* 163.
[509] Broad-Based Black Economic Empowerment Act 53 of 2003.

of the Act. A classic example of such a charter is the Broad-Based Socio-Economic Empowerment Charter for the South African Mining Industry. One of the primary objectives of this charter is to promote employment and advance the social and economic welfare of mining communities and the major sending areas. [510] This Charter mandates the government and the industry to allow historically disadvantaged South Africans to benefit from the exploitation of the mining industry. Hence, both the government and the industry are to ensure collective investment through ESOPs and mining dedicated unit trusts. When the aforementioned charter was passed, the mining companies agreed to achieve 26% of historically disadvantaged ownership and mining industry assets in 10 years by each mining company. Was this simply a political statement, or was any fruit derived from this undertaking? The realisation of this undertaking is still much awaited.

Practice directives have been issued under the Act to promote and give effect to its objectives bearing in mind that allowing black people to have meaningful participation in the economy will bring about transformation. This calls for changing the racial profile of the companies' owners, managers and skilled professionals by ensuring that there is an increase in the ownership and management of companies by black women, communities, workers and cooperatives. Companies are encouraged through this piece of legislation to help those in need but cannot afford to have access to more economic opportunities. However, due to economic recessions and the failing of world markets, companies are no longer in the position to undertake this task.

Although BEE policies were endorsed to serve and bring about economic equality, evidence shows that in South Africa, such policies have failed to enhance economic empowerment. It seems as if the gap between the rich and the poor is on the rise, with only a small number of black businesspeople being benefactors of BEE policies. Training and development are key to ensure that black people are marketable, but in South Africa, a major portion of the black people are still under-trained and thus not well-represented in the top and senior management positions. Ownership is crucial to economic empowerment, but only a few black South Africans are proud owners of shares in

[510] Objectives of Broad-Based Socio-Economic Empowerment Charter for the South African Mining Industry.

companies listed on the Johannesburg Securities Exchange. There is a strong belief that the State has not directly taken up the mandate to ensure that BEE policies are taken seriously by all and the implementation and operations of BEE policies have been allowed to operate in a framework effectively directed by the corporate sector.[511]

The objectives of the BBBE Act are clear, as outlined above, which are primarily to ensure the participation of black people in the South African economy. However, the question is whether the Act has been successful in achieving its objectives or not. It is one thing to enact a law but a different matter altogether to ensure proper implementation of such laws. The mere fact that many people in South Africa are still poor and cannot participate in ownership is a clear indication that BBBE has not been successful in achieving its objectives. Again, in the current status quo in which South Africa finds itself, BBBE Act cannot assist with the effective implementation of ESOPs. As pointed out in chapter 1 of this thesis, any legislation or policy will not be effective in ensuring the economic transformation of the poor as long as such laws and policies are adopted from a purely social approach. The incorporation of economic theories into the legal principles derived from the BBBE Act, for example, will guarantee long-lasting and meaningful economic transformation.

4.4.3 Income Tax Act 58 of 1962

The South African Revenue Service (SARS) is a legislative body mandated to deal with the administration of revenue services in South Africa. All companies intending to undertake commercial activities and who fall within the categories of paying tax are required to register with SARS as taxpayers and submit tax returns annually.

The Income Tax Act[512] provides for taxation of amounts derived from a broad-based employee share plan. In terms of section 8 of the Income Tax Act,[513] the income of an employee who is being assessed during a particular year should include any amount

[511] Croucher R & Miles L Corporate Governance and Employees in South Africa Journal of Corporate Law Studies-October 2010.
[512] Income Tax Act 58 of 1962.
[513] Ibid.

received by such an employee during that particular year as part of his or her interest in a qualifying equity share if the employee received such an amount in terms of a broad-based employee share plan. Disposal by the employee within five years from the date of granting of the qualifying equity share should also be included in the employee's income under assessment.

In terms of this particular provision, it is clear that the dividends received by the employee through ESOPs are taxable. It is, thus, submitted that this will mean two forms of benefits. The employee receives something in the form of dividends, which helps improve the employee's quality of life. On the other hand, taxing the dividend received by the employee means tax income for the government. The government can then channel this received amount in the form of tax towards other social grants and services aimed at poverty alleviation. In other words, the tax received by the government can be used to improve the provision of social resources to the public. Although public resources are for all individuals in the country, the poor mostly depend on public resources, and they are likely to benefit more from the provision of resources. The more tax the government receives, the more it can provide improved and better services to its people.

In addition, section 8C provides that the taxpayer must deduct from his or her income any gain or loss in respect of the vesting during that year of any equity instrument if he or she acquired that equity instrument on the basis of his or her employment.

Through its department of exchange control, the South African Reserve Bank (SARB) regulates transactions involving foreign exchange. This regulation aims to prevent the loss of South Africa's foreign currency reserves through the transferring of real or financial capital assets out of South Africa, which have their origins in South Africa.[514]

It is possible for an employee of a subsidiary company located in South Africa to hold shares in the mother company outside South Africa. Thus, to assist foreign investors to enable South African employees to hold shares in the foreign company rather than the

[514] Exchange Control 1794. Implications of international share incentive schemes December 2009- Issue 124, available at https://www.saica.co.za/integritax/2009/1794_Implications_of_international_share_incentive_schemes.htm, accessed on 20 June 2021.

local operating company or a branch, the SARB has relaxed exchange control restrictions. As such, South African residents can participate in ESOPs offered by a parent company. A participating company must submit to the SARB for approval a formal written application from an authorised dealer. A detailed prospectus outlining the number, market value and the method of payment must accompany the application.[515] The proposed changes to corporate income tax might be beneficial for corporations in South Africa. Due to global effects on the economy of South Africa, the Minister of Finance, in his budget speech for the 2021-2022 financial year, indicated that the government intends to lower the corporate tax to 27 percent.[516] This form of commitment from the government is a step in the right direction. In reducing corporate tax, the government would encourage companies to set up ESOP funds with ease.

4.4.4 Banks Act 94 of 1990

The Banks Act[517] provides for the regulation, control and supervision of the commercial activities of companies taking deposits from the public and any other matters incidental or ancillary thereto. Section 37 of this Act grants permission for persons to hold shares in a bank or controlling company.[518] A person is not allowed to hold shares in which total nominal value or voting rights in respect of the issued shares of the concerned bank or controlling company are exercisable by such a person.[519] In other words, an individual may not be a majority shareholder in a bank. The idea behind disallowing majority ownership is to ensure that there are proper checks and balances. The minority shareholders cannot act in response to inefficient governance where there is majority ownership.[520] The voice of the minority will not be heard, and the economic progress of the business is left in the hands of the majority shareholders. Thus, to maintain good

[515] Ibid.
[516] Tito Mboweni, Budget Speech, South Africa, available at https://www.gov.za/speeches/minister-tito-mboweni-2021-budget-speech-24-feb-2021-0000, accessed on 09 May 2021.
[517] Banks Act 94 of 1990.
[518] Stand*ard Bank Investment Corporation v The Competition Commission and others* CASE NO. 44/2000
[519] Section 37 (1) (a) of Banks Act 94 of 1990.
[520] Lauren Yu-Hsin Lin "Controlling Controlling-Minority Shareholders: Corporate Governance and Leveraged Corporate Control" (2017) *Columbia Business Law Review* 10.

corporate governance principles and ensure that the business's strategic objectives are achieved, it is crucial to maintain a good balance of ownership.

As a general rule, an individual cannot hold shares exceeding 15 per cent of the total nominal value or total voting rights in respect of all the issued shares of the bank or controlling company. The Registrar may, however, grant permission to an individual to hold shares in excess of the aforementioned value, should he/she deem it fit for a person to hold such shares for 12 months or shorter. In this instance, the Registrar is required to grant his/her permission in writing.[521] It is important that the Registrar grants such permission in writing because the written document will serve as a proof if such a dispute arises.

Furthermore, in order for an individual to hold shares exceeding 15 per cent as permitted by the Registrar, he or she may not hold shares exceeding 49 per cent of the total shares, or the voting rights in respect of the issued shares without written authorisation from the Minister. Should the Minister grant permission to an individual to hold shares exceeding 49 per cent, as stated above, such holding should not exceed 74 per cent. For a person to have shares exceeding 74 per cent of the total shares or the voting rights in respect of the issued shares, the Registrar is required to give his/her permission in writing.[522]

In summary, the special requirements to be complied with pertaining to the holding of shares in a bank include: Firstly, the permission to hold such shares should be granted by the Registrar in writing. Secondly, the holding of the shares in question should not be contrary to the public interest.[523] Thirdly, it should also not be contrary to the interest of the bank concerned or its depositors or the controlling company concerned for an individual to hold such shares.[524]

The Minister or the Registrar may apply to the High Court seeking an order compelling a shareholder to reduce his/her shareholding or voting rights regarding the issued shares

[521] Section 37 (2)(a) (i) of Banks Act 94 of 1990.
[522] Section 37(2)(a)(iii) of Banks Act 94 of 1990.
[523] Section 37(4)(a) of Banks Act 94 of 1990.
[524] Section 37(4)(b) of Banks Act 94 of 1990.

for a bank or controlling company. [525] As stated above, it is important to guard against majority shareholding as this may lead to abuse of power and a possible violation of corporate governance principles.

The banking sector has taken a positive approach through legislation by allowing persons to own shares in various banks in South Africa. Although no reference is specifically made to employees, the fact that the public can acquire shares is an indication that the majority of the black people previously denied any form of ownership can now have access to ownership. Additionally, as the legislation permits persons to have shares, banks can take directives to create ESOPs and allow employees to have ownership. One approach how this can be done is past regulations in terms of the Banks Act that speaks to employee ownership. If the latter approach is followed, banks will be more willing to introduce ESOPs and enable their employees to benefit from such ESOPs. Therefore, the Banks Act shows great potential in promoting the implementation of ESOPs as far as banks are concerned.

4.4.5 Mineral and Petroleum Resources Act, 28 of 2002

The primary purpose of this Act is to provide for equitable access to and sustainable development of South Africa's mineral and petroleum resources. This piece of legislation recognises the need to promote local and rural development and the social upliftment of communities affected by mining. The State, through this Act reaffirms its commitment to reforming the industry and ensuring equitable access to South Africa's mineral and petroleum industries. The apartheid era was dominated by racially discriminatory laws and practices. Thus, after attaining freedom, South Africa enacted laws and implemented regulatory practices to redress the results of past racial discrimination.[526] The Mineral and Petroleum Resources Act is one of such laws enacted not only to regulate the mining industry, but also to give hope to the poor communities of South Africa through possible beneficiation from the mining industry.

[525] Section 37 (5) of Banks Act 94 of 1990.
[526] This notation is based on section 9(2) of the South African Constitution calling on the legislature to enact laws do address aimed at achieving equality.

The Minister of Minerals and Energy is mandated to facilitate assistance to any previously or historically disadvantaged person to conduct prospecting or mining operations.[527] In other words, one of the many functions of the Minister of Minerals and Energy is to promote the transformation and economic emancipation of those who were previously denied benefits through mining and related activities. The laws, regulations and policies enacted through the Ministry of Minerals and Energy thus help to inform the economic landscape and transformative agenda of South Africa. Thus, the Minister must facilitate this important mandate of transformation through the amendment of laws, regulations, and the implementation of policies.

Section 1 of the Act[528] defines a historically disadvantaged person to mean any person, category of persons or community disadvantaged by unfair discrimination before the constitution took effect. The section further provides that a juristic person who is managed and controlled by a person and whose majority of members hold shares within such a body qualifies as a historically disadvantaged person.

At various time intervals, the minister may determine the terms and conditions to be satisfied before facilitating assistance to persons previously disadvantaged to conduct mining operations.[529] Importantly, the factors that the minister needs to take cognisant of include the need to promote equitable access to the nation's mineral resources; the financial position of the applicant; the need to transform the ownership structure of the minerals and mining industry; and the extent to which the proposed prospecting or mining projects meet the objectives as set out in section 2 of the Mineral and Petroleum Resources Development Act.[530]

The Minister must therefore work towards achieving a society where the mineral resources of South Africa are at the disposal of those historically disadvantaged with the aim of transformation. The ownership of mineral resources previously placed in the "well-

[527] Section 12(1) of Mineral and Petroleum Resources Development Act 28 of 2002.
[528] Mineral and Petroleum Resources Development Act 28 of 2002.
[529] Ibid, section 12(2).
[530] Ibid, section 12(3).

off minority" should be made available to those that once had the shorter end of the stick. The idea is to achieve transformation.

As in the case of the Banks Act, the Minerals and Petroleum Resources Act offers the potential to guarantee the implementation of ESOPs in the mining sector. As the minister for Mines and Energy is obligated by law to facilitate assistance to any previously or historically disadvantaged person for them to conduct prospecting or mining operations. Though no mention is made of employees and ESOPs in particular, the words ''previously or historically disadvantaged'' could cater for employees. This is because most employees, especially the black majority, were previously disadvantaged, having been denied access to ownership and the right to participate in the mainstream economy. Hence, the extent to which the Minister and the mining sector may go to promote employee-ownership is unknown. However, the prospects of allowing employee ownership does exist.

4.5 South Africa's Approach to Economic Growth to Date

The analysis of the approach followed by South Africa in its aim to address poverty has been through applying the principles of the Keynesian theory.[531] This is supported by the government's legislation and policies that have been introduced since 1994, such as the NDP policies and the Broad Base Black Economic Empowerment Act 2003. Without restating the principles in detail, the Keynesian theory calls for government intervention in the economy through its fiscal and monetary policy. The government's intervention in the economy may be required for a multiplicity of reasons. For instance, the government's intervention may be required as a law-maker to make policies on competition in markets and as a taxer and supplier of public goods and welfare services to influence policies relating to national tax and welfare services.[532] However, the application of the Keynesian

[531] In South Africa, a large number of companies are either fully owned or indirectly owned by the State. This includes ESKOM, Post Office, Transnet, Sentech, South African Airways and Armsor. Although some form of government ownership may be needed, privatisation seems to offer benefits such as growing capital ownership, leading to economic growth and development of the country.

[532] Black P Calitz E & Steenkamp T '*Public Economics'* 5 ed (2011) 127.

theory is not sustainable in a developing country in which the disparity between the rich and poor continues to widen. This view is supported by Schumpeter, who states that 'the practical Keynesianism is a seedling which cannot be transplanted into the foreign soil: it dies there and becomes poisonous before it dies'.[533] The Keynesian approach can work on a short-term basis, but in the long run, it will deplete the state coffers with very little effect on economic growth and development.

To remove the burden of taking care of its citizens and providing services from the government, it would be plausible to look for avenues that could encourage capital growth and development. Even though governmental involvement may be required at the initial stage of this process, individual capital will continue to grow, thereby leading to national economic growth and development. Therefore, the government should focus on promoting free trade, competition, and investment in the private sector. The privatisation of some state-owned companies could also be a possible factor to consider, as this may make some of these companies more profitable, again leading to economic growth and development.

4.6 Practical aspects of Employee Share Ownership Plans

Statutory rights, their nature and scope, and how they are implemented and enforced are important in protecting workers' rights. However, statutory rights are not absolute and often need to be balanced against the competing rights of the employers and third parties. Employers' rights relate to profit maximisation. Each business owner starts a business with the primary aim to make a profit, even though employers may have various other interests. On the other hand, the most noticeable reason why employees give their services to the employer is for a salary or some form of return or benefit. Most often than not, the employer will do everything in his or her power to gain profits and even increase them. Hence, there is a need to have a balancing act where the employer's interests are recognised and given priority while ensuring that the interests of the employees are

[533] Schumpeter J 'John Maynard Keynes 1883-1946' (1946) (36) (4) *The American Economic Review* 506.

equally protected. Thus, checks and balances need to be put in place to ensure that the employers do not exploit employees and that employees do not cause financial harm to the employer's business. Financial harm relates to employees not owning up to their duties, resulting in profit reduction.

Botha opines that the corporation is not a social institution but rather a private institution where the corporation is the private property of the shareholders (owners), and thus, the business, legally and ethically, can be conducted only in the best interests of the owners.[534] This view cannot be correct as corporations do not operate in a vacuum. Corporations are set up in a given society, and most often, they are there to serve the interests of the people in whose community they operate. It is true that corporations are set up to make a profit. However, the aspect of corporate social responsibility should not be forgotten as it forms part and parcel of every corporation, albeit at various levels. It is submitted that providing shares to the employees is a corporate function of the corporation as the employees' possible benefits will go a long way in assisting the particular family within the community setting. It is important in this context to take note of the role that employees play in corporations: firstly, an employee is a stakeholder and should be consulted pertaining to all the affairs of the company, and secondly, as the creators of the company's wealth or worth, they constitute a core constituency in the organisation.[535] Employees are crucial role-players in contributing not merely in a labour capacity to the organisation they work for, but also by being a necessity or prerequisite for the company's existence and success, in addition to being a stakeholder.[536] In other words, the company's very existence depends on its employees, who may influence the company's success in various ways. For example, productive employees may help their employers' business to thrive in profit retention. Conversely, if an employee comes to work late or is simply lazy, the business will suffer financially, resulting in low profits.

Whether an employee works hard to contribute towards the company's continued success or not depends to a larger extent on how the employer treats his or her employees. It is

[534] Botha (2015) op cit note 41.
[535] Ibid.
[536] Ibid.

submitted that providing financial ownership, as it is in the case of share-ownership plans, is one of the ways in which the employer can encourage employees to be more productive. If people know that they are part-owners of the affairs of their employer's work, they will work even harder as they know that they will benefit from their hard work. A farmer will take better care of the farmland and the farm animals if he/she knows that he/she is a part-owner of what they administer. Similarly, a waitress/waiter will serve her/his clients better if she/he has financial interests in the business of the company that employs him or her.

In South Africa, the majority of agreements concerning financial participation occur through collective bargaining in which trade unions or employee representatives negotiate, on an annual basis, improvements in the financial elements of employee packages and so forth.[537] As indicated earlier, employees can thus, partake in the affairs of their employer individually or through their trade union.

The employee-shareholder provisions are drastic and will arguably not work in the current labour law and Corporate Law dispensation in South Africa, as this will temper with the employees' rights, such as the right to severance pay.[538] One cannot ignore the growing need for the private sector to hold hands with the government in fighting poverty and gearing its efforts towards sustainable economic growth for the country and its citizens. Compared to most African countries, South Africa has the firmest economy[539] and ESOPs may be one of the ways in which economic growth can be achieved. If employee share ownership schemes cannot work in the current economic dispensation, it is submitted that changes in the economic environment need to be considered. This will help South Africa to come up with a workable model where ESOPs can find their place in South Africa without impeaching the employees' rights as well as the employers' interests.

Shares issued by a company to its employees by virtue of their employment relationship constitute equity instruments subject to the provisions of section 8C of the Income Tax

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[537] Ibid.

[538] The employee shareholder provisions are drastic and will arguably not work in the current labour law and Corporate Law dispensation in South Africa.

[539] Enaifoghe A & Adetiba T 'South African Economic Development in SADC Sub-Regional Integration' (2018) 10 (1) *Journal of Economics and Behavioral Studies* 135.

Act. Any gain determined in respect of the vesting of such a share in an employee must be included in the employee's income for the year of assessment in which vesting takes place.[540] Income to be received and enjoyed by the employee may take various forms, whether it's a bonus or dividends declared by the company. Upon adopting ESOPs, the company board must decide in respect of the benefits to be received by the employees. However, it must, be noted that such a decision will be informed by the reasons why the employee share-ownership plan was introduced in the first place. The underlying objective would be to reduce poverty and aid employees concerned to access resources, as is outlined in the next chapter. This should be applied universally to the employees across the company. If there is any differentiation, it must be justifiable and lawful in the circumstances, for example, adherence to the principle of affirmative action.

Share plans are usually designed as a long-term incentive to bolster employee retention and reward. Such incentives typically make up a far larger portion of potential executive pay than the rank and file employees, usually because management must have more skin in the game if their interests are to be properly aligned with those of the shareholders.[541] Those at the bottom of the food chain are most affected by the effects of inequality and poverty in South Africa. As stated earlier, the application of employee share ownership schemes in its current form does not necessarily cater for those at the bottom of the food chain, these being the employees in the low earning brackets. The top executives benefit from employee share ownership schemes where such schemes have been introduced. Arguably, this would be attributed to the qualifications, skills and knowledge of those in top management. It is submitted that an employer would want to retain a well-educated and qualified employer who mostly happens to be part of the executive team rather than an unskilled or semi-skilled employee. Ironically, the latter needs the benefits linked to ESOPs than the former. Inequality and the gap between the rich and the poor widen if you give more benefits in the form of dividends and other benefits attached to share plans to the company's top executive. Thus, this practice defeats the object of using employee share ownership schemes to tackle and reduce inequality. It is, therefore, suggested that

[540] Laurens P, 'Share incentives schemes dividends' (2015) 15 (10) *Without Prejudice* 64 - 65.
[541] Foster D, 'Executive share incentives at the crossroad: tax' (2015) 16 (9) *Without Prejudice* 26-27.

companies should come up with ways to appreciate their top executives without tempering with the ESOPs, and the latter to be channelled towards wealth creation for the less privileged.

ESOPs have not been widely adopted in South Africa despite their operation being not a new or an unusual phenomenon. According to the Business Report, a subsidiary of The Star[542], the Industrial conglomerate group Barloworld limited, launched its public offer for Khula Sizwe Property Holdings, a black-owned property company, in a bid to enable black South Africans to own a stake in a property company.[543] Approximately 14 000 of Barloworld's management and employees were set to own shares in Khula Sizwe, with blue-chip Barloworld as the tenant. As a result of this development, black South Africans would own their share of a commercial property portfolio valued at the time at R2.86 billion.[544] It is submitted that the people employed by Barloworld will no longer just be ordinary employees providing their time and services towards the company's success. The employer, being Barloworld limited, sees the invaluable contribution its employees bring to the table and thus, rewards the latter with the aim of economic development. This speaks to transformative constitutionalism, a change that influenced the creation of a new legal system, which addresses the eradication of material prejudices bequeathed from the past. It is a permanent ideal, a way of seeing the world that generates a space where debate and contestation are conceivable, where new ways of being are continually investigated and created, accepted and rejected, and where change is unpredictable, but the idea of change is constant.[545] Hence, it will be incomplete if it does not encompass change in the social, economic and legal perspectives. Employee share ownership schemes may be one of the ideas that may bring about social and economic change.

In the mining sector, Kumba Ore, a limited liability company incorporated and domiciled in South Africa, focuses on the exploration, extraction, beneficiation, marketing, sale and

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[542] The Star is one of South Africa's Newspapers reporting various local and international news.
[543] Business report, 10 April 2019, available at https://www.iol.co.za/business-report/companies/barloworld-offers-employees-general-public-stake-in-r35bn-bee-property-scheme-20885534, accessed on 24 October 2020.
[544] Ibid.
[545] Langa P "Transformative Constitutionalism" 2006(17) *Stellenbosch Law Review* 354.

shipping of iron ore.[546] About 6209 employee-shareholders of Kumba iron ore became pre-tax half-millionaires in 2011 when the company paid out R2.7-billion during the first phase of the ten-year Envision employee share ownership plan (ESOPs).[547]

Kumba Ore was formed in 2006, and it takes its broad-based black economic empowerment (BBBEE) initiative seriously.[548] It is designed to promote economic empowerment among historically disadvantaged permanent employees below the managerial level through an increase in broad and effective participation in the Sishen Iron Ore Company (SIOC) equity by workers who contribute daily to meet production targets.[549]

The aforementioned companies voluntarily introduced employee share-ownership plans, benefiting thousands and thousands of employees. The lives and welfare of the South African people will improve drastically if all companies in South Africa introduce and implement employee share-ownership schemes. The bonuses and dividends declared to employee-owners will go a long way in adding value to the lives of employee-owners and their families.

Although the route travelled by these companies is a good start, much still needs to be done. South Africa has a population of about 57 million, with millions of people still living below the poverty line.

4.7 Socio-Economic Rights

It's an undeniable fact that poverty is an economic issue, and as such, it has to be addressed from an economic perspective. Addressing poverty from an economic perspective helps a country to look for suitable and plausible ways to create wealth and promote economic development. However, viewing poverty from a social perspective

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[546] Kumba Iron Ore Limited, Reviewed interim results, available on http://www.kumba-reports.co.za/kumba-interim-2018/fin-notes.php, accessed on 30 June 2020.

[547] Smit S, ''Kumba's employee share ownership plan lauded all round as pay-outs keep rolling in'', available at https://www.miningweekly.com/article/kumba-iron-ore-worker-shareholders-set-to-benefit-from-second-esop-payout-2014-01-31/rep_id:3650, accessed on 30 June 2020.

[548] Ibid.

[549] Ibid.

helps identify the effects of poverty on the poor. Hence, even though poverty is an economic issue, we cannot totally ignore its social effects. These social effects can aid in demonstrating the extent to which South Africans suffer from poverty. The social effects of poverty inform the suitable economic theories to address poverty, and they can be analysed well through socio-economic rights. Hence, the present thesis deemed it necessary to study socio-economic rights to demonstrate the urgency of employing ESOPs to address poverty in South Africa.

According to Mulaudzi and Liebenberg, the NDP suggests that post-democratic era challenges required a different approach to address issues that South Africa is facing.[550] They suggest that the development plan ideally brings the poor and vulnerable through active participation in the mainstream economy.[551]

Most constitutions, including that of South Africa, have horizontal application.[552] This is a shift from the interim Constitution of South Africa, where the constitution had vertical application premised on the relationship between the state and its subjects.[553] Horizontal application simply means that all persons are entitled to the equal protection of their rights as guaranteed in the constitution. Furthermore, these rights are enforced equally against any person who seeks to violate another's right. Hence, the principle of 'equality before the law' upholds the horizontal application of the Bill of Rights. Therefore, the horizontal position assures that there is fairness in the relationship and dealings between individuals by providing minimum social justice to the "weaker" party.[554] The second justification for the disposition towards the horizontal application of the Bill of Rights is that a constitution as an expression of a society's fundamental values should apply to all its members – the state and private actors. The South African Constitution envisages a society based on democracy, founded upon the core values of human dignity, the attainment of equality

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[550] Mulaudzi, M & Liebenberg, I, Planning and Socio-Economic Interventions in a Developmental State: The Case of South Africa (2017) 52, 1, *Journal of Public Administration* 29.
[551] Ibid.
[552] Bhana D 'The Horizontal Application of the Bill of Rights: A Reconciliation of section 8 and 39 of the Constitution' (2013) 29 (2) *South African Journal on Human Rights* 354.
[553] Madlanga M (2018) The Human Rights duties of companies and other private actors in South Africa (3) *StellLR* 359.
[553] Ibid.
[554] Maqakachane ST "Horizontal application of the bill of rights: comparative perspective" (2018) (26)(2) *Lesotho Law Journal* 24.

and the promotion of human rights and fundamental freedoms.[555] A proper interpretation and application of the Bill of Rights will ensure that social justice is achieved in the society and that all members of the society enjoy an improved quality of life, where each person has an opportunity to substance and not necessarily formal opportunity. [556]'

It could be a grave injustice if the author does not make reference to the basic socio-economic rights to which South Africans are entitled to in a thesis that seeks to introduce an avenue for poverty reduction. This is to illustrate which constitutional rights all South Africans are entitled to enjoy. Furthermore, there is a need to show the extent to which these rights are currently enjoyed by bearers of such rights. This aims to solidify the need to test avenues such as ESOPs to ensure that all persons in South Africa live above the poverty line and, therefore, be in a position to enjoy their socio-economic rights. The justiciability of socio-economic rights has been the topic of much jurisprudential and political debate for decades[557], and one cannot assess the feasibility of a system to alleviate poverty in South Africa without considering socio-economic rights. Thus, this section provides an analysis of identified constitutional socio-economic rights and the extent to which they are protected.

4.7.1 The Right to Food

South Africa is one of 20 countries in the world that constitutionally guarantees the right to food. [558] The South African Constitution expressly provides that every individual has a right to have access to food[559] The right to food is a human right, and it is primarily interwoven into one's right to life and dignity and thus, requires that good food is readily available, accessible and affordable by all persons.[560]

To a certain extent, some people and families in South Africa do not have sufficient income that can be channelled towards purchasing food. Such families are unable to

[555] Bhana (2013) op cit note 552.
[556] Ibid.
[557] *Government of the Republic of South Africa and Others v Grootboom and Others* 2001 (1) SA 46.
[558] Sakiko Fukuda-Parr ''Debate on the right to food in South Africa: Entitlements, endowments and the role of economic and social policy'' (2012) (13) (2) *ESR Review,* 5.
[559] Section 27 1 (b) of the Constitution of the Republic of South Africa.
[560] Sakiko Fukuda-Parr (2012) op cit note 556.

produce food for their consumption.[561] Thus, despite the policy and legal framework, the right to food is far from being realised.[562]

Not every person has access to food in South Africa, as there are households that do not know where their next meal will come from. Statistics indicate that about 870 million people are undernourished globally, while about 23 per cent of the people in South Africa suffer from food insecurity.[563] Furthermore, the study conducted in Johannesburg by the South African National Health and Nutrition Examination Survey (SANHANES) revealed that the people living in informal areas are severely affected by food security, indicating that at least 32% of the households are at risk, while 36% are experiencing hunger.[564] Poverty is said to be one of the major contributing reasons why many South Africans do not have access to food.[565] Some have access to food, but this does not mean that such food is healthy and suitable for human consumption.[566] Thus, some lack nutritious food due to their inability to afford good quality food products. Thus, they resort to purchasing cheap food readily available in supermarkets[567] and on the streets. The inability to have access to a good, healthy and nutritious diet can severely affect one's health and proper functioning of the brain activity. Measures need to be put in place to ensure that even the poor of the poorest have access to a well-balanced diet.

Adequate food is essential for health, survival and development, be it physical or intellectual, and is a precondition for social integration.[568] A lack of food sovereignty has

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[561] Addaney M Dube H & Getaneh S 'Light through the storm: Safeguarding the human right to water in challenging landscapes in Africa' (2018) 5 *Journal of comparative law in Africa* 1.

[562] Sakiko (2012) Op cit note 556.

[563] Ramkissooon Y 'The Right to Access Nutritious Food in South Africa' (2018) 4 (10) *ESR Review.*

[564] Rudolf M *et al*, 'Food Security in Urban Cities: A Case Study Conducted in Johannesburg, South Africa' (2021) (9)(2) *Journal of Food Security* 48.

[565] Ramkissooon (2018) Op cit 563.

[566] Ibid.

[567] Ibid.

[568] The Guiding Principles on Extreme Poverty and Human Rights, available http://www.ohchr.org/Documents/Publications/OHCHR_ExtremePovertyandHumanRights_EN.pdf, accessed on 30 June 2020. These are the first global policy guidelines that are intended to focus on the human rights of people, especially those living in poverty. These Guiding Principles on Extreme Poverty were adopted by the Human Rights Council through its resolution 21/11, in September 2012.

a negative impact on people's dignity and compromises their autonomy.[569] As a result of poverty, people often have minimal access to adequate and affordable food[570]

It is clear from the wording of the South African Constitution and international human rights law that the state has obligations to fulfil the right to food. This obligation of the state to fulfil the right to food is not limited to the provision of food during drought and emergency shortages but extends to the state's development incentive policies[571] and investment programmes. Access to food remains a major challenge in South Africa even though there is a strong international and national legislative framework that protects and promotes one's access and right to food.[572]

Should the government gear its efforts towards empowering its subjects financially to place them in a position to exercise their rights to access food? Giving man money while he did not work for it or earn it breeds laziness. Income should therefore be earned. Earning income through employee share-ownership plans is a good way to place employee-shareholders in a position to enjoy their rights to food. Seeing that someone in an employment relationship already earns an income which they work for, the phenomenon of free income breeds laziness is negated.

4.7.2 The Right to Water

The horrific events experienced by South Africa during the apartheid era left South Africa with a range of inequalities in respect of enforcing and enjoying socio-economic rights. One area that was affected greatly was one's right to water.[573] Several pieces of legislation were enacted to give effect to the right to water. For example, in terms of the World Health Organization (WHO) and United Nations Children's Fund (UNICEF), 'access to water' is defined as having not less than twenty litres of water each day from a household connection, public standpipe or a protected source, and the distance to the

[569] Ibid.
[570] Ibid.
[571] Sakiko (2012) op cit note 556.
[572] Ramkissooon (2018) Op cit note 563.
[573] Oluwabunmi Lucy Niyi-Gafar Realising the Right to Water in South Africa: Challenges of Incorporating a Human Rights-based Approach (2015).

water should be less than one kilometre.[574] This, therefore, means that 'no access to water' can mean several things. Either the source of water is not protected, or the distance to access a protected source is more than one kilometre, or though the distance might not be far, the quantity available is less than twenty litres. People cannot survive without water, and it is crucial for one's right to access water to be protected. [575] Rights are interrelated and, to some extent, indivisible, and thus, it is difficult if not impossible to enjoy any other right without water.[576]

Unsafe water and lack of access to sanitation are the principal causes of contracting diseases such as diarrhoea, which is linked to very high levels of infant mortality among families highly affected by poverty. This restricts their rights to enjoy their human rights, such as the right to dignity. The right to water is entrenched in the South African Constitution, where everyone has the right to access sufficient water.[577] In addition to the constitutional imperative, various legislative instruments were enacted to promote access to water, such as the National Water Act and the Water Services Act.

Section 11 of the National Water Act places the duty on the water services authority to ensure efficient, affordable, economic and sustainable access to water services. As much as the water services authority seeks to provide economical access to water resources, the poor and needy persons of society cannot keep up with the municipal tariffs. In the past, water was discontinued because of the inability to pay. Similarly, ensuring that people have the right to water is not enough if a large part of the population cannot pay for such services. Thus, there is a need to empower people economically for them to enjoy their right to access water resources. Allowing employees to own shares in a company and paying them dividends and other financial benefits will place low-income employees in a position to pay for water services and enjoy the right to access water. The governments should ensure that those faced with poverty have access to at least the minimum amount of water for personal and domestic uses.[578] Once people are financially

[574] Ibid.
[575] Ibid.
[576] Ibid.
[577] Section 27 (1) (a) of the Constitution.
[578] The Guiding Principles on Extreme Poverty and Human Rights. Op cit note 565.

empowered, they will be better positioned to finance their water services. Ultimately, the right to have access to water will not be a theoretical phenomenon but a reality.

4.7.3 The Right to Health Care

It is no secret that private hospitals provide better medical care than state hospitals. This is largely due to the unavailable or limited pool of resources in state hospitals.[579] For instance, a patient suffering from chronic kidney disease (CKD) will require a dialysis machine to undergo proper treatment.[580] Due to the large number of patients relying on state medical assistance[2], this patient may find it challenging to access adequate treatment. As a result of kidney failure, toxins can accumulate in the patient's body resulting in decreased quality of life or even death.

Magnetic resonance imaging (MRI) and computed-tomography (CT) scans generate images of the body to assist in the diagnosis of diseases.[581] Without these machines, a medical practitioner cannot make a complete diagnosis, for instance, of mental diseases. MRI is the most sensitive in breast cancer diagnosis, and it has a high negative predictive value (NPV) and therefore can with high accuracy exclude any malignancy.[582] On the other hand, CT scans reduce over-diagnosis in patients with pneumonia and avoid unnecessary antibiotic treatment.[583] Additionally, shortages of devices, instruments and equipment can lead to missed, delayed or wrong diagnosis. Diagnostic errors lead to the initiation of wrong treatment, or limited treatment poses a major health risk to the patient's life.

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[579] Shivani R, South Africa's hospital sector: old divisions and new developments'' (2017) *South African Health Review 5.*

[580] Norton J M, Newman E P, Romancito et al 'Improving Outcomes for Patients with Chronic Kidney Disease Part 2' (2017) 117 (3) *The American Journal of Nursing* 28.

[581] Turner M, Mayo J. Muller L *et al* , The value of thoracic computed tomography scans in clinical diagnosis: A prospective study (2016) 13 (6) *Canadian Respiratory Journal* 12.

[582] Schoub P K ''Understanding indications and defining guidelines for breast magnetic resonance imaging'' (2018) 22 (2) *SA J Raiol* 1353 doi:10.4102/sajr. v22i2.1353.

[583] Garin N Marti C Scheffler M et al, 'Computed tomography scan contribution to the diagnosis of community-acquired pneumonia' (2019) *Current opinion in pulmonary medicine* 4.

Private hospitals are better equipped with pharmaceuticals, medical devices and even human resources[584] , which guarantee higher quality of services. This is opposed to state hospitals that are overburdened with large numbers of patients and sometimes few medical staff. As a result of this disproportionality between staff and patients and lack of medical devices and pharmaceutical equipment, the staff facilities fall behind when it comes to providing medical care.

Those from poorer communities face challenges in accessing health services from private institutions as these facilities are not free. In addition, they are usually non-negotiable on initial deposit payments and are at times costly. Therefore, these communities are highly likely to access lower-quality health services in the public and private sectors.[585] In summary, one's right to health care cannot be enjoyed without economic emancipation. Giving employees ownership through shares and paying them dividends will place them in a (financially) better position to enjoy good health.

4.7.4 The Right to Housing

The population of South Africa is rapidly increasing, and the population increases the need to provide social benefits. Moreover, each person needs a roof over his or her head, and a home gives the owner a sense of belonging. A home is a place one returns to after visiting another person.

Due to the apartheid racial segregation, South Africa is left with a public housing crisis.[586] apartheid did not passively deny blacks from owning proper housing, but laws were enacted to achieve this goal.[587] The Urban Areas Act[588] regulated the entry into and exit from urban areas, which , to a larger extent, was for mending to the needs of the white

[584] Moodley S Wolvaardt L Louw J & Hugo J 'Practice intentions of clinical associate students at the University of Pretoria, South Africa' (2014) 14 (3) *Rural and Remote Health*. 6

[585] Gilson L Goodman C Mills A *& et al* 'Private Health Care the Answer to the Health Problems of the World's Poor' (2008) 5 (11) *PLoS Medicine.*

[586] Ratshitanga T, 'South Africa's Public Housing Challenges' (2017) 52 (1) *Journal of Public Administration*. 7

[587] Ibid.

[588] The Urban Areas Act 21 of 1923.

man.[589] The Group Areas Act of 1950[590] and 1966[591] disallowed black people from "roaming" around in areas designated for white persons except in cases where the former had to provide their services to the latter in the form of domestic work.[592] People of African descent were prohibited from owning property.[593] These are some of the laws enacted before South Africa attained freedom, and they were meant to deny black people their right to access housing.

Legislated apartheid was discontinued ever since 1994. In 1997, the Housing Act of 1997 was enacted, which makes provision for the government's responsibility to provide its subjects with fully serviced houses, thereby allowing people to have a place to call home.[594] However, despite these positive developments, some, especially the black majority, have been in the cold without proper housing. This places a burden on the government to strategise and develop a workable solution for assuring its people access to affordable housing.

People living in poverty live in inadequate housing conditions mainly characterised by slums and informal settlements, with minimal to no access to basic amenities of life.[595] Living in slums and informal settlements may, in the long run, post health risks and expose people to natural disasters[596] which could otherwise have been avoided had those that are economically challenged been in a better financial position to afford decent accommodation.

4.8 Possible Avenues for Guaranteeing the Success of ESOPs in South Africa

Without reiterating the arguments in support of asserting that poverty exists in South Africa, it is worth stating, as shown in the preceding paragraphs, that most South Africans still do not have access to basic resources such as food, water, housing and health care.

[589] Ratshitanga (2017) Op cit note 586.
[590] The Group Areas Act 41 of 1950.
[591] The Group Areas Act 36 of 1966.
[592] Ratshitanga (2017) op cit note 586.
[593] Ibid.
[594] Ibid.
[595] The Guiding Principles on Extreme Poverty and Human Rights op cit note 565.
[596] Ratshitanga, (2017) op cit note 586.

These basic resources are indicators of one's poverty line. In other words, if one does not have access to basic resources, one is regarded as poor. Consequently, poverty is the main reason for the lack of access to basic resources. Furthermore, some people, though employed, do not earn enough money to live a decent life. This is despite the noticeable efforts such as the BEE that the government implemented to assist the poor to take part in the economy, aiming to foster economic growth and development. This section of the thesis explores the possible use of existing Corporate Law principles to propose an ESOP mechanism in addressing the existing poverty and disparity in respect of income and wealth in South Africa.

The objective of ESOPs is to enable employees to participate in economic development. Hence, employees assist firstly with wealth creation and then share in this wealth.[597] Considering the difficulties experienced by the employees in acquiring funds to purchase shares, the South African Companies Act has liberalised Corporate Law to facilitate financial assistance for share acquisition. Not all companies may be experiencing the same difficulties when it comes to capital ownership, assets base and profitability. Thus, to analyse and propose a workable solution, it is essential to group companies into three categories: financially healthy companies[598], financially distressed companies[599] and terminally ill companies.[600] The approach to be followed in implementing ESOPs in the three types of companies may differ depending on the conditions that these companies find themselves in.

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[597] The Cambridge dictionary defines wealth as ''a large amount of money or valuable possessions that someone has.''

[598] A financially healthy company may be described as a company which is solvent and liquid. In other words, the company's assets fairly valued exceed its liabilities. The net result of this is that the company has enough assets to pay for the liabilities. Furthermore, the financial statements of such a company indicate that the company is profitable, with its income exceeding its expenditure, ensuring the company continues to make a surplus. In addition, a financially healthy company has a positive cash flow. This means that such a company receives more sums of money as compared to the money paid out.

[599] A financially is a company that is not financially stable. This means that in terms of the company's financial statements, the company does not have a positive liquidity and solvency ratio. However, a floating company has the potential of being rescued. This can happen using the unique Corporate Law procedures such as business rescue in the South African context.

[600] A terminally ill company is the one that is operating at a loss. The company's assets are no longer sufficient to pay for the liabilities. In other words, the company's debts and liabilities far exceed its assets, making it impossible for the company to meet its obligations towards external third parties, i.e., its creditors.

4.8.1 Financially Healthy Companies

The company law in South Africa has moved away from strictly requiring cash payment in return for acquiring shares. Potential shareholders can therefore pay for their shares through the provision of services or by offering their skills.[601] Furthermore, the interpretation of section 40 (6) (c) (ii) of the Act permits the issuing of shares that are partly paid or for which payment will be made in future. Under normal circumstances, a company must comply with the liquidity and solvency test before it can offer some form of financial assistance to employees to participate in ESOPs. In other words, the company must be in a healthy financial position to assist employees with acquiring shares in the company. Determining the company's financial health involves two processes, namely, analysing the financial statements and analysing the cash flow statements. The income statement and balance sheet are financial statements indicating the financial result and financial position, respectively. A situation where the company's income exceeds its expenditure reflects a healthy financial position as far as converting assets into cash is involved. Similarly, if the company's assets exceed its liabilities, it is in a financially healthy position. For a proper analysis, the financial statements must be analysed to determine the healthy financial statement of a company. The cash flow statement reflects how the company has used its cash over the period under review. More cash inflows when compared to cash spending indicate that a company is in a financially healthy state.

Consequently, the first mechanism that financially healthy companies can employ to implement ESOPs is to follow the practice of allowing employees to use alternative means to pay for their shares. This arrangement entails an agreement between the company and a potential shareholder for the employee to receive shares in return for his/her labour. The parties to such an agreement may also decide on the provision of skills as adequate consideration for shares as prescribed by the Act.[602] With the world becoming digital and skills-based, no digital literacy may be crucial for issuing skills-based shares in South Africa. Allowing potential shareholders to pay for their shares makes ESOPs possible

[601] Section 40 (1) of the Companies Act 71 of 2008.
[602] Section 40 (1) of the Companies Act 71 of 2008.

without the purchaser's liquidity position. However, the downside is that it does not guarantee capital growth in the country. The alternative means to paying for shares may result in under capitalisation for companies. As postulated by Kelso through the theory of binary economics, capital growth is key to growing the economy.

Alternatively, allowing potential shareholders to pay for their shares using means other than cash implies that the board of directors may authorise the company, through the MOI, to provide financial assistance to potential shareholders to purchase shares in a company.[603] This financial assistance may be in the form of a loan, a guarantee or the provision of security for the purpose of subscription to any option issued or to be issued by the company. Thus, in ESOPs, the company's MOI can make provisions for providing financial assistance to employees to participate in ESOPs. However, in order for this financial assistance to be provided for the purpose of establishing or operating ESOPs, the provisions of section 97, as alluded to earlier in this chapter, must be complied with. In other words, a compliance officer or a trust must be created to administer the fund for the benefit of the employees.

The ailing economies of developing countries make it somehow difficult, if not impossible, for companies to provide financial assistance to employees for ESOPs. Again, even if the companies offer some form of financial assistance to employees to participate in ESOPs, it will not grow the company's capital. The net result of financial aid by companies to operate ESOPs does not positively contribute to economic growth and development.

The government has a role to play in assisting companies to finance ESOPs on behalf of their employees. Firstly, the government must introduce favourable conditions for companies in respect of corporate tax. This calls for the elimination of corporate tax on corporate income paid to an ownership trust. This will enable trustees to: Firstly, repay the loans taken out to facilitate ESOPs and, secondly pay employee-shareholders their dividends.[604] Secondly, the government can assist by ensuring that companies can finance ESOPs by reducing the cost of repaying the loans for ownership trust.[605] In South

[603] Section 44 (2) of the Companies Act 71 of 2008.
[604] Ashford (2015) Op cit note 251 at 22.
[605] Ibid.

Africa, this might become a reality in the future. During the 2021 budget speech, the Minister of Finance proposed various economic reforms, of which one is based on corporate income tax.[606] The minister proposed to reduce the corporate income tax to 27 per cent with years of assessment commencing on, or after 1 April 2022. This will result in reducing the income tax deductions.[607] The route that the government intends to travel in this regard will not only encourage companies to introduce ESOPs but also encourage potential businesses to be established in South Africa, thereby promoting economic development. It is important for the government and the private sector to work together to build and maintain a well-functioning private sector, which will create wealth needed to respond to issues of poverty eradication.[608]

Advancing fair competition and promoting investment are key to growing the economy and developing a country. This is to ensure that financially healthy companies continue to increase their capital and do not suffer financial setbacks. By offering shares to employees, the government can foster fair competition and trade liberalisation. South Africa has made a progressive move on the legislative front to foster fair competition. In its preamble, the Competition Act of South Africa places importance on recognising a competitive economic environment, balancing the interests of all relevant stakeholders: workers, owners and consumers. The goal of placing emphasis on providing a competitive economic environment is foster development.[609] Another equally important feature of the Competition Act is its aim to promote a greater spread of ownership, particularly to increase the ownership stakes of historically disadvantaged persons.[610] The distribution of ownership across all sectors for the benefit of historically disadvantaged persons cannot be a reality until the entrepreneurial principle of 'advancing fair competition' is implemented in all sectors of the economy. In a continuously growing economy, one can use ESOPs to address issues of poverty by allowing small and

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[606] Tito Mboweni, Budget Speech, South Africa, available at https://www.gov.za/speeches/minister-tito-mboweni-2021-budget-speech-24-feb-2021-0000, accessed on 09 May 2021.
[607] Ibid.
[608] Mbaku J, 'Providing a foundation for wealth creation and development in Africa: The Role of the Rule of Law' (2013) *Brooklyn Journal of International Law,* 981.
[609] Preamble of the Competition Act, 89 of 1998. Also see section (2) (a) of the Act which outlines the purpose of the Act, which is to promote the efficiency, adaptability and development of the economy.
[610] Section 2(f) of the Competition Act 89 of 1998.

medium-sized enterprises to have equitable opportunities to participate in the economy.[611] Competition law helps developing countries to meet their developmental goals and prevents restrictive business practices such as cartels and monopolies. The SADC Declaration on Regional Cooperation in Competition and Consumer Policies, of which South Africa is a member, necessitates the member countries to recognise the vital role of competition and consumer policy in promoting economic growth and alleviating poverty.

The government of South Africa established the Industrial Development Zone (IDZ) programme to reposition itself in the world economy.[612] IDZ aimed to attract investment from around the world by offering top-class infrastructure and minimal tax incentives.[613] The IDZ programmes were regarded as failures due to a weak policy and legislative framework, poor governance arrangements and lack of IDZ specific incentives.[614] A well-drafted policy framework is important to implement economic policies aimed at development. Furthermore, it would be difficult to attract and retain foreign investment in the absence of attractive incentives.

It is crucial to provide an enabling environment for both domestic and international trade and investment when it comes to trade and investment. Section 12(1) of the Protection of Investment Act [615] voices South Africa's commitment to foster economic growth, beneficiation and redressing historical, social and economic inequalities and injustices. To promote investment, whether inter or intra, the government must provide and or make information accessible to place investors in a position to make informed decisions regarding their investments.[616] Guaranteeing this protection on paper is not enough if foreign investors are denied access to investment information. Thus, in order to grow the economy, South Africa must focus on external investment as well. This requires extending

[611] Section 2 (e) of the Competition Act 89 of 1998.
[612] The Department of Trade, Industry and Competition: Republic of South Africa.
[613] Etherington, L 'The impact of Industrial Development Zones on Employment in South Africa: a CODEGA IDZ case study', available at https://www.academia.edu/8683972/THE_IMPACT_OF_INDUSTRIAL_DEVELOPMENT_ZONES_ON_EMPLOYMENT_IN_SOUTH_AFRICA_A_COEGA_IDZ_CASE_STUDY, accessed on 08 May 2020.
[614] Ibid.
[615] Protection of Investment Act 22 of 2015.
[616] Protection of Investment Act 22 of 2015.

favourable treatment that South African investors enjoy to foreign investors.[617] South Africa's foreign investors seem to be worried about legal uncertainties which discourage foreign investment. Although the Protection of Investment Act guarantees and promotes foreign investment, the legal requirements of Black Economic Empowerment policies have the potential to discourage foreign investment. The General Agreement on Trade in Services Barriers to trade and investment can negatively impact the economic growth and development of South Africa. In an economy that is not growing, it is impractical to introduce and effectively administer ESOPs.

Although rich in natural resources, African countries are highly dependent on investment from the first world countries. Because of this high dependency, economies in Africa compete for foreign investment. South Africa is, fortunately, one of the four large economies in Africa, alongside Nigeria, Egypt and Algeria. The fact that South Africa is amongst the top four economies means that the country is doing well and can compete for resources. However, more needs to be done to attract and retain investment for the greater good of the nation. Efforts could include addressing issues such as the high cost of doing business in South Africa and maintaining peace and stability.[618]

Furthermore, South Africa has eight ports, namely Richards Bay, Durban, East London, Ngqura, Port Elizabeth, Mossel Bay, Cape Town and Saldanha.[619] The ports are beneficial for South Africa because they promote the ease of doing business compared to landlocked countries that have to rely on the other countries' ports to export and import goods. For South Africa, its ports are one of the factors that may attract and retain investment. Furthermore, South Africa has nineteen border posts as it shares borders with Zimbabwe, Lesotho, Swaziland, Botswana, Mozambique and Namibia.[620] Sharing borders with six SADC countries promote inter-regional trade and hence, contributes to

[617] Section 8(1) of the Protection of Investment Act 22 of 2015.
[618] Issues such as the fees must fall movement, Gender-Based Violence (GBV) and Xenophobic attacks can negatively impact South Africa's foreign investment.
[619] Harbours and Ports of South Africa, available at https://www.southafrica.com/business/ports/, accessed on 18 April 2022.
[620] See sars.gov.za/ClientSegmentsSouth Africa's border post includes BeitBridge, Caledonspoort, Ficksburg Bridge,Golela, Grobler's Bridge, Jeppes Reef, Kopfontein, Lebombo, Mahamba, Mananga, Maseru Bridge, Nakop, Nerston, Oshoek, Qacha's Nek, Ramatlabama, Skilpadshek Border Post, Van Rooyens Gate & Vioolsdrift.

South Africa's economic development. International trade is a necessary component of a thriving economy.[621]

The agreement establishing the African Continental Free Trade Area (AFCFTA) seems to yield favourable results for South Africa.[622] The AFCFTA emerged from discussions around the ''Abuja Treaty Establishing the African Economic Community and the 2000 Constitutive Act of the African Union''[623] The AFCFTA signatories seek to promote intra-Africa trade. To achieve this aim, the AFCFTA established a free trade zone.[624] Intra-Africa trade currently stands at 16%, which is very low compared to globally.[625] AFCFTA aims to "contribute to the movement of capital and natural persons and facilitate investments building on the initiatives and developments in the State Parties and recs."[626] Capital is what keeps the business community operational, and it is capital that either facilitates or hampers business activities. Hence, an agreement that seems to foster the movement of capital is a move in the right direction as far as economic growth and development are concerned.

Furthermore, AFCFTA seeks to "enhance the competitiveness of the economies of State Parties within the continent and the global market."[627] Competition drives economic growth as it allows businesses to provide quality products and/or services at the disposal of consumers.

Another key objective of AFCFTA is to "progressively eliminate tariffs and non-tariff barriers to trade in goods."[628] This again promotes trade between African nations, subjects consumers to a broad range of products and services, promotes the provision of quality products and leads to growth in the GDP of member states.

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[621] Harbours and Ports of South Africa, available at https://www.southafrica.com/business/ports/ accessed on 18 April 2022.
[622] The AfCFTA was signed on 21 March 2018.
[623] Kuhlmann K & Agutu AL ''The African Continental Free Trade Area: Toward A New Legal Model For Trade and Development'' (2020).
[624] Gachuiri E ''African Continental Free Trade Area Phase II Trade Negotiations: A Space for Competition Protocol?'' UNCTAD Research Paper No.56 UNCTAD/SER.RP/2020/15 p.3.
[625] Ibid.
[626] Article 3 (c) of AfCFTA.
[627] Article 3 (f) of AfCFTA.
[628] Article 4 (a) of AfCFTA.

The implementation of AFCFTA will reveal possible challenges, whether it's economic or political and successes derived from its implementation. It is, however, too early to assess the outcome of AFCFTA's implementation. The proper implementation of AFCFTA will "promote economies of scale and value chains that can boost African companies to compete on international markets."[629] If companies can compete in international markets, it will boost their returns, and this will enable companies to adopt and implement ESOPS.

4.8.2 Financially Distressed Companies

As pointed out in chapter 1, ESOPs may be used as a tool to ensure business success and assist companies that are on the verge of insolvency. Some companies, especially financially distressed ones, may thus be transferred to employees as the owners or founders of such companies can no longer keep the company profitable. A company showing signs of insolvency[630] is not profitable and cannot successfully implement ESOPs. In such a scenario, it would be financially wise first to take advantage of business rescue practices and, once the company financially recovers, then implement ESOPs. The business rescue procedure has a legislative basis and methodology. Firstly, it provides for the supervision of the company and the management of its property on a temporary basis. Secondly, it places a moratorium on creditors' rights against the company. Thirdly, it makes provisions for the development of a business rescue plan. This plan aims to restructure the company's affairs, property, business, debts and

[629] Kuhlmann K & Agutu AL 'The African Continental Free Trade Area: Toward A New Legal Model for Trade and Development'.

[630] There are several things that a company may look out for as signs of insolvency. One of the early signs of insolvency is when the business is unable to meet its financial demands. In other words, if the business is unable to pay their employee staff salaries, this is an indication of the company becoming insolvent. In the same vein, it is also a sign of insolvency, if the company is struggling to meet its financial obligations towards external third parties. The financial statements of the business can be used to depict the possible problems relating to the financial position and the financial results of the company. Though the causes of insolvency may differ, the poor management of funds may result in inadequate investments. In the case of *Merchant West Workings Capital Solutions (Pty) Ltd v Advanced Technologies Engineering Company (Pty) Ltd and Another* (13/12406) [ZAGPJHC 109 (10 May 2013), the court said that 'it is clear that a business rescue process plan cannot be invoked where a company is already insolvent. This is one of the aspects differentiating business rescue from judicial management. Proceedings can be started six months in advance when the tell-tale signs are starting to appear. For instance, a company that is trading profitably and is cash positive but does not have the wherewithal to repay a large debt which will become due and payable within the next six months would qualify to be classified as being financially distressed'', thus being a candidate for business rescue.''

liabilities. This restructuring aims to salvage that which can be salvaged and ensure the company's continued existence on a solvent basis.

The business rescue proceedings may either be initiated by the company or ordered by the court. From the company's perspective, the process starts with identifying a company as a financially distressed company and determining the reasonable prospects of restructuring the company.[631] In terms of section 128 (1)(f), a company is described as financially distressed it seems unlikely that the company will be in the position to settle all its debts within the six months immediately when such debts become due and payable; or if it seems that there is a high likelihood that the company will become insolvent within six months after the debt has become due and payable.[632]

Hence, business rescue is considered only when the company is struggling to pay its day-to-day expenses. The reason for invoking business rescue proceedings is to guard against insolvency.

The company's board may take a resolution to the effect that the company voluntarily begins the business rescue proceedings.[633] The outcome of this is to place the company under supervision.[634] This involves the appointment of a business rescue practitioner.[635] Once the company has decided to restructure the business with business rescue, an application is lodged with the Companies and Intellectual Property Commission (hereinafter CIPC).[636] The company is required to publish a notice of the board resolution regarding the envisaged business rescue proceedings. This notice must be served on all affected persons.[637]

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[631] Section 129(1)(b) of the Companies Act 71 of 2008.
[632] *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* ((609/2012) [2013] ZASCA 68 (27 May 2013).
[633] Section 129(1) of the Companies Act 71 of 2008.
[634] Ibid.
[635] Section 129(1)(b) of the Companies Act 71 of 2008.
[636] Section 129 (1) (3) of the Companies Act 71 of 2008.
[637] Section 129(3)(a) of the Companies Act 71 of 2008. The Act defines 'affected person' to include a shareholder or the creditor of the company; any registered trade union representing employees of the company, and if any of the employees of the company is not represented by a registered trade union, each of those employees or their respective representative.

Any person who falls within the definition of an affected person in terms of section 128(1)(a) of the Act may apply to a court at any time for an order placing the company under supervision and commencing the business rescue proceedings.[638] As in the case of a voluntary commencement of the business rescue proceedings, all affected persons must be notified of the application in court.[639] However, an additional requirement is placed on persons applying for a business rescue order to the court. This is to the effect that the copy of such an application must be served on the CIPC and the company. [640] The court may make an order to place the company under supervision and commence the business rescue proceedings if satisfied that, amongst others that the company is financially distressed and there is a reasonable prospect for restructuring the company.[641] The court is not obliged to make an ordering commencing the business rescue process. The court may equally decide to dismiss the application and give other directives such as placing the company under liquidation.[642]

The business rescue process has various advantages for the company and its stakeholders. It involves placing the company in the hands of a qualified person who knows how to protect the interests of the company, including the property and the human capital. [643] The commencement of the business rescue process does not bring employment relationships to an end. This means that the employees continue to be in employment on the same terms and conditions unless the company and the employees mutually agree to different terms and conditions.[644]

The business rescue procedure provides an excellent advantage to employees primarily because it allows for fair and equitable treatment of employees when a company is

[638] Section 131(1) of the Companies Act 71 of 2008.
[639] Section 131(1)(b) of the Companies Act 71 of 2008.
[640] Section 131(2)(a) of the Companies Act 71 of 2008.
[641] Section 131(4)(a)(ii) and (iii) of the Companies Act 71 of 2008. In the case of *A G Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others* 2012 (5) SA 515, the refused to grant the order commencing the business rescue process because the court was of the opinion that the applicants failed to indicate any reasonable prospects of the company returning to solvency. As a result, that court was not convinced that the company could achieve the alternative result which is better than liquidation.
[642] Section 131(4)(b) of the Companies Act 71 of 2008.
[643] Section 138(1) provides for the requirements for the appointment of a business rescue practitioner. This person must be a member in good standing of a legal accounting or business management accredited by CIPC.
[644] Section 136 (1)(a) of the Companies Act 71 of 2008.

financially distressed.[645] Thus, business rescue offers the employees protection during the business rescue process.[646] The administration of the business rescue process excludes employment contracts.[647] Thus, employees may not be dismissed whilst the business rescue process is in progress.

The implementation of ESOPs may be considered if the company goes through the business rescue process and recovers. This means that if the company shows signs of insolvency, the first thing is to initiate the business rescue process. As indicated above, this can be done through an application to the court or voluntarily by resolution of company directors. ESOPs can then be introduced if the business rescue process hel.ps the company towards 'financial recovery'. Companies owned by employees may prove to be profitable. This is because the employees are shareholders of the company and because of their loyalty and hard work, which contribute to the business' financial success and continuity. The company's continued existence has benefits for all the stakeholders of the company. The creditors derive business from the company. Furthermore, the customers of the business benefit from the company business in the form of purchasing goods or services from the company. Most importantly, the employees enjoy the benefits of the company's continued existence through receiving their monthly salary and bonuses, medical aid benefits and all other benefits they are entitled to in terms of the labour laws of South Africa. However, limiting employee benefits only to their employment contract and labour law is of little significance as far as poverty alleviation is concerned. Employees would better move out of poverty by enjoying the right to ownership and receiving benefits associated with such ownership instead of being tied only to their salary.

Financially distressed companies can therefore enjoy continued existence through the introduction of ESOPs. It is important to note that the business rescue proceedings must first be commenced and stay their course before ESOPs can be introduced in such a company. However, the government must provide financial support to aid the ailing

[645] Cassim et al., *Contemporary Company Law* Op cit note 35.
[646] Ibid.
[647] Ibid.

companies, for this to happen. An example of this can be seen in the recent example of South African Airways, which was placed under business rescue and recently handed back to its executives.[648] The government injected R7.8 billion into the company, and this will help the company to become financially stable. To avoid the company having a relapse, one could consider introducing an ESOP.

4.8.3 Terminally ill Companies

The worst-case scenario is when the possibility of saving the company is non-existent. This means that the company is not meeting its primary objective of making a profit. Thus, the benefits of liquidation and winding-up of such a company far out-weighs the benefits of keeping the company open for business.[649] The only option for terminally ill companies is to invoke the provisions of liquidation and winding-up as prescribed by the Companies Act. In the case *of Absa Bank Limited v Summer Lodge (Pty) Ltd*[650], the court, making reference to Webster's Third International Dictionary, observed that liquidate means to settle (a debt) by payment or other adjustment or settlement; to get rid of; to dispose of; to convert (assets) into cash.

Furthermore, according to Cilliers and Bernade, liquidation is

> *"the process of dealing with or administering a company's affairs prior to its dissolution by ascertaining and realising its assets and applying them firstly in the payment of creditors of the company according to their order of preference and then by distributing the residue (if any) among the shareholders of the company in accordance with their rights, is known as the winding-up or liquidation of the company."*[651]

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[648] SA news, available at http://www.sanews.gov.za/south-africa/saa-placed-under-business-rescue, accessed on 20 June 2021.

[649] The Court in the case *Van Staden v Angel Ozen Products CC and Others* 2013 (4) SA 630 (GNP) (12 October 2012) made a distinction between liquidation and winding-up by stating that the former refers the legal proceedings before the court of law, and the latter is a process that is overseen by the Master. Furthermore, the court went on to say that winding up proceedings should be seen as a continuation of liquidation proceedings.

[650] ZAGPPHC 544 (23 May 2013).

[651] *Richter v Absa Bank Limited* op cit note 176.

Liquidation is the process by which the company's business is brought to an end with the result of distributing the assets.[652] A business, once liquidated, cannot enter into new business transactions to further the interest of the business. Hence, the aim to liquidate the business cannot coexist with furthering the business objective of making a profit. Therefore, liquidation must be turned to as a last resort.

In terms of the South African law, companies facing financial difficulties can implement one of the two options, namely the business rescue process outlined earlier in this chapter or liquidation. The extent of business financial problems will determine the procedure to choose. Liquidation is used in instances where the prospects of 'business recovery' are very slim or non-existent.

A liquidator is appointed by the Master as soon as the court or resolution has made a winding-up order for creditors winding-up has been registered.[653] Firstly, he or she is required to take control of the assets of the insolvent company and, secondly, sell such assets to pay company's creditors, in respect of debts validly proven claims.[654] The liquidator takes control of the affairs of the company.[655] This includes taking possession of the company's assets, collecting debts, and paying the liquidation costs and the creditors.[656] Furthermore, the liquidator is required to distribute any surplus pro rata amongst the shareholders.[657] The liquidator is accountable to the Master in the performance of all these duties and thus, required to prepare and provide a liquidation

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[652] Winding-up of insolvent companies is dealt with in terms of the provisions of the 1973 Act. The legislature has not relied on these provisions when drafting the 2008 Act. This rationale for this could be found in the fact that the 2008 Act seeks to promote the continued business of a company instead of liquidation. This liquidation is the very last option in terms of the current company regime in South Africa.

[653] Section 368 of the Companies Act 61 of 1973. Also see Cilliers, HS *et al*, *Corporate Law* 3ed (2000) 519.

[654] Cilliers Corporate Law (2000) Op cit note 180 at 521.

[655] Ibid.

[656] Ibid.

[657] Ibid. In terms of 1973, a liquidator has extensive powers which are linked to the purpose of distributing the proceeds of the sale of assets of the insolvent company. Section 386 (1) sets out the powers of the liquidator as follows: (*a) execute deeds, receipts and other documents in the name and on behalf of the company; (b) prove a claim in the estate of any debtor or contributory and receive payment in full or a dividend in respect thereof; (c) draw, accept, make and endorse any bill of exchange or promissory note in the name and on behalf of the company; (d) summon a general meeting of the company, or creditors or contributories in order to obtain authority in regard to any other matter he considers necessary; and (e) take such measures, subject to the provisions of subs (3) (4) and (5), for the protection and better administration of the company's affairs and property as the trustee of an insolvent estate may take in the ordinary course of his duties and without the authority of a resolution of creditors.*

account to the Master, whose account should lay the amount for inspection by the interested parties.[658] When the liquidation process is completed, the liquidator's duties are terminated, and the company is dissolved.[659]

Section 38 (5) of the Insolvency Act[660] provides that a trustee (in this case, a liquidator) may not terminate the employment contract unless he or she has consulted with the employee(s) concerned. However, the usual consequence of liquation is that the employees are left unemployed. Thus, employment is only secured for the period of the liquidation process. Once liquidation is concluded, the employment contracts typically come to an end.[661] This is only far for the company because it would not make sense for a liquidated company to have persons in its employment as it ceases with its business operations (which would otherwise generate income) upon liquidation.

As previously stated, the liquidator is required to realise the assets of the insolvent estate. The liquidator must realise the assets for the benefit of the creditors.[662] Thus, in discharging his or her duties, the liquidator must always act in the interest of the creditors and the members, not the public interest.[663] This, in actual fact, means that all the assets of the insolvent company must be sold to generate money to pay debts owed to the creditors. At creditors' meetings, the creditors must give directives as to how this sale can be made and in the absence of such a meeting, the assets can be sold at a public auction.[664] The Companies Act does not contain any provision with regards to the sale of property of the insolvent company, and therefore, the provisions of the Insolvency Act apply in this regard.[665] Furthermore, the 1973 Act also makes provisions for liquidation. However, both the 1973 Act and the Insolvency Act only make reference to the sale of assets for the benefit of creditors. Thus, in terms of the law, anybody can buy these

[658] Ibid.
[659] Ibid.
[660] Insolvency Act 24 of 1936.
[661] Section 38 of the Insolvency Act 4 of 1936.
[662] *GCC Engineering & others v Lawrence Maroos & others*, (901/2017) [2018] ZASCA 178 (3 December 2018).
[663] *Waterkloof Marina Estates (Pty) Ltd v Charter Development (Pty) Ltd and Others (*64309/2009) [2013] ZAGPPHC 543 (10 May 2013).
[664] Section 82 (1) of Insolvency Act 24 of 1936.
[665] *Waterkloof Marina Estates (Pty) Ltd v Charter Development (Pty) Ltd and Others* (64309/2009) [2013] ZAGPPHC 543 (10 May 2013).

assets. What is important in terms of the current law is that the income earned through such sale is used to pay the creditors. The employees are oftentimes left in the cold upon liquidation.[666] If one looks at the number of liquidations experienced in South Africa annually, unemployment will continue to rise and have severe economic crises in the country. In 2019, 636 liquidations took place in South Africa, while approximately 434 and 674 were recorded in 2020 and 2021, respectively.[667] These totals indicate the number of households that will have to bear the consequences of unemployment and poverty. However, these effects could be minimised if a different route is taken upon liquidation. This entails the compulsory offer of assets to employees upon liquidation.

To provide employees with an opportunity to purchase assets to start up an ESOP, companies may, upon liquidation, give ex-employees an option to purchase the assets. In the case of *Waterkloof Marina Estates (Pty) Ltd v Charter Development (Pty) Ltd and Others*[668]*,* in addressing issues relating to the sale of assets on liquidation in terms of section 386(3), the court said that for the liquidator to act, he or she must obtain authority from both the creditors and members or contributors or on direction by the Master of the High Court.

It is often difficult for employees to raise enough capital to finance the establishment and operations of ESOPs. However, giving them an option to purchase assets will place them at an advantage stage since the liquidated company will not sell assets to a third party during the option period. An option contract can be entered into with the employees. This option agreement will bar the liquidator from selling the insolvent company's assets to any other party without first considering the interests of the ex-employees. The option will stay open for the duration stipulated in the option contract. Suppose the period provided for in the option contract lapses without acceptance. In this case, the option will automatically lapse, and the liquidator will be free to sell the assets as per any other agreement or

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[666] Playtext, a company which manufactures and sells apparel products left over 700 people unemployed following liquidation. Another company, STA South Africa stated that its liabilities were estimated to be at least 213.5 million with the assets worth just 3.7 million. This is a clear indication of insolvency, and the net result of insolvency is liquidation. Once the liquidation process is completed, the employees of the company would suffer a natural consequence of unemployment.

[667] Evans S, Business Insider, South Africa 27 May 2021.

[668] *Waterkloof Marina Estates (Pty) Ltd v Charter Development (Pty) Ltd and Others* (64309/2009) [2013] ZAGPPHC 543 (10 May 2013).

action provided by law. Financial entities such as the African Development Bank can partner with the government and come up with initiatives on how best to assist the ex-employees of a liquidated company from purchasing its assets.[669]

Once the ex-employees of a liquidated company acquire or purchase the assets of such a company to establish an ESOP company, it will prevent severe effects on unemployment. Liquidating a company and leaving employees out in the cold breeds unemployment and increases poverty. This then helps employees purchase the assets of a liquidated company by providing financial assistance, enabling to start up ESOPs with little to no financial hurdles.

4.9 Conclusion

The usefulness of the ESOP in South Africa lies in its ability to be infused into the Corporate Law principles to address inequality and poverty in South Africa. This chapter examined the applicability of the Corporate Law principles to ESOPs intending to foster economic growth and development in South Africa. In South Africa, the Corporate Law reform made the process of company formation and operation simpler. This allows businesspersons to establish companies through minimal legislative formalities and is an

[669] According to the Preamble of the Agreement Establishing the African Development Bank, the bank takes cognisance of *"the necessity of accelerating the development of the extensive human and natural resources of Africa to stimulate economic development and social progress in the Region."* Further, the bank is required through its functions to make use of resources at its disposal to finance investment projects and programmes aimed at the economic and social development of its regional members. The African Development Bank has partnered with governments of many African member states to stimulate economic development and social progress. In April 2021 the African Development Fund's Board of Directors approved funding for the Ethiopian government's Multi-Sectoral Approach for Stunting Reduction Project (MASReP). The approved funding amounts to 31 million dollars. In 2020 The African Development Bank and the Government of Uganda have signed 500,000 dollars grant agreement for financing Micro, Small and Medium Enterprises (MSMEs) to boost business linkages on the East African Crude Oil Pipeline Technical Assistance project. The awarding of this grant was prompted by the request from the governments of Uganda and Tanzania for assistance in preparing local business communities to be able to retain a portion of the 3.5-billion-dollar investment in the construction of a crude oil pipeline from Hoima in western Uganda to Tanga, on the Coast of Tanzania, agreed in 2016. These are just two of the many examples of how the African Development Bank has assisted the governments of member countries in financial social and economic development projects. South Africa can thus seek assistance from the African Development Bank in assisting employees to finance their ESOPs.

important development because a company and its operations positively influence economic growth and development.

As indicated in this chapter, some South Africans still do not have access to basic resources due to poverty. It is clear that the South African government has committed itself to improve the living conditions of the society's poor and previously disadvantaged persons. This can be seen through the enactment of the Broad-Base Black Economic Empowerment Act and other social programmes. Through the interrogation of the laws and policies, it appears that the government has concentrated on social programmes aimed at distributing resources. This approach has failed because it is rather more short-term and can easily exhaust the government's resources, as has been the case in South Africa.

The government, with all stakeholders across the economic sphere, needs to look at proposals that are long-term and have the potential to grow the country's economy. Hence, ESOPs could be one of such long-term plans that can equally grow the companies' capital and contribute meaningfully towards the economic development of South Africa. The proposals for implementing ESOPs across all types of companies, as discussed in this chapter, are plausible and will yield better economic development and poverty reduction results if all stakeholders play their part. A financially healthy company can partner with the government and take advantage of policies based on trade, competition and investment to increase capital ownership and thereafter implement ESOPs. This will reduce or eliminate any financial burden for employees to use personal savings for ESOPs. Financially distressed companies restructure their business through business rescue, once it becomes viable to implement ESOPs, transfer ownership to employees so as to guarantee the continued existence of the company. This approach can also ease potential job losses. In the worst-case liquidation scenario, the company can sell its assets to employees. This can serve two purposes, as shown in this chapter firstly to do good to the creditors and secondly, to enable employees to access assets for starting an ESOP. Implementing ESOPs in the South African company will not be easy, but it is possible, as this chapter attempted to demonstrate.

CHAPTER FIVE

BRAZIL AND EMPLOYEE SHARE-OWNERSHIP PLANS

5.1 Introduction

The Federal Republic of Brazil is the largest country in South America and the fifth largest country in the world. It has a land size of approximately 8.6 million square kilometres and a population size of more than 190 million people.[670] Brazil shares its borders with ten countries, namely, Argentina, Bolivia, Colombia, French Guyana, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela. This is an important fact considering Brazil's regional trade could continuously promote with its immediate neighbouring countries to foster economic development. Good neighbourliness and trade-friendly laws can aid in this regard. On the political front, Brazil remained a Portuguese colony for over 300 years. [671] It became independent from Portugal in 1882 with the subsequent establishment of a constitutional monarchy.[672] A federal republic was declared in 1889.[673] Several political and democratic interruptions took place. However, democracy was restored in 1985, followed by an enactment of a new constitution in 1988.[674] On the economic side, the Brazilian economy is broad-based and thus includes every type of industry.[675] It is based on a mixed economy, including semi-state companies, foreign-owned companies, state monopolies and small businesses.[676]

The adoption of employee share-ownership schemes continues to gain momentum in Brazil because of the economic benefits offered to employees and companies. The popularity of ESOPs finds justification in the economic argument that it helps with the

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[670] Gouvea R 'Doing business in Brazil: A strategic approach' (2004) *Thunderbird International Business Review* 165.
[671] Gallo F *Doing Business and Investing in Brazi*l (Sao Paulo: PWC 2016), available at https://www.pwc.de/de/internationale-maerkte/assets/doing-business-and-investing-in-brazil.pdf, accessed on 13 April 2021.
[672] Ibid, 12.
[673] Ibid.
[674] Ibid, 13.
[675] Ibid.
[676] Ibid.

alignment of employees' and shareholders' interests.[677] The ESOPs assist employees to acquire share ownership in a company freely through donated shares or at a subsidised price. The shareholders benefit from ESOPs as this motivates employees, which leads to increased productivity[678]and ultimately results in higher profits. Because of this economic advantage Brazil as a member of the OECD, follows the international wave of ESOPs.

This chapter provides a study on the Corporate Laws of Brazil with particular emphasis on ESOPs and how they can be used to promote economic development and wealth distribution.

5.2 Historical Underpinning of ESOPs

The Brazilian Corporate Laws underwent significant changes throughout the country's history. [679] The Brazilian government adopted a Commercial Code in 1850 which regulated basic corporate features: (i) requisite governmental approvals, (ii) transferable shares, (ii) limited shareholder liability, (iii) publicity of constitutional documents, (iv) causes for dissolution, and (v) unlimited management and director liability prior to the company's registration.[680]

In 1882, a more liberal corporate statute was enacted. The underlying purpose of this statute was to abolish the requirement of governmental approval for most corporations.[681] Important portions contained in this statute included provisions relating to the shareholder rights to sue management directly for violations of law, the obligation of members of management to offer security for their administration and the imposition of criminal liability in cases of fraud, improper dividend payments, and irregular liquidation.[682] Furthermore, the 1882 statute provided for continuing seller liability for subscribed but not yet paid-in capital for up to five years after share transfer.[683]

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[677] Voss A ''The tax treatment of employee stock-options: A Brazilian Perspective'' (2018) available at http://dx.doi.org/10.17768/pbl.y6.n9-10. 60, accessed on 20 March 2021.
[678] Ibid.
[679] Pargendler, M 'Politics in the Origins: The Making of Corporate Law in Nineteenth-Century Brazil.
[680] Ibid.
[681] Ibid.
[682] Ibid.
[683] Ibid.

The drafters of Brazil's corporation Law of 1976 maintain ((((that the Brazilian Commercial Code followed the French Commercial Code. ESOPs, which function as a vehicle for the employees to acquire shares in the employer's business were not a feature the Commercial Code.[684]

The study of the legislative landscape of Corporate Law in Brazil before the enactment of the Corporations Act shows that the political will intensively controlled the business environment. The concept of company's legal personality, though inherent in company law, seems to have little force and effect. It was only with the enactment of the 1882 legislation that companies began to function independently with lesser influence from the government. Legal personality ensures that a company is able to acquire rights and duties separate from members.[685] This entails that for companies to function as a corporate body, there must be no external influence from other stakeholders. External influence can result in the company being guilty of corruption and dereliction of corporate duties.

According to Murphy,[686] the stock-based compensation plan, or ESOP, first appeared in the United Kingdom and the United States between 1950 and 1960 to offer agents the right to acquire stocks at a predetermined price for a predetermined duration through contracts. The nature of the ESOP has not gone through many drastic changes since its inception.

The creation of the ESOP is usually credited to Louis Kelso, a San Francisco attorney and investment banker. In 1956, Kelso implemented the first ownership transfer to employees for a San Francisco newspaper what later became known as The Kelso Plan. In 1958, he collaborated with the philosopher Mortimer Adler to write The Capitalist Manifesto outlining the economic, social and political benefits of broad-based employee ownership. In the early 1970s, the concept attracted an important ally, Senator Russell Long of Louisiana, the longtime Chairman of the Senate Finance Committee. Kelso and Long claimed that employee ownership builds commitment, which leads to productivity and profits. They argued that legislation facilitating broader-based ownership would not

[684] Voss (2018) Op cit note 672.
[685] Davis, D *et al* 'Companies and other Business Structures in South Africa' Op cite note 61 at 35.
[686] Murphy, K. J.*Executive compensation. Handbook of Labor Economics* 3 ed (1999) 2485.

only increase corporate performance but also ease workplace tensions, reduce disparities of wealth, and help build a better society.[687] In Brazil, however, as highlighted by Nunes and Marques,[688] this mechanism dates back to the 1970s, greatly due to the U.S. companies installed in the country. Also, according to the authors, the adoption of this mechanism has risen in recent years in the country. It is regulated by Article 168 of Law n. 6,404, of December 15th of 1976, which describes the possibility of paying agents using stock options plans. It is worth mentioning that the Accounting Pronouncements Committee (CPC) also regulates the adoption of stock-based plans, through the CPC or ***Pronunciamento técnico CPC 10 (R1) – Pagamentos baseados em ações*** (Pronouncement Technical CPC 10 (R1) – Share-based payments), highlighting procedures for recognising and disclosing in accounting statements stock-based payment transactions carried out by the entity.

The primary purpose of employee share plans, as advanced by Netto *et al.,* is to promote the interests of the company and its shareholders by retaining, motivating and encouraging employees, officers and services providers to acquire or increase their equity interests in the company, thereby giving them an added incentive to work toward the continued and observed growth and success of the corporation.[689]

ESOPs are regulated in Brazil by the ***Pronunciamento técnico CPC 10 (R1) – Pagamentos baseados em ações*** (Pronouncement Technical CPC 10 (R1) – Share-based payments). This piece of legislation brought by way of a Pronouncement, sets the tone for ESOPs in Brazil by providing that Entities often grant shares or stock options to their employees or other parties. Generally, stock and stock option plans constitute a common feature of the compensation of directors, executives and many other employees. Some entities issue shares or stock options to pay its suppliers and professional service

[687] Freedman S F 'Effects of Adoption and Employee Ownership: Thirty years of Research and Experience'' (2007). Organisational Dynamics Working Paper 2, available at https://repository.upenn.edu/pd-working_papers/, accessed on 10 November 2021.
[688] Nunes, A. de A., & Marques, J. A. V. da C. 2005. "Planos de incentivos baseados em opções de ações: Uma exposição das distinções encontradas entre as demonstrações contábeis enviadas à CVM e à SEC''. *Revista Contabilidade & Finanças*, Vo. 16(38), pp. 57-73. Also available at: https://www.scielo.br/j/rcf/a/FMjm3bfk6sqBs5gqCpPLPQG/?lang=pt, accessed on 6th September 2021.
[689] Netto DF Homsy L et al., 2020. *Employee share plans in Brazil: regulatory overview*. Also available at: www.practicallaw.com/employeeshareplans-guide, accessed on 06th September 2021.

providers. A summary reading of the pronouncement's objectives informs us that the statement's purpose is to specify procedures for recognition, measurement and disclosure, in its financial statements, of transactions with payment based on actions performed by an entity. Specifically, the legislative framework of Brazil requires that the effects of share-based payment transactions be reflected in the entity's results and financial position, including expenses associated with transactions in which stock options are granted to employees. Furthermore, the principal characteristics [690] of the pronouncement provide for an entity to recognise payment transactions based on shares, including transactions with employees or other parties, regardless of the form of settlement: in cash (or other assets) or entity's equity instruments (shares and stock options). Ideally, the pronouncement does not provide for exceptions to the application of the pronouncement, provided that the matter is not the subject of another pronouncement.[691] The pronouncement further provides for measurement principles and specific requirements established for three types of share-based payment transactions; namely: (a) share-based payment transactions settled by the delivery of equity instruments of the entity (usually shares), in which the entity receives products and services in return for these instruments; (b) cash-settled share-based payment transactions, in the which the entity acquires products and services incurring obligations with the suppliers of these products and services, the amount of which is based on the price (or value) of the entity's shares or other equity instruments; and (c) transactions in which the entity receives products and services and the terms of the agreement grant the entity or supplier of these products or services to freedom to choose the form of settlement of the transaction, which can be in cash (or other assets) or through the issuance of instruments of capital.[692]

Additionally, as per the pronouncement for share-based payment transactions settled by the delivery of the entity's equity instruments, the standard requires that the entity

[690] See Section 3 of the *Sumário do Pronunciamento Técnico CPC 10: Pagamento Baseado em Ação,* available at: http://www.cpc.org.br/CPC/Documentos-Emitidos/Pronunciamentos/Pronunciamento?Id=41, accessed on 12th September 2021.
[691] See generally, Section 4 of the *Sumário do Pronunciamento Técnico CPC 10: Pagamento Baseado em Ação.*
[692] Ibid.

measure products and services received directly, i.e., based on fair value of goods and services received, unless such fair value cannot be reliably measured. In the case of compensation to managers and employees, this is usually the case. Then the entity must measure the products and services received based on the fair value of the equity instruments granted, measured on the grant date. Thus, in transactions with employees and other similar service providers, the entity must measure the fair value of the equity instruments granted, usually in the form of stock options, based on the value and fair share of these options on the grant date. In transactions with other parties (other than employees or services providers'), there is a premise that the fair value of the products and services received can be reliably estimated. The fair value will be measured on the date the entity obtains the products or services as provided by the counterparty. In rare cases, if the premise is false, the transaction will be measured indirectly, that is, based on fair value of the equity instruments granted, with the measurement being carried out on the date where the entity obtains the products or where the counterparty provides services. When products and services are measured based on the fair value of the equity instruments granted, the pronouncement specifies that all non-grant conditions are considered in estimating the fair value of capital instruments unless these grant conditions are not concerned with market conditions. The grant conditions must be considered to adjust the number of equity instruments included in the measurement so that the total (cumulative) amount recognised in relation to the products or services received corresponds to the effective amount of instruments granted. Therefore, on an accumulated basis, no amounts will be recognised for products or services received if the corresponding capital instrument granted is not granted due to non-compliance or compliance with some concession condition. Thus, the eventual dropouts from the program and non-achievement of goals.

The standard requires that the fair value of equity instruments granted corresponds to the respective market price, considering the terms and conditions under which the instruments were granted. In the absence of market prices, the fair value will be estimated using some valuation technique to estimate the prices at which the respective equity instruments could be exchanged for, on the date of the measurement, in an unfavourable transaction, between parties knowledgeable on the subject and willing to negotiate. The

valuation technique must be consistent with generally accepted assessment methodologies for the pricing of financial instruments. It must incorporate all factors and known assumptions that would be considered by the participants of the market in setting the price. There is no determination as to a valuation technique in particular. The statement also establishes procedures for cases where the terms and conditions of a stock option granted are modified (for example, when an option is repriced) or when a grant is cancelled, repurchased or replaced.[693]

The pronouncement also provides that, as a rule, shares, stock options or other equity instruments are granted to employees as part of their remuneration package, in addition to salaries and other benefits.[694] In addition, shares and stock options are sometimes granted as part of a bonus payment agreement rather than being granted as part of the basic remuneration of employees. For cash-settled share-based payment transactions, the standard requires the entity to measure the products and services acquired and the corresponding liability assumed, at the fair value of the obligation, on the date the liability was assumed. Until the liability is settled, the entity must adjust the fair value of the liability at the end of each fiscal year and on the date of its settlement, with changes in values recognised in profit or loss for the period. As the fair value of the cost of fees for services needs to be allocated over the period the services are received, the standard determines their distribution by accrual over that period. In the case of share-based payment with settlement in instruments assets (shares, as a rule), the consideration for recognising the expense or cost of the good is an account of the net equity itself. The statement specifies the conditions for payment transactions based on actions in which the terms of the agreement provide that either the entity or the counterparty has the option to choose whether the settlement will be in cash (or other assets) or by issuing equity instruments (in which case the entity must account for this transaction as a share-based payment transaction with cash settlement), and in other situations.[695]

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[693] See Section 6-7 of the *Sumário do Pronunciamento Técnico CPC 10: Pagamento Baseado em Ação.*
[694] Section 10-11 of the Pronunciamento Técnico CPC 10 (r1) Pagamentos baseados em ações Correlação às Normas Internacionais de Contabilidade – IFRS 2 (IASB – BV 2010), available at: http://static.cpc.aatb.com.br/Documentos/211_CPC_10_R1_rev%2014.pdf.
[695] Ibid.

Lastly, the CPC Statement sets forth various information disclosure requirements to enable users of financial statements to understand: the nature and extent of share-based payment arrangements signed during the period; how the fair value of the products and services received was determined or the fair value of equity instruments granted during the period; the effect of share-based payment transactions on the result the entity's period and on its financial and equity position.[696]

Another piece of legislation regulating ESOPs in Brazil is *Article 168 of Law* n. 6,404, of December 15th of 1976 (As amended by the "Brazilian Corporate Law) and the Novo Mercado Listing Rules of B3 S.A. Generally, in Brazil, it is quite common for those employees who hold strategic management positions to be offered participation in an employee share plan. These people are usually members of the board of directors, executive officers, non-statutory officers, general managers and high-level managers, to mention but a few. The aim is to bring at par the interests of such employees and those of the stakeholders. For this reason, Brazil enacted Article 168 of Law n. 6,404/76 to provide a statutory framework on how employees were to participate in these share plans. The provisions of the later law provide as a priority that in the instance where it is authorised by a bylaw under the empowering legislation and within its authorised capital limit, a company can grant a stock option to its officers or employees or to services providers (this will include individuals and entities) under a stock option plan approved by the shareholders general meeting.

Additionally, Article 168 of Law 6,404/76 also codifies a provision governing share option plans recognised under Brazilian law. In terms of this law, the only share option plan provided expressly is the 'stock option plan'. However, because the laws governing corporations are primarily based on contractual obligations, the law in Brazil still recognises other types of share option plans as long as they are derived from a commercial agreement which is valid and compliant with all the requirements for validity. The agreement which recognises the analogous share option plan must be executed by

[696] Sumário do Pronunciamento Técnico CPC 10 (R1). 2010. *Pagamento Baseado em Ações*, available at: http://static.cpc.aatb.com.br/Documentos/212_CPC10_R1_Sumario.pdf, accessed on 6 September 2021.

the parties. The law in Brazil also takes a strict approach when it comes to stock option plans as they are quite often seen as largely granted by corporations and relatively less by limited liability companies.

Furthermore, in 2014, the Brazilian government enacted the Federal Law No. 12,973/14 to, amongst other things, specify the general rules for a company to deduct expenses incurred from share-based payments from its corporate income tax. This legislative framework refers to these forms of payments as a form of compensation for services rendered by employees or similar.

5.3 Suggested Methods for Effecting ESOPs in Brazil

Different types of associations are allowed under Brazilian law to perform economic activities aimed at the production or circulation of goods and services. The company ("Sociedade Anônima S/A") is one of the most common, and the limited business company (LTDA), both should be registered with the Junta Comercial ("Commercial Board"). Furthermore, there are various principles relating to share capital or share plans, in Brazil. Ideally, employees can be offered a share plan where the shares to be acquired are in a foreign parent company, even where the share option plan is provided for in the employees' foreign contract; that is, however, in the instance where the employee is an expropriate.[697] Essentially, companies are governed by their bylaws and byLaw 6404/76 and are extensively recommended when forming joint ventures in Brazil. Hence, the structure of a corporation allows for the adoption of more robust corporate governance practices. The capital stock of a corporation can also be controlled or fully owned by foreign legal entities and/or individuals. The registry is fulfilled when registered at the *Registro Público de Empresas Mercantis* (Junta Comercial). The corporate governance regarding shares in Brazil is that such shares can either be: (i) closely held (securities are not traded on the stock market) or (ii) publicly held (securities are traded on the stock market, subject to Law 6,385/76 and the Normative Rulings issued by the Brazilian

[697] Netto D F Homsy L *et al* Employee share plans in Brazil: regulatory overview (2020) available at: www.practicallaw.com/employeeshareplans-guide, accessed on 06 September 2021.

Securities Commission (*Comissão de Valores Mobiliários* – CVM)), which corresponds to the U.S. Security Exchange Commission (SEC). Furthermore, in Brazil, there exists a share option plan which is as discussed previously, expressly recognised and set out in Article 168 of Law 6, 404/76. This is the so-called 'stock option plan' and other share option plans, provided they are framed within the ambit of the contract governing the commercial dealing amongst the parties. Generally, when it comes to the granting of share option plans the laws of Brazil are governed by common law rules, more especially to the granting of the share option plan recognised within Brazil, which is the 'stock share plan'. Ideally, in granting a stock share plan to an employee under Brazilian law, the following rules are applied:

(a) *Discretionary*: The principle of discretion warrants that the granting of a stock option plan is discretionary, and this applies to all employees. In granting the stock share plan, proper and sound judgement must be employed within the discretion.

(b) *Non-Employee participation*: This rule maintains that when it comes granting stock option plans. Such plans are not exclusively afforded to the employees. The rule suggests that options can be granted to non-employees and consultants, as well as employees.

(c) *Maximum value of shares*: There is no maximum value of shares over which options can be granted. Thus, it is fair to say that there are no quotas imposed on options for share plans in Brazil.

(d) *Market value*: Furthermore, the rules regulating options do not need to have an exercise price equivalent to market value, except where this is expressly required under the plan. However, an exercise price below market value may trigger various tax implications.

In Brazilian Corporate Law, the number of Shareholders is at a minimum of two, and they are entitled to the mandatory dividend. Furthermore, these shareholders enjoy a limited liability limited only to the price of the subscribed or acquired shares. From a legal point of view, corporations have a separate legal identity, and they observe a distinct existence from that of their shareholders. Hence, there is capital autonomy in relation to the partners. In an instance where obligations are incurred on third parties such as creditors,

it is the assets of the corporation that constitute the guarantee of creditors for debts incurred on its behalf. However, it is important to note that this rule is not absolute, because for the protection of third parties, Brazilian legislation sets forth some cases wherein the partners are exceptionally accountable for the debts of the corporation. Such exceptions include situations where there is liability of the controlling shareholder for abuse of power in certain situations, the liability of partners for labour, tax and social security debts, liability for damages caused to consumers, liability for violations of the economic order (Antitrust Law), all arising from the application of the 'piercing the corporate veil' theory. These are exceptions established by law that cannot be quashed by a contractual provision.

Furthermore, the transfer and assignment of shares is free and does not depend on a bylaw change, operating by a term entered into the "Transfer of Registered Shares" book, dated and signed by the transferor and transferee or their lawful representatives.[698]

The Corporations Act defines a corporation as a commercial entity governed by commercial law and practices.[699] In other words, to qualify as a corporation, an entity has to perform activities that yield profits. This is important to distinguish corporations from NGOs and organisations established not for gain. The Act sets out requirements that must be complied with before an entity is incorporated.[700] Corporations are not permitted to issue shares below their part value, and if corporations issue shares below their part value, such transactions shall be rendered void.[701] A company that issues shares below its par value will be operating at a loss. Hence, issuing shares below a par value is not only prohibited by the law but it goes against the business' aim to make a profit.

The Corporations Act, under article 154, expressly recognises employees as stakeholders and authorises the board of directors to take reasonable steps to benefit the

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[698] *The essential Corporate Law in Brazil (ii) Corporations SA,* (2019) available at: https://www.ilpabogados.com/en/the-essential-corporate-law-in-brazil-ii-corporations-sa/, accessed on 13 September 2021.

[699] Article 2 of the Corporations Act (Law 6.404/1976).

[700] Article 80 of the Corporations Act (Law 6.404/1976) provides that there must be a subscription of at least two persons of all the shares; initial payment for the shares subscribed must be received, this amount being total to at least ten percent of the issue of the price of the shares subscribed in cash, and the share capital must be paid into authorised banking institution.

[701] Article 13 of the Corporations Act (Law 6.404/1976).

employees.[702] Although there is no express mention of ESOPs under this particular provision, the interpretation of the words “reasonable gratuitous acts” may be taken to include the establishment and administration of ESOPs. The only difficulty in this form of interpretation is that “gratuitous acts” are placed in the context of corporate social responsibility, while ESOPs are benefits that are granted to employees for their participation in productive economic activities with the view of growing the economy. This line of thought is encapsulated by Article 168 of the Act which allows companies through their bylaws to grant share purchase options to employees. The two requirements that must be complied with are such share purchase options must be within the limits of the authorised capital, and secondly, it must be in accordance with a plan approved by a general meeting. Unlike most national corporate legislations, the Corporate Act of Brazil is quiet on solvency and liquidity considerations before financing ESOPs on behalf of the employees. However, the omission of liquidity and solvency considerations from the national corporate legislation does not mean corporations cannot include them in their bylaws. Having the said considerations in the national legislation would avoid uncertainty and guarantee uniformity.

The legislative and regulatory developments in respect of Corporate Law in Brazil promote economic development and the distribution of income and wealth. The legal framework is the machinery that informs economic growth, and therefore, national laws should continuously change and evolve consistently with international standards and best practices to foster development.

5.3.1 The Availability of Sufficient Share Capital to Effect ESOPs

(a) Rules Affecting the Issuing of Unissued Share Capital and ESOPs

[702] Article 154 of the Corporations Act (Law 6.404/1976).

The prospectus of a company is a founding document in terms of the company law of Brazil.[703] The company's prospectus sets out, amongst others, the amount of capital to be subscribed, how such capital is to be paid up and whether or not a future increase has been authorised.[704] The shareholders are required to pay up for the shares they acquired in terms of the conditions stated in the bylaws or the subscription offer when shares are issued that can be taken upon payment.[705] The statutory rights of shareholders include the right to participate in corporate profits, the right to participate in the assets of the company during liquidation and to supervise the management of the corporate business in accordance with the law.[706] Velasco maintains that shareholders invest in corporations primarily for economic gain. The investment of shareholders in the company entitles them to profit from the company in two ways. Firstly, they profit by receiving distributions of the company's profits and secondly, through the sales of all or part of their interest in the company.[707] As owners, shareholders have the inherent right to oversee the company's affairs. But in most jurisdictions, including South Africa, this right is not expressly included in the legislation. This may be because of the concept of separate legal personality. However, Brazil's position in expressly including this right in the legislation is important for two reasons. Firstly, it gives shareholders a sense of value as owners of the corporation in that they have a say in the affairs of the company. Secondly, it gives shareholders a sense of responsibility. Thus, although directors are responsible for the day-to-day running of the company's business affairs, the shareholders are also responsible for an oversight role in the company's corporate affairs.

(b) Necessity of and Rules Affecting the Increase of Authorised Share Capital for ESOP Purposes

[703] Article 82 of the Corporations Act (Law 6.404/1976).
[704] Article 84 of the Corporations Act (Law 6.404/1976).
[705] Article 106 of the Corporations Act (Law 6.404/1976).
[706] Article 109 of the Corporations Act (Law 6.404/1976).
[707] Velasco J, 'The fundamental Rights of the Shareholder' (2006) University of California Davis Law Review 413. Velasco further maintains that shareholders' rights to receive dividends are limited to the extent that such dividends have been declared by the board of directors. Dividends may thus be declared, and the profits of the company may be reinvested or alternatively, they may be distributed to the shareholders.

The share capital of a company may only be changed as provided for in terms of the Corporate Act and the bylaws.[708] Accordingly, the bylaws shall determine the number of shares into which the share capital shall be divided and also state whether or not such shares shall have a par value.[709]

As stated in the previous section, the prospectus may refer to the future increase in capital. In addition to what was stated in the previous section, article 168 provides that bylaws may authorise capital increases without the need to amend the bylaws. From the procedural point of view, it is advisable for a company to authorise a future increase of capital. This will prevent administrative and procedural hurdles such as amending the prospectus if the company wishes to increase its capital in future. The prospectus must also outline the amount of initial payment to be made upon subscription.[710] This provision is essential considering the general understanding regarding the issue of shares to the effect that shares cannot be taken upon without paying for the value of such shares.

The share capital of the company may be increased only in terms of the authorisation obtained under article 166 as follows:

The share capital may be increased by a resolution made at the annual general meeting. This resolution can be to adjust the monetary expression of its amounts as per article 167. Furthermore, the capital may be increased by resolution of a general meeting or the administrative council, subject to the relevant provisions in the bylaws, in the case of any issues within the limit of authorised shares by the bylaws. Capital may also be increased by converting debentures or founders shares into shares and by the exercise of rights conferred by subscription bonuses or an option to purchase shares.[711] This means that the company may increase its capital in order to implement ESOPs. Lastly, where there

[708] Article 6 of the Corporations Act (Law 6.404/1976).
[709] Article 11 of the Corporations Act (Law 6.404/1976). The South African position, in1973 recognised the distinction between shares with par value and shares with no par value. Section 19 of the said Act in particular provided that 'a company having share capital may either be a public company or a private company having shares of par value of shares of no par value.' However, in terms of the current company law in South Africa, i.e., the Companies Act 71 of 2008, no such distinction is made. Section 35 (2) in particular provides that a share does not have a nominal or par value subject to Schedule 5, which mainly deals with transitional arrangements, i.e., from 1973 to 2008 Act.
[710] Article 84 of the Corporations Act (Law 6.404/1976).
[711] Article 166 of the Corporations Act (Law 6.404/1976).

is no express authorisation to increase the capital or if such authorisation has been exhausted, a company may still increase shares through the amendment of the bylaws at an extraordinary general meeting convened for that particular purpose.[712]

It is clear from the above discussion that in terms of the company laws of Brazil, a company, i.e., the directors, can obtain authority to increase capital, in particular, to implement ESOPs in one of the two forms. The first form can be termed as 'general authorisation' provided for in the company's prospectus. In terms of this form, the prospectus of the company outlines from the onset that the share capital of the company may be increased in the future to implement ESOPs. This approach may be particularly useful for new companies or companies that have been established with the sole objective of creating and implementing ESOPs. Suppose it so transpires that the share capital of a company is not sufficient for ESOPs, the directors can use the provisions of section 166 to increase the capital and implement ESOPs. The second form in which the company can obtain authority to increase capital to implement ESOPs involves seeking a resolution through an extraordinary meeting to first amend the bylaws in order to increase capital and thereafter implement ESOPs. The latter approach involves a lengthy procedure. First of all, an extraordinary meeting must be convened.[713] The proposed amendment of the bylaws must be registered and published before it can be enforced against third parties.[714] Within thirty days of the registration of the proposed amendment, the company's officers must publish such amending documents and a certified copy of the registration document in the official newspaper of the corporations' head office.[715] Furthermore, the commercial registry is required to inquire whether the incorporation complied with the legal requirements and whether the bylaws include any provisions that may be contrary to the law of public order or decency. The commercial registry may deny the registration of the amendment of the bylaws if the company fails to comply with the

[712] Article 166 of the Corporations Act (Law 6.404/1976).
[713] Article 35 of the Corporations Act (Law 6.404/1976).
[714] Article 35 paragraph (1) of the Corporations Act (Law 6.404/1976).
[715] Article 98 of the Corporations Act (Law 6.404/1976).

legal requirements or for any other irregularity.[716] In the case of such denial, the officers must immediately call a general meeting to correct the omission or irregularity.[717]

Amending the bylaws to increase capital to implement ESOPs is a lengthy process. Therefore, it is advisable that the company, in its prospectus, makes a provision for increasing capital to implement ESOPs at a later date. This procedure would significantly reduce the time spent on administrative duties implementing ESOPs.

(c) Share Buy-Backs and ESOPs

According to Brazilian Company law, a company may not trade in its own shares, as a general rule.[718] The law, however, provides exceptions to this general rule. Thus, a company is allowed to trade in its shares under the following circumstances:

Where the company redeems, refunds, or does an amortisation in accordance with the law;[719] in terms of shares acquired to be held in the company treasury or cancelled, limited to the amount of the balance of profits or legal reserve, provided that it does not reduce the corporate capital. This includes the sale of shares so acquired;[720] dealings in shares acquired by donation;[721] and lastly, in terms of "*the acquisition of shares, when resolved that the capital will be reduced through a cash refund of part of the value of the shares, their stock exchange price is less than or equal to the amount to be refunded."*[722]

Share repurchase or redemption relates to the paying of the value of shares to withdraw it from circulation.[723] In accordance with Article 44, the bylaws or an extraordinary meeting may authorise the allocation of profits or reserves to the redemption of shares. It shall set out the conditions and the procedure for this purpose. Shareholders who represent at least half of the shares of the affected classes must approve the redemption of shares at

[716] Article 97 paragraph (1) of the Corporations Act (Law 6.404/1976).
[717] Article 97 paragraph (1) of the Corporations Act (Law 6.404/1976).
[718] Article 30 of the Corporations Act (Law 6.404/1976).
[719] Article 30(a) of the Corporations Act (Law 6.404/1976).
[720] Article 30 (b) and (c) of the Corporations Act (Law 6.404/1976).
[721] Article 30 (b) and (c) of the Corporations Act (Law 6.404/1976).
[722] Article 30 (d) of the Corporations Act (Law 6.404/1976).
[723] Article 44 paragraph (1) of the Corporations Act (Law 6.404/1976).

a general meeting called for this specific purpose for the redemption to be effective. The bylaws may fix different conditions, which should be followed for the redemption of shares to be effective.[724]

A share buy-back has various advantages for the company. Firstly, it allows greater flexibility[725], because the company generally does not have any duty to conduct a share buy-back programme.[726] Therefore, this means that although there is provision in the bylaws, it is not a mandatory requirement that all companies should conduct a share buy-back. However, companies that are operating in ESOPs must comply with the bylaws.

Another benefit associated with share buy-backs is that it offers tax incentives to the company[727] ,because share buy-backs have a lower capital gain tax than the dividend tax rate.[728] Since share buy-backs are taxed in terms of capital gains, investors will opt for share repurchases instead of cash dividends.[729]

5.3.2 The Adequacy of Requirements and Methods of Financing the ESOP transaction

(a) Provision of the Share Purchase Option

The Brazilian company law allows companies to include a provision in the bylaws regarding a share purchase option.[730] This gives companies a latitude to come up with requirements and conditions to be complied with before share options can be exercised in the company. This form of arrangement is extremely helpful because not all companies are the same and, therefore, the conditions to be complied with may vary.

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[724] Article 44 paragraph (6) of the Corporations Act (Law 6.404/1976).
[725] Buy Back Analytics, available at https://buybackanalytics.com/advantages-and-disadvantages-of-share-buybacks/, accessed on 01 October 2021.
[726] Ibid.
[727] Ibid.
[728] Ibid.
[729] Ibid.
[730] Article 168 paragraph (3) of the Corporations Act (Law 6.404/1976).

One of the conditions that may be set out in the bylaws is the financing of shares by the employees in line with the general requirement that shares may not be issued at a price below their par value.[731] This means that, as a general rule, employees must pay the value of the shares before they can subscribe to such shares and enjoy the rights attached to them.

A company may also decide to donate shares to employees. Donation normally takes place where the company is in a financially healthy position not to be impoverished by such a transaction of donating shares. The company laws of Brazil do not expressly require compliance with solvency and liquidity tests before the donation of shares to employees can be made. However, to ensure that the company remains profitable and has sufficient assets to finance its liabilities, it is crucial to comply with the solvency and the liquidity test. These tests can be done by analysing the financial statements. In accordance with article 176, a company is required at the end of each fiscal year to prepare a balance sheet, a statement of retained earnings, an income statement and a statement of changes in the financial position.

(b) Mandatory Offer Rules and Implementation of ESOPs Through Empowerment Deals

The mandatory offer rule is divided into two broad categories in terms of the Corporate Act (Law 6.404/1976), namely, the merger of controlled corporations and the acquisition of control by a public offer. In order to ensure the meticulous outline and discussion of the rules, the rules pertaining to the merger of corporations are discussed separately from the acquisition of control by a public offer.

Generally, in terms of the law, the merger of all the shares of a corporation into assets and liabilities of another Brazilian corporation to convert the former into the other wholly-owned subsidiary must be approved by the general meetings of both corporations.[732] Once this transaction is approved, it must subsequently authorise the capital increase to

[731] Article 14 of the Corporations Act (Law 6.404/1976).
[732] Article 252 of the Corporations Act (Law 6.404/1976).

be effected with the merged shares and appoint experts to value such shares. [733] Subjecting the merger to the approval by the general meetings of both corporations ensures transparency and limits any possibility of fraud or corporate misconduct.

(i) Merger of Controlled Corporations

The first rule in terms of the merger of controlled corporations relates to the general meeting and the information to be provided at such a meeting. At the said meeting, the information outlined in Articles 224 and 225 and the calculation of the share exchange ratio of shares owned by the non-controlling shares of the controlled corporation, must be provided.[734] Furthermore, the assets and the liabilities of both the controlling and the controlled corporations must be presented. The calculations must be based on the net values of the assets and liabilities on the same date and at market prices.[735]

Secondly, the assessment of the assets and liabilities of the two corporations shall be done by at least three (3) experts or by a specialist firm. Where the take-over involves a publicly-held corporation, the assessment must be done by a specialist firm.[736] This ensures that the assessments are correct and a true reflection of the company's affairs.

Thirdly, the dissenting shareholders have a right to choose between the refund value determined in accordance with section 45 and the value adjusted in accordance with the provisions of Article 264. This choice may become applicable where the exchange condition provided for in the merger protocol is less advantageous than that resulting from the comparison made in terms of Article 264.

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[733] Article 252 Paragraph 1 of the Corporations Act (Law 6.404/1976).

[734] Article 264 of the Corporations Act (Law 6.404/1976). Article 224 and 225 relate to the protocol conditions and reasons for the merger. The Protocol conditions require that amounts to the information must include the number, type and class of shares that shall be attributed in substitution for extinguished rights and information as to how the shares or quotas owned of one corporation will be dealt with.

[735] Article 264 of the Corporations Act (Law 6.404/1976).

[736] Article 264 paragraph 1 of the Corporations Act (Law 6.404/1976).

The last rule relates to the exclusion of a public offer or acquisition of shares through a stock exchange.[737] This rule, therefore, necessitates the discussion of the rules of acquisition through a public offer separately.

(ii) The Acquisition of Control by Public Offer

Firstly, for a share of a publicly held corporation to be traded, thirty per cent of its issue price must be paid.[738]

The second rule calls for the participation of a financial institution to guarantee the fulfilment of the liabilities undertaken by the bidder before an offer can be made to acquire the control of the corporation held publicly.[739]

Thirdly, registration with the Securities Commission is required where the offer relates to a total or partial exchange of securities.[740]

The fourth rule requires that the offer comprise adequate voting shares to ensure the corporation's control, and such an offer shall be irreversible.[741]

Fourthly, because the rationale of the takeover is to ensure control, if the bidder already holds voting shares in the corporation, which is the subject of the takeover, the offer may only relate to the number of shares required to effect the control.[742]

Fifthly, it is required that the public offer may only acquire control if such is issued by the Securities Commission.[743] This requires transparency and procedural fairness because the Securities Commission will only issue such control for acquisition if all procedural requirements as set out in the law have been complied with.

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[737] Article 264 paragraph 5 of the Corporations Act (Law 6.404/1976).
[738] Article 29 of the Corporations Act (Law 6.404/1976).
[739] Article 257 of the Corporations Act (Law 6.404/1976).
[740] Article 257 paragraph 1 of the Corporations Act (Law 6.404/1976).
[741] Article 257 paragraph 2 of the Corporations Act (Law 6.404/1976).
[742] Article 257 paragraph 3 of the Corporations Act (Law 6.404/1976).
[743] Article 257 paragraph 4 of the Corporations Act (Law 6.404/1976).

The sixth rule relates to the publication of the instrument of the offer to purchase and provides that such an instrument shall be published in the press, stating the minimum and maximum number of shares that the bidder intends to acquire.

The last rule pertains to the negotiation during the offer and states that the Securities Commission may issue rules that govern the negotiation of shares offered during the offer period.

Some observations can be made regarding the mandatory offer rules outlined above. Firstly, it is noticeable that Brazilian law distinguishes between a public offer and the merger of a controlled corporation. This is because the public companies are large, and the rules pertaining to a public order ought to be different from those applied to a merger of a controlled corporation.

Another noticeable feature is the reference made to negotiation during the offer period. The normal principles of offer and acceptance under the law of contract are based on consensus, and therefore, it is important that the statute refers to 'negotiations during the offer'. However, it is regrettable that the statute does not explicitly state that the parties are entitled to negotiate prior to the acceptance of the offer. One could argue: the fact that the Securities Commission has the mandate in terms of the legislation means the parties must negotiate during the offer period. Negotiation is a crucial aspect of reaching mutual consent as each party gets an opportunity to scrutinise the conditions set before them. In the case of mandatory offers, minority shareholders' rights need to be afforded maximum protection and negotiation may be one of the ways in which this protection may be afforded.

By extension to the above observation, the Corporate Law of Brazil requires that the selling of control of the publicly held corporation can only take place if the purchaser agrees to conduct a mandatory offer to acquire shares. [744] This again brings us to the concept of mutual understanding and agreement between the parties to the transaction. Hence, the transaction is based on consensus, which is the basis of concluding an agreement. The reliance on the law of contract principles of offer and acceptance ensures

[744] Testa P, 'The Mandatory Bid Rule in the European Community and in Brazil: A Critical View' (2006) 15.

that the non-controlling shareholders are not pressured to tender their shares.[745] This means that employee-shareholders who are minority shareholders will be well protected in the event that ESOPs are effected as far as the mandatory offer rule is concerned.

A further observation made from the rules on mandatory offers relates to the valuation of shares by experts. This ensures that those required to sell their shares receive a fair value for their shares. Furthermore, the feature relating to the authorisation of capital increases is worth noting. Capital increases are important inensuring that new shares are issued to achieve a particular aim. For example, where a merger takes place, and ESOPs are to be effected through such a merger, capital increases would enable the newly formed corporation to effect ESOPs.

It is important to note that all shareholders, including employee shareholders, must be equally treated where there is a change in controlling ownership, and thus, any share must control the premium that is paid to the former controlling shareholder.[746] Furthermore, as is the case in most jurisdictions, shareholders in Brazil may not be forced to remain in a corporation and thus have a right to exit if there is a change of control of the corporation.[747] There is a likelihood that after the change in control of the corporations, conflicts may occur. Thus, it is advisable to allow the minority shareholders to exit the corporation if they so wish to avoid these conflicts.[748]

The identity of controlling shareholders largely influences the performance of companies because their choices depend on their interests.[749] In other words, the actions of controlling shareholders are geared towards achieving maximum benefits for themselves. If care is not taken, controlling shareholders may even triumph over the interests of minority shareholders. Under Brazilian law, dissenting shareholders can sue the corporation's management, directors, majority shareholders, or even a single shareholder.[750] A minority shareholder of a Brazilian firm may recoup any damages

[745] Ibid at 37.
[746] Ibid at 15.
[747] Ibid at 18.
[748] Ibid.
[749] Ricardo P.C *et al* 'An evaluation of board practices in Brazil" Corporate Governance (2002) 21.
[750] Fernandez J W ''Corporate Caveat Emptor: Minority Shareholder Rights in Mexico, Chile, Brazil, Venezuela and Argentina', (2001) 32 (2). *U.Miai Intter-Am. L. Rev* 26

caused by "abuse" of his dominating position from the "controlling shareholders" in addition to legal action against the company's managers. Generally, in Brazil, the minority shareholders are hesitant to take control of shareholders and/ or the corporation to court because the cost associated with the lawsuits is often times greater than the amounts of money in dispute.[751]

Regardless of the arguments that may be advanced against the mandatory offer rule, such a practice is important as it affords protection to non-controlling shareholders.[752]

5.4 The Influence of Labour Law on ESOPs

5.4.1 Labour laws

The Federal Constitution of 1988, as amended, and the Consolidation of Labour Laws of 1943 regulate labour relations in Brazil. The constitution recognises labour as a social right.[753] This can be controversial as some may argue that the right to labour is the best place as an economic right. This is so because once someone is employed, he or she can contribute meaningfully towards the country's economic development through the payment of taxes and other means. Another aspect that favours recognising labour as an economic right relates to the payment of one's salary. Aspects surrounding compensation fall squarely in the economic sphere of rights. On the converse side, it may be argued that a labour right is a social right. Ideally, the right to labour has to do with being granted the opportunity to work. Social aspects such as gender, race, educational qualifications and social class may inform a person's right to labour or the extent to which such a right may be exercised. Despite the resultant controversies, what is commendable is the fact that there is constitutional recognition of the right to labour. The discussions around the recognition of labour right are important to this thesis for two reasons. Firstly, unemployment promotes poverty and the act of being able to exercise the right to labour through employment helps fight poverty. Secondly, issues surrounding labour are

[751] Ricardo P.C *et al* 'An evaluation of board practices in Brazil" Corporate Governance Op cit note 749.
[752] Testa P 'The Mandatory Bid Rule in the European Community and in Brazil: A Critical View' (2006) Op cit note 744.
[753] Article 6 of the Constitution of Brazil.

important to ESOPs. One must be able to exercise the right to labour first before being a participant in ESOP. Employment is crucial, especially in a developing country that seeks to reduce the gap between the rich and poor. Furthermore, the constitution guarantees the provision of social assistance to promote integration into the labour force.[754] Clearly, this is an important transformative provision of the constitution. Some employees require skills development and education upgrade, for proper integration into the labour force.

An important development of labour law in Brazil is the establishment of independent labour courts and judges.[755] It is desirable for parties to the employment relationship to resolve their disputes out of court and through other means. However, the existence of independent labour courts illustrates the importance of labour relations and guarantees employees an independent forum through which they can enforce their rights. The judicial system of resolving employment disputes in Brazil is similar to South Africa. In South Africa, there is a specialised labour court dealing with employment disputes.[756] The labour court judges deal solely with labour matters. This striking similarity between South Africa and Brazil illustrates the importance of using Brazil as a comparative jurisdiction in this study.

Inclusive employment plays an important role in reducing inequality. The legislative and policy framework should prevent discrimination and unfair treatment with regard to employment activities. The constitution being the supreme law has set the tone by expressly prohibiting discrimination on any of the enumerated grounds. Employers may not discriminate when hiring or compensating employees based on their sex, age, colour, or marital status.[757] However, affirmative employment programmes may be necessary to integrate the previously disadvantaged groups of persons into the labour market. Though affirmative action policies may solely not address inequality, they may aid and bring about noticeable changes when infused into economic policies based on entrepreneurial law.

[754] Article 204 of the Constitution of Brazil.
[755] Fernandes J R L Labor Law CLT and the 2017 Brazilian Labor reform 2017, available at http://dx.doi.org/10.17768/pbl.a5.n7-8.p210, accessed on 24 March 2021.
[756] Section 157 (2) (a) of the Labour Relations Act of 66 of 1965 as amended.
[757] Article 7 of the Constitution of Brazil.

In Brazil, it is generally observed that the judicial system favours and protects employee rights as opposed to creditors' and shareholders' rights.[758] Furthermore, the Bankruptcy law prioritises labour and fiscal debts as opposed to any other form of debt, whether secured or not.[759] This approach could most likely be based on the notion that the employer has a better bargaining power and the power of authority. Thus, judicial protection should be given to employees to maximally protect their rights and interests. This approach will most certainly benefit employee-shareholders in terms of ESOPs, as they are first and foremost employees before they are shareholders. South African judges need to be accommodating to employee rights, assisting employees in enforcing their rights are such rights stand to be violated. Hence, learning from Brazil is a necessity.

5.5 The Role of the Constitution in Fostering Economic Transformation

As a developing country, the general policy of the Brazilian government has been to promote economic growth and fight poverty.[760] As in the case of many developing countries, the development agenda has been negatively affected by the prevailing problems related to the difficulties in reducing the foreign debt and the introduction of high interest rates to assist with reaching the developmental agenda. [761] Brazil has become famous for its export ability in such fields as soya, steel, cotton, oil, biofuels and regional aircraft. Resultantly, there has been a decline in income inequality and the incidences of extreme poverty. Brazil is thus an example of the compatibility of growth and equity. [762]

The constitution expressly recognises the need to eradicate poverty and substandard living conditions and reduce social and regional inequalities.[763] The constitutional recognition of the need to eradicate poverty calls for the enactment of legislation which

[758] Ricardo PC *et al* 'An evaluation of board practices in Brazil" Corporate Governance, Op Cit note 746.
[759] Ibid.
[760] Ibid.
[761] Ibid.
[762] Edmund Amann Werner Baer Brazil as an emerging economy: a new economic miracle? *Brazilian Journal of Political Economy*, available at http://dx.doi.org/10.1590/S0101-31572012000300004, accessed on 07 May 2021.
[763] Article 3 of the Constitution of Brazil.

addresses poverty and fosters economic growth. Furthermore, the constitution prohibits discrimination based on origin, race, sex, colour and age. [764]

In terms of Article 5 of the Constitution, foreign capital is afforded the same legal treatment as local capital. This is important as a way to attract and maintain foreign investment for economic development and wealth creation. This protection and treatment will encourage foreign companies to incorporate new business ventures in Brazil, employ the local personnel and introduce ESOPs. All of these can contribute positively to the fight against poverty. The transformation trajectory also calls for affirmative action procedures.

5.6 Economic Empowerment Programmes and ESOPs

5.6.1 The Economic Freedom Act

The purpose of the Economic Freedom Act is to stimulate the country's economic development agenda. This statute advocates for the principles of free enterprise and minimal state intervention and influence in the economy.[765] Furthermore, the Act has introduced a new set of rules to facilitate how business is conducted.[766] Ultimately, the goal is to foster new businesses and increase economic activities across various sectors.[767] Brazil is a developing country, and hence, the enactment of this Act will certainly promote entrepreneurial principles of competition and free trade, and these are activities contribute to economic growth and development. The legislature that has enacted legislation that promotes economic development must be applauded. Most jurisdictions have enacted legislation that indirectly promote economic development, but Brazil's position is a clear example of the legislature's intention to actively promote and foster economic growth. The enactment of the Economic Freedom Act will most likely encourage people to start businesses and those already conducting business activities to continue to do this. Furthermore, encouraging economic and enterprise freedom will

[764] Ibid.
[765] Silva, C Martins R ''The Economic Freedom Act and its impact on the Brazilian investment fund industry'' (2020) available at http://www.ibanet.org/Article/NewDetaul.aspx, accessed on 16 April 2021.
[766] Ibid.
[767] Ibid.

encourage businesses to implement ESOPs. As shown throughout this thesis, ESOPs offer benefits not only got the employee-shareholders but can also foster the country's economic development.

The Brazilian stock market is one of the most developed among emerging markets, and the Brazilian economy is one of the world's top ten.[768] The continuous economic growth and development of Brazil make it to be the centre of jurisdiction regarding talks of poverty reduction in developing countries.

5.6.2 Foreign Capital Law

The primary piece of legislation that regulates foreign investment in Brazil is the Foreign Capital Law enacted in 1962 and amended in 1964.[769] The Act enables the international community to carry out investment activities in an existing company or incorporate a new local company.[770] According to the law, foreign investment, relates to any goods, machines and equipment brought into Brazil as well as funds brought into the country to for economic activities.[771] Foreign capital must be registered with the Central Bank of Brazil.[772] This is important for control purposes as well as transparency, and this helps to guard against money laundering and corruption.

The foreign investment laws and policies are available for public access through the Brazilian Access to Information Law. It is important for potential investors to have access to information to enable them to make informed decisions with regard to their intended investments.[773]

The government of Brazil has also established several institutions that promote investment. This includes the Brazilian Trade and Investment Promotion Agency, the

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[768] Ricardo P.C *et al* 'An evaluation of board practices in Brazil" Corporate Governance Op cit note 749.
[769] World Bank "*2019 Investment Policy and Regulatory Review – Brazil*" (World Bank, Washington, DC. 2020, available at https://openknowledge.worldbank.org/handle/10986/33602, accessed on 13 April 2021.
[770] Ibid.
[771] International Capitals and Foreign Exchange Market in Brazil, available at https://www.bcb.gov.br/rex/LegCE/Ingl/Ftp/International_Capitals_and_Foreign_Exchange_Market_at_Brazil.pdf, accessed on 18 April 2022.
[772] Ricardo P.C *et al* 'An evaluation of board practices in Brazil" Op Cite no. 746.
[773] Ibid.

Brazilian Board of Foreign Trade and Investments, and the National Investment Committee (Coninv).[774] The Brazilian Trade and Investment Promotion Agency was created in 2003 as an independent government agency to promote Brazilian products and services abroad and attract foreign investment.[775] This initiative is important as it not only promotes foreign investment but helps to grow the local market, which is essential for local development.[776] The Brazilian Board of Foreign Trade and Investments was established in 1995 to promote trade, investment, and Brazil's international competitiveness.

Labelling Brazil as an investment hub could be very much accurate, because of the progressive move it has followed in encouraging trade and investment. It has created the Manaus Free Trade Zone to boost economic development.[777] To achieve this, Brazil offers benefits to companies established in the zone.[778] These benefits include reducing import tax, total exemption on the industrialised products for products to be sold in Brazil, and reducing income tax applicable to legal persons. The continued existence of the Zone, at least until 2073, is guaranteed by the 83rd constitutional amendment of 2014.[779]

Furthermore, Brazil's solid and continuous economic growth can also be credited to the strengthening of enforcement bodies such as the federal police, financial intelligence unit, public prosecutor, competition watchdog and tax authorities.[780] The proper functioning of such bodies helps to fight corruption and ensures that resources are used to meet the country's developmental goals.

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[774] Ibid.
[775] Ibid.
[776] The implementation of ESOPs requires resources and a well-functioning business. Therefore, growing the local market is key to the aim of implementing and operating ESOPs.
[777] Castilhos G V 'A Special Economic Zone in Brazil: The Manaus Free Trade Zone' Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2801920 accessed on 07 May 2021.
[778] This companies include Sony Brasil Ltda, Pepsi Colo Industrial D Amazonia Ltda, Nokia do Brasil Techologia, Philips Do Brasil Ltda. See Castilhos, G.V ''A Special Economic Zone in Brazil: The Manaus Free Trade Zone'', available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2801920, accessed on 07 May 2021.
[779] Castilhos G V 'A Special Economic Zone in Brazil: The Manaus Free Trade Zone' Op cit note 777.
[780] OECD Economic Surveys Brazil 2020, OECD Publishing, Paris, (2020) available at https//.doi.org/10.1787/25024. available at https://www.oecd.org/about/secretary-general/oecd-sg-remarks-2020-oecd-economic-survey-of-brazil-16-december-2020.htm, accessed on 08 May 2020.

5.6.3 Tax Laws

The income tax law of Brazil is silent on whether stock options granted in terms of the companies' plans should be treated as compensation income or investment income.[781] However, the tax authorities demand that stock options be treated as compensatory income requiring social security contributions from companies. The reasons for this include the fact that employees are allowed to purchase shares at lower prices as opposed to the market value and thereafter resell them at higher values.[782] However, where stock options serve an investment purpose, the payment of social security would neither be due nor expected.[783] The uncertainty pertains to whether the income earned by employees relates to remuneration earned as a result of work done or income derived from a commercial agreement.[784] Thus, an assessment regarding the requirement of contributing towards social security in respect of ESOPs must be done on a case-by-case basis. The Brazilian Federal Revenue Service views gains received through stock options as profit earned from the remuneration of the work performed for the company.[785] If this view holds true, then financial obligations should be performed by the company in respect of social security payments for stock options. Having a financial obligation in the form of social security contributions may discourage firms from adopting and implementing ESOPs.

5.6.4 Clean Company Act

Corruption has severe consequences on a country's economy as it may slow down the economic development of the country. The Brazilian government enacted the Clean

[781] Voss (2018) op cit note 677.
[782] Ibid.
[783] Ibid.
[784] International Tax Review 2018, available at Internationaltaxreview.com/article/b1f7n1397b6sws/controversy-about-the-tax-treatment-of-stock-option-plans-in-brazil, accessed on 13 April 2021.
[785] Ibid.

Company Act to curb corporate corruption. The said legislation applies to corporations and associations in Brazil and foreign companies with any presence in Brazil.[786] The new law outlines certain acts as prohibited, amounting to bribery.

The prohibited acts include any promise or gift, whether directly or indirectly, and undue advantage to a related third party or public agent; the act of paying for or sponsoring the performance of a prohibited act; using a natural or juristic person to conceal its real interests or the identity of the beneficiaries of the acts performed; fraudulently creating a legal identity to participate in any advantage.

The Clean Company Act does not only have a domestic application but binds both local and foreign officials. In other words, it prohibits bribery of both local and foreign nations.[787] Therefore, any foreign company that has an office, branch or representation in the Brazilian territory can be held liable for any prohibited conduct committed in terms of the law.[788]

The enactment of the Clean Company Act was a progressive move by the Brazilian government to attract foreign investment. Corruption has severe consequences for the country and its citizens. It depletes the resources of an organisation, and it prevents those that could have benefited from the resources with the result of leaving the less privileged ones in a socially and economically worse off position. No international and/or corporation wants to carry on business in a country with high levels of corruption and bribery. Legislative and policy measures taken against fighting corruption reassure the international business community of Brazil's stance on corruption. This will attract and retain foreign investment leading to economic growth and development. ESOPs will thrive in an economy that continues to grow.

5.7 Practical Aspects of Employee Share-Ownership Plans

[786] Ibid.
[787] Tobolowsky Z B "Brazil Finally Cleans Up Its Act with the Clean Company Act: The Story of a Nation's Long-Overdue Fight Against Corruption" 2016 *Law & Business Review America* 383.
[788] Ibid.

SEBRAE (*Sevico Brasileitro de Apoio as Mirco e*) is an institution supporting the development of small and micro companies in Brazil.[789] The government established SEBRAE in 1972 and managed it until 1990, whereafter it became private with the aim of promoting competition between companies.[790] This is essentially important for economic growth as competition leads to development. SEBRAE provides consulting services, training, financial services and access to markets. Training offered by SEBRAE includes individual entrepreneurship.[791] Although SEBRAE as an institution does not necessarily focus on ESOPs, it assists corporations to gain in-depth knowledge and understanding of entrepreneurial policy. This is important in a developing country as training of this sort can help promote investment and development.

5.7.1 Cas Tecnologia

CAS is a company which applies technology, science and engineering to develop solutions that solve critical problems for its clients.[792]

CAS enables employees at all levels and in all areas to have the right to purchase shares in the company after working for at least a year for the company. The founders of CAS value the dedication and commitment of employees, and thus, they have founded the company's participatory management based on employee ownership.[793]

5.7.2 SEMCO

SEMCO is a manufacturing company that was founded in 1952, and it has three important values, i.e., employee involvement, profit sharing and information. Owners of SEMCO believe that these three values are interwoven, and one would be meaningless without the other.

[789] Ibid.
[790] Ibid.
[791] Ibid.
[792] Ibid.
[793] Article 26 of the Constitution of Brazil.

In order to use a profit-sharing scheme as a mechanism to encourage employees, according to SEMCO, it is important to make employees understand how their work contributes to profits and how these profits are divided. Another important feature of SEMCO regarding employee participation is that it affords its employees the opportunity to learn how to read and understand numbers. Requiring or allowing employees to participate in the company's affairs without enabling them to understand issues relating to their participation in the company's affairs could be very disastrous.

5.8 Brazil's Approach to Economic Growth to Date

Article 170 of the Federal Constitution of Brazil guarantees a system based on free enterprise. This system of free enterprise is founded upon the principles of national sovereignty, private property, free competition, consumer protection and environmental protection.[794]

Brazil is a global commodities powerhouse and a leading exporter of animal products such as meat and chicken, grain such as soya and beans, and sugar. Through its state-owned company called Petrobras, Brazil has discovered a mega oil field, and this places Brazil amongst the top oil-exporting countries.

Imports to and exports from Brazil are controlled by the foreign trade department of the Central Bank of Brazil (BCB). Previously, Brazil had set up trade barriers to industrialise and develop local industries.[795] It is important to develop the local industry as it assists with increasing the national exports.[796] But if care is not taken, trade barriers may have adverse consequences on the country's economy. To avoid this from happening, barriers to trade and imports were gradually reduced, thereby allowing fair trade and competition.

[794] Section 170 of the Federal Constitution of Brazil.
[795] Gallo Op cit note 671.
[796] Ibid at 142.

Foreign investment is constitutionally guaranteed and highly encouraged, provided it is in the national interests and promotes the long-term commitment to economic development.[797]

Brazil has taken progressive steps to make trade, that is, imports and export transactions, less burdensome and simplify its customs processes.[798] In 2014, customs introduced the 'blue line' regime to improve its efficiency. In terms of this regime, the goods of the authorised importers with strong internal control systems are preferentially directed towards the so-called green channel, for which clearance is automatic.[799] Scanners were also introduced in 2006, where customs premises are equipped with modern-day scanners that permit non-invasive inspection. This development exempts the uploading of physical cargo for inspection, significantly reducing the clearance time at customs. Furthermore, in 2009 the government of Brazil introduced a computerised system that processes all custom procedures, monitors imports and shortens customs clearance. [800]

The government has also taken steps to reduce the administrative burden faced by the importing countries before their products enter Brazil. In the past, importing countries had to fill in approximately 935 fields in different forms, which hindered the import process.[801] The new system has introduced a paperless ports system to reduce the use of forms and make the administration of importing goods more friendly.[802]

Despite the noticeable achievements made in Brazil, the policymakers are still faced with some difficulties in promoting sustainable economic growth due to employment-related issues and poverty-alleviation challenges.[803] Hence, there is a need to continuously revisit existing legislation and policies to address gaps hampering unemployment and poverty alleviation.[804] Where the existing legislation and policies prove to be outdated, new pieces of legislation must be enacted to promote economic growth and development

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[797] Ibid at 143.
[798] Brandi C 'Successful trade promotion: Lessons from emerging economies'' (London: ODI 2013) 33.
[799] Ibid at 34.
[800] Ibid.
[801] Ibid.
[802] Ibid.
[803] Polaski S *et al.,* 'Brazil in the Global Economy: Measuring the Gains from Trade', available at https://carnegieendowment.org/files/brazil_global_economy.pdf, accessed on 30 September 2021.
[804] Ibid.

adequately. Furthermore, apart from enacting legislation, the policymakers must also take an innovative approach to testing the efficacy of the institutions created to promote economic development. Hence, both legislative and institutional refining and reform are necessary for addressing the issue of economic growth adequately.

Ultimately it is important that policymakers continuously study the evolving business strategies to improve the soundness of trade and investment policies.[805] For trade policies to adequately foster trade and development between trading partners, it is important to monitor economic issues of competition, taxation, and customs regulation.[806] These economic issues, to a greater extent, influence trade and development between the trading partners.

5.9 Application of the Bill of Rights in the Brazilian Context

As indicated in chapter 4, the ability to access basic resources may indicate one's social class and income and wealth status. Brazil has made efforts to provide a constitutional guarantee to socio-economic rights. But poverty hinders persons of certain class structures from accessing the said resources. Poverty alleviation may be the answer, and ESOPs can be an attractive way to achieve property ownership and access to basic resources. This section discusses the constitutional mandate of guaranteeing socio-economic rights and the ability to access and enjoy such rights.

5.9.1 The Right to Food

In terms of its social rights, the constitution grants powers to administrative bodies such as the Union, Federal District and Counties to promote agricultural and livestock production and organise food supply.[807] This provision implies that the government of Brazil will take progressive steps to ensure that there is enough supply of food for local

[805] OECD ''Hamlet without the Prince of Denmark: can we talk trade policy without considering investment?'', available at http://www.oecd.org/trade/topics/trade-and-investment/, accessed on 24 March 2021.
[806] Ibid.
[807] Article 23 of the Constitution of Brazil.

consumption. This gives powers to the aggrieved persons to bring a claim against the government should there be insufficient food. However, it is important to note the difference between promoting food supply and the provision of food. The former means that the state will ensure that there is enough food in the country, while the latter implies giving food to the population. In the case of the Brazilian Constitution, the right to food extends to ensuring enough food supply in the country. This means that even if there is enough food in the country and people cannot have access to food because of non-affordability, such people cannot bring a claim against the state or demand food from the state. Because of this, it is important to fight poverty and inequality that would otherwise prevent people from having access to food.

Joisael Alves and others v. General Director of the Alcântara Launch Centre[808]

This is a fundamental case in Brazil where the right to food was scrutinised by the Federal Trial Court in the Judicial Section of Maranhão. In this case, generally an action for the protection of constitutional rights (acción de amparo) was filed by members of a community of African descendants who live in the traditional territory ("quilombola"). Ideally, this action was directed against the activities of an aerospace base located near the community. In terms of the petition, it was alleged that the activities of the aerospace base negatively impacted their traditional forms of production, thus also preventing the members' access to their farm plots. The appellants requested that the launch centre be ordered to cease its activities that prevented the community from farming and harvesting their subsistence crops in their traditional areas. In its judgement, the Court considered the prejudice to be well-founded; it thus granted the action for the protection of constitutional rights and ordered the aerospace base to abstain from affecting the activities of traditional farming by the community of African descendants. In reaching its conclusion, the court relied heavily on Article 3 of the Constitution of Brazil as well as the International Labour Organisation (ILO) Convention No. 169, specifically Article 14.[809]

[808] Judgment No. 027/2007/JCM/JF/MA, Case No. 2006.37.00.005222-7, Judgment of February 13, 2007.
[809] Yupsanis A ILO Convention No. 169 Concerning Indigenous and Tribal Peoples in Independent Countries (2010) *N. J. l. Int. L.* 79(3) 456.

The court further emphasised that the state could not ignore the constitutional protection and that is one of the fundamental objectives of the Federal Republic of Brazil. Brazil is well codified as "to promote the good of all, without regard to origin, race, gender, age, or any other form of discrimination" (Federal Constitution of 1988, article 3, IV), which by extension, therefore, included the traditional communities of African descendants (surviving communities of quilombos), and how the legislature's intention as established under the public policy is to fight discrimination against the traditional ways of life of the indigenous and tribal peoples, pursuant to the publication of Legislative Decree No. 43/2000, ratifying ILO Convention No. 169, which sets out in Article 14: "The rights of ownership and possession of the peoples concerned over the lands which they traditionally occupy shall be recognised".[810]

The court's decision is important from a human rights perspective because it was primarily concerned with the right to non-discrimination and the court reasoned that the right to equality under the law of Brazil is intrinsically connected to the right to food. Thus, as argued by Courts,[811] judicial monitoring of procedural conditions before the state authorities or third parties undertake to evict a group of people is a fundamental safeguard against arbitrary interference both to the rights to food and the right to housing.

5.9.2 The Right to Water

Water is an essential natural resource and therefore requires careful use and management.[812] The constitution provides that the surface or underground waters, whether flowing, emerging or in reservoirs, belong to the state.[813] Furthermore, the ocean and the coastal island areas under their dominion also belong to the state. Lastly, the ownership of water of the state extends to rivers and lake islands within its jurisdiction. The constitution does not provide an express right to water, and given the fact that water

[810] Ibid.
[811] Courtis C "The Right to food as a justiciable Right: Challenges and Strategies" (2007) *M. P. Y. U. N. L.* 11 334.
[812] Ibid.
[813] Article 26 of the Constitution.

is a natural resource, one could expect that the constitution expressly guarantees the right to water and ensures that all its citizens have a constitutional right and claim to water.

There are various uses of water, such as municipal usage, industry and agricultural usage. Thus, it is crucial to ensure that mechanisms are put in place to control the use and enjoyment of water to satisfy all the competing needs.[814]

Apart from the constitution's reference to water and water resources, Brazil has promulgated the National Water Act,[815] which defines the objectives and instruments of the National Water Resources Policy. The Act also establishes the institutional arrangement under which the country's water policies are to be implemented.[816] Water pricing as a natural resource is based on the 'economic value'. But the question is whether there is enough supply of water and, secondly can the citizens afford the payment to have access to water. Usually, prices are high when the supply is limited, and the demand is high. Looking at the population size of Brazil, this may be the case. Brazil, mainly because of its population size the excessive growth of local demand and industrialisation, has experienced water supply problems. Promoting individual ownership through ESOPs can be an answer, to a larger extent to problems associated with the ability to pay for water usage.

In the case of *Manoel do Rosario Ferreira da Silva v Rondonia Water and Sewer Company*[817], the author's claim was based on an interruption of his water supply at his residence, even though he had paid his water bills. Thus, he remained without a water supply for five days, which was only re-established on June 19, 2020. Furthermore, he alleged that he suffered another interruption on 17 / 11/2020, but the reestablishment of the water supply occurred on 11/20/2020, after 3 (three) days had passed. He complained, and the news was published in a local newspaper, but the water supply was

[814] Porto M & Kelman J "Water Resources Policy in Brazil" (2000) In *Rivers – Studies in the Science Environmental Policy and Law of Instream Flow* 7(3) 3, available at https://www.researchgate.net/profile/Jerson-Kelman/publication/242113835_Water_resources_policy_in_Brazil/links/5b919b8692851c78c4f3d3ad/Water-resources-policy-in-Brazil.pdf, accessed on 13 April 2021.
[815] Ibid.
[816] Ibid.
[817] Caerd - Cnpj: 05.914.254 / 0001-39 (executed) Rondonia Water and Sewer Company.

only re-established 05 (five) days later in a precarious manner. The court highlighted in this matter that according to doctrinal and jurisprudential prediction, the provision of drinking water is an essential service for a dignified life as it meets one of the basic needs of citizens. A dignified life cannot be conceived without the supply of water, which is indispensable for routine domestic activities.

The court contended that the long period of interruption, as narrated in the initial action, occurred for 05 (five) consecutive days without water, and it goes beyond what is reasonable, leaving the plaintiff, an effective consumer, without treated water, to perform domestic activities, cooking, cleaning and other needs.

The contentions shared in this case are similar to those made by the Chief Justice in the Brazilian Supreme Court, the case of *ETEP construções S.A. v. Companhia Catarinense de Águas e Saneamento*,[818] where a court had denied a request to suspend construction of a sewage treatment system. The court's sentiments were that: "In a country where there are no sewage systems because it is an invisible service that, therefore, does not pay with votes, we cannot lose the opportunity of avoiding damage to public health and environment."

The right to water is often quoted as being a substrate of the right to sanitation. Barcellos argues that[819] Brazilian law does not describe sanitation services directly as a right, but this has not prevented the courts from considering the human rights duty imposed upon the government as enforceable. Moreover, court's decisions frequently refer to a right to sanitation services as a social and economic right, relying on an understanding of health rights. This is, of course, in line with the universality of human rights.

5.9.3 The Right to Health Care

The constitution, in terms of Article 6, clearly states that "health" is a social right. Furthermore, the right to health is meant to improve the social condition of people.[820]

[818] CASAN (Brazilian Superior Court of Justice, AgReg na SS 2418, March 16, 2011).
[819] De Barcellos A P "Sanitation rights public law litigation and inequality: a case study from Brazil In Charting the Water Regulatory Future" 2014 *HH R J* 16(4) 40.
[820] Article 27 of the Constitution of Brazil.

Therefore, the state has the mandate to safeguard public health. In terms of Article 194, it is reiterated that 'health is the right to all and the duty of the National Government'. The constitution furthermore guarantees the protection of one's health through economic and social policies aimed at reducing the risk of illness and equal access to services. It is undisputed that all persons have access to primary public health care services. However, where one needs special care, for example, services of a specialist, this may be costly and not affordable. In most jurisdictions, private health care, which is sometimes preferred due to the challenges faced by public health care, is expensive and can only be afforded by those who are well-off. This is ideally so because private-health care providers are established to make a profit, and in addition, they do not receive any public funds.[821] Again, as in the case of the right to food, it is good to have a constitutional right to health care, but limited choices regarding health care services and treatment makes the right meaningless. Even though the enactment of laws indicates the seriousness of the government to address social problems, legislation alone, guarantees social change, let alone rapid change.[822] All role-players must be proactive in ensuring that the aspirations of the legislators become a reality.

In the case of *Referendo Na Medida Cautelar Na Arguição De Descumprimento De Preceito Fundamental 709 Distrito Federal*[823] the Brazilian Supreme Court was called upon to address an issue relating to the right to health care. In August 2020, the plenary of the Brazilian Federal Supreme Court delivered a decision affirming the legal capacity of an indigenous *movement*, the Articulation of Indigenous Peoples of Brazil (APIB), to bring a claim before the Supreme Court for the review of actions and omissions of the federal government and the National Indian Foundation (FUNAI) when addressing the threat of Covid-19 to indigenous peoples – and ordering both the government and FUNAI to take precise actions for the protection of the indigenous peoples against such a threat. The claim, amongst other things, raised questions about the right to health.

[821] Article 199 of the Constitution of Brazil.
[822] Octavio Luiz Motta Ferraz The right to health in the courts of Brazil: Worsening health inequities' (2009) 11 (2) ? *Health and Huma Rights Journal* 33
[823] ADPF 0097227-03.2020.1.00.0000 DF 0097227-03.2020.1.00.0000, Judgement delivered on March 16, 2021, available at http://portal.stf.jus.br/processos/downloadPeca.asp?id=15344621000&ext=.pdf, accessed on 13 April 2021.

Generally, despite the significant achievements in terms of rights, indigenous peoples in Brazil continue to face some old challenges. According to Droubi,[824] the enjoyment of certain rights such as the right to health has been restricted in practice, to those indigenous peoples living in formally demarcated lands. That said, illegal miners, loggers and farmers have relentlessly invaded demarcated lands. It was in this context that APIB and six political parties lodged a claim before the Supreme Court, requesting the Court to order the federal government and FUNAI to implement sanitary barriers for the protection of isolated and recently contacted people; to implement a situation room (described below) with the participation of representatives of indigenous peoples; to remove invaders from indigenous lands (including the Yanomami reserve), and to ensure that the Indigenous Health Subsystem be available to all indigenous individuals including those living in urban areas. It also requested the Court to order the Human Rights National Council to consult with indigenous peoples and specialised authorities to produce a plan to address Covid-19 among indigenous peoples and order the government to implement such a plan. Except for removing invaders, Justice Rapporteur Barroso provisionally granted all the measures, and the plenary later confirmed his decision.

Thus, this judgement has confirmed that so far, the government has failed to comply fully with the decision, with the Court rejecting the government's plan for addressing Covid-19 among indigenous peoples and infringing their right to health.

5.9.4 The Right to Housing

The right to housing is provided for in terms of the Brazilian Constitution.[825] The state has constitutional powers and the mandate to establish directives for urban development,

[824] Droubi S 'The Brazilian Federal Supreme Court comes to the protection of indigenous people's right to health in the face of Covid-19' 2020 https://www.ejiltalk.org/the-brazilian-federal-supreme-court-comes-to-the-protection-of-indigenous-peoples-right-to-health-in-the-face-of-covid-19/, accessed on 13 April 2021.

[825] Article 26 of the Constitution of Brazil.

including housing and sanitation.[826] Apart from the mandate given to the country through housing and land, there is no express constitutional right to housing and or land.

In this case of *RE 410715 agr, Justice Celso de Mello*[827] the Brazilian Constitutional Court emphasised that the primary prerogative in formulating and executing public policies belongs to the legislative and executive powers. However, it possible that the such powers to be executed by the Judiciary, on exceptional basis, especially when it comes to public policies designed by the constitution itself, to order their implementation by a defaulter state agency, that implicates in the non-fulfillment of their juridical and political mandatory. Significantly, that first proclamation was repeated and extended to the housing right recently, as per the comparable decision in ARE 639337, Justice Celso de Mello ruled on 08/23/2011. The Constitutional Court asserted that the minimum core notion in fundamental rights is enough to "guarantee to citizenry, goods and services provided by the State, sufficient to achieve the full enjoyment of basic social rights as a right to education, child protection, right to health, social security, housing, food and public security".

Thus, what is apparent from these judgements [828] is that housing rights in the Brazilian system are qualified as fundamental (despite their socioeconomic nature); and they are provided with immediate efficacy, meaning that the state has duties to guarantee those rights at the same pace. The judiciary may scrutinise public policy on the subject, assuring priority to the protection of the minimum core of the housing right.[829]

5.10 Possible Avenues for Guaranteeing the Success of ESOPs in Brazil

Brazil's company laws and insolvency laws offer various stakeholders, including the debtors, their creditors and potential investors in financially distressed companies a broad range of options, including liquidation, judicial reorganisation and out-of-court

[826] Article 21 of the Constitution of Brazil.
[827] Delivered on 11/22/2005.
[828] Valle V R L D *Judicial adjudication in housing rights in Brazil and Colombia: A comparative perspective* (2014) *Revista de Investigações Constitucionais* 1(2) 86.
[829] Ibid.

reoganisation.[830] Once proceedings are lodged on behalf of the insolvent company, all individual enforcement measures against the company get suspended. However, such claims may be entered into the claims register at a reserve value, which is subject to a decision in the judicial recovery or liquidation proceedings. [831]It must be noted that this does not have an impact on the employment-related disputes.[832]

Companies that find themselves in various financial conditions may implement ESOPs. Hence, a financially healthy company, a company in financial distress or a terminally ill company may implement ESOPs.

5.10.1 Financially Healthy Companies

The Corporate Law of Brazil is comprehensive in assisting directors and any other responsible persons to determine the company's financial health. This determination is done by checking the financial position and the financial result of the entity. The law calls for companies to do a financial forecast and determine whether they will be in a financially healthy position if such companies intend to provide financial assistance to employees to acquire shares in the company. A healthy company can meticulously follow the Corporate Law principles relating to authorisation and the issue of shares to make shares available to employees for a subscription. If the employees are unable to finance the acquisition of such shares, the company may rely on the corporate rules relating to the provision of financial assistance to assist employees in acquiring shares. This can be done by making funds available for the said process. Another way a financially healthy company may assist employees in acquiring shares is to allow them to pay for the shares in non-monetary forms such as in services.

5.10.2 Financially Distressed Companies

[830] Moritz CRA, 'The Brazilian Business Insolvency Act in a Nutshell- An Introduction to Insolvency Law in Brazil' (2016) 1.
[831] Ibid at 7.
[832] Ibid.

Transformation, also referred to as reorganisation or business rescue, is the new corporate move to salvage ailing companies. Transformation is an operation in which a corporation is changed from one type into another without dissolution or liquidation.[833] The purpose of judicial recovery in insolvency proceedings is to overcome the financial crises in which the company finds itself.[834] For transformation proceedings to commence and be effective, the unanimous consent of shareholders must be obtained, except where the bylaws provide otherwise.[835]

During the judicial recovery proceedings, the company's management remains in control and oversees all the company's management activities.[836] A court-appointed trustee, together with a creditors' committee, once formed, oversees the self-administration of the company in financial distress.

The creditors of a company in financial distress and which is in the transformation process continue to enjoy their rights and guarantees until the debts are paid in full.[837] This, by implication, means that even if the company is bought by new owners as per the transformation agreement, such new owners will bear the responsibility of paying the creditors of the corporation.

5.10.3 Terminally ill Companies

As in the case of most jurisdictions, liquidation in Brazil may take place either voluntarily or through the order of the court. The latter is also referred to as compulsory sequestration in other jurisdictions such as South Africa. To the extent that the bylaws are silent, a general meeting shall establish the method of liquidation for all instances provided for in Article 206.[838] Article 206 deals with the dissolution of a company and states that a company shall be dissolved when the duration terminates, in instances set out in the

[833] Article 220 of the Corporations Act (Law 6.404/1976).
[834] Moritz CRA, 'The Brazilian Business Insolvency Act in a Nutshell- An Introduction to Insolvency Law in Brazil' Op Cit note 830.
[835] Article 221 of the Corporations Act (Law 6.404/1976).
[836] Moritz CRA, 'The Brazilian Business Insolvency Act in a Nutshell- An Introduction to Insolvency Law in Brazil' Op Cit note 830 at 6.
[837] Article 222 of the Corporations Act (Law 6.404/1976).
[838] Article 208 of the Corporations Act (Law 6.404/1976).

bylaws, or by a resolution taken at the general meeting. Another instance in terms of Article 206 where the company can be dissolved is by the existence of a single shareholder, verified at the annual general meeting if the minimum of at least two shareholders is not reconstituted by the annual general meeting of the following year. This latter instance is subject to article 251.

Furthermore, the company shall, at the general meeting, appoint the liquidator and the statutory audit committee to serve during the period of liquidation.[839]

Article 206 provides for cases where the liquidation proceedings are to be controlled by the court. A court may thus order for liquidation to commence under the following instances:

> *(a) when its incorporation is annulled in proceedings commenced by any shareholder;*
>
> *(b) when it has been proved, in proceedings commenced by shareholders representing five per cent or more of the capital, that the corporation cannot achieve its corporate purpose;*
>
> *(c) In the event of bankruptcy, in the manner provided for by the relevant law.*

Liquidation as a result of bankruptcy requires detailed scrutiny at this stage.

Creditors may file a petition in Court for an order against a debtor (bankrupt company).[840] In this petition, the creditor must allege that the debt owed to the petitioning creditor amounts to not less than ten thousand dollars and that the debtor has committed an act of bankruptcy within six months immediately before filing the petition. [841] The order declaring the debtor bankrupt is applied normally when the debtor fails to meet the liabilities generally as they become due.[842] Upon filing the petition for a receiving order, the court may appoint a licensed trustee as the interim receiver of the debtor's property.

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[839] Article 208 of the Corporations Act (Law 6.404/1976).
[840] Section 5 (1) of the Bankruptcy and Insolvency Act No.14, 112/20.
[841] Section 5 (1)(a) and (b) of the Bankruptcy and Insolvency Act No.14, 112/20.
[842] Section 4 (1)(j) of the Bankruptcy and Insolvency Act No.14, 112/20. Section 4 (1)(a)-(j) list all other acts which may qualify as an act of bankruptcy.

For the interim receiver to be appointed, it must be shown that there is a need for the estate of the debtor to be protected.[843] The interim trustee is required to perform certain functions as directed by the court. This includes the mandate to:

> (*a) take possession of all or part of the debtor's property;*
>
> *(b) exercise such control over that property, and over the debtor's business, as the Court considers advisable; and*
>
> *(c) take such other action as the Court considers advisable.*[844]

The primary purpose of the aforementioned section is to ensure that all the company's assets are realised. After the realisation of assets has taken place, the liquidator can then proceed with paying creditors any claims that have been lawfully proven against the debtor.

As in the case of creditors, the insolvent person (the bankrupt company) may also invoke the provisions of section 49 (1) and obtain leave of the court to make an assignment of all his/her property for the general benefit of the creditors.[845] This assignment must be accompanied by a sworn statement which sets out the following:

> *(a) the property of the debtor divisible among his creditors;*
>
> *(b) the names and addresses of all his creditors; and*
>
> *(c) the amounts of their respective claims;*[846]

The importance of this provision lies in ensuring that all assets are realised. Thereafter creditors can be paid the debts owed to them, provided that they have legally proven the claims. The analysis of the Brazilian corporate liquidation process has not established or

[843] Section 8 (1) of the Bankruptcy and Insolvency Act No.14, 112/20.
[844] Section 49 of the Bankruptcy and Insolvency Act No.14, 112/20.
[845] Section 49 (1) of the Bankruptcy and Insolvency Act No.14, 112/20.
[846] Section 49(2) of the Bankruptcy and Insolvency Act No.14, 112/20.

found any situation where assets of the insolvent company were sold to employees for them to use those assets and form ESOPs. As suggested in chapter 3, this is possible, though not an easy approach to follow.

Once appointed, the liquidator performs key duties. These duties include the responsibility of the liquidator to take custody of the property, books and documents of the company; prepare a balance sheet within the period set at the general meeting or the court; realise the assets of the corporation, pay any liabilities and apportion the residue among the shareholders. The liquidator also has the duty to call upon shareholders to pay up their shares when the assets are insufficient to cover the liabilities.

In terms of article 215, a general meeting may decide that prior to completing the liquidation and after all creditors have been paid, the company assets can be apportioned among the shareholders as such assets are ascertained.

Normally, employees who are at the centre of an ESOP formation are unable to secure enough funds to finance their subscription of shares. The inability to raise enough funds may thus discourage employees from participating in ESOPs. As a liquidated company becomes dissolved and can no longer continue to operate as a business, as usual, the remaining assets could be sold to employees to start an ESOP company. In other words, the assets that remain after creditors have been paid and the remainder of the assets could be first offered to employees before any offer of sale can be made to third parties. Although the availability of the assets is not the only important aspect of ESOP formation, it could be the first step in the right direction. It is often difficult for employees to raise enough capital to finance the establishment and operations of ESOPs. This form of arrangement will guard against unemployment, which could have otherwise resulted from liquidation without any condition to sell the liquidated company's assets to the ex-employees.

5.11 Conclusion

The Brazilian Corporate Law rules, as in the case of South Africa, permit the issuing of unissued securities to effect ESOPs. In Brazil, the shareholders have the right to supervise the company's corporate affairs, including the issuing of shares or increasing the share capital. This is different from some jurisdictions where this right, though it can be inferred, is not expressly provided in the statute. The latter approach is preferable to allow for a separation between the functions of the board of directors and shareholders. In the case of ESOPs, employee shareholders have a dual role to play. Firstly, they are employees, and thereafter also shareholders. Hence, if no distinction is made between the function of shareholders and employees (whether on the management level or not), conflicts of interest may arise. The Brazilian Corporate Law also allow for share repurchase as a mechanism to be used where the need arises to the extent that it is provided for in the law for effecting ESOPs. Brazil's solvency and liquidity tests are comprehensive as they set out the information to be contained in the financial statement.

Furthermore, the general theme that has run throughout this thesis is that economic growth is required to achieve equal participation of all individuals in the economy and thus receive their share from such growth. Government policies may hamper or facilitate trade, a key driver of the economy.[847] Therefore, it is important to identify and analyse the factors, be it legislative, policy or administrative, that may hinder trade both regionally and internationally.[848] Governments should take legislative and administrative steps to reform legal and administrative issues to foster and facilitate trade for economic growth.

As demonstrated in this chapter, over the years, the Brazilian government has introduced various legislation and policy frameworks in order to achieve a more even distribution of income and wealth, maintain foreign-trade surplus, encourage personal savings as well as attract foreign capital.[849] Although Brazil has not enacted ESOP legislation, it has amended its tax legislation to relax the tax burden and afford companies and employees to enjoy the benefits associated with ESOPs.

[847] Brandi C ‘Successful trade promotion: Lessons from emerging economies’ Op cit note 798 at 41.
[848] Ibid at 42.
[849] Gallo *Doing Business in Brazil* (2016) 140.

CHAPTER SIX

CANADA AND EMPLOYEES SHARE OWNERSHIP SCHEMES

6.1 Introduction

Canada, a country located in North America, is the second largest country in the world, covering an area of approximately 10 million square kilometres. It is bordered by three oceans: the Pacific Ocean in the west, the Atlantic Ocean in the east and the Arctic Ocean to the north. Canada further shares two borders with the United States. [850]

According to the Gini coefficient, a metric widely used by economists, income inequality has risen in Canada over time. The largest and most persuasive increase occurred in the wake of the 1990 recession until about 2000.[851] It appears that income inequality has been a creeping problem in Canada and other advanced economies for many years now. The 2008 financial crisis, and the recession that followed it, led to job and asset losses, especially among those in the lower-income groups, even though Canada is a developed country with huge wealth of natural resources such as gas, oil and coal. In 2020, Canada exported mineral fuels to the value of US$ 69.1 billion, vehicles to the value of US$ 28.9 billion, electrical machinery to the value of US$ 11 billion and pharmaceuticals to the value of US$ 8.5 billion.[852] Generally, a country's wealth and economic growth are based on its natural resources and the extent to which it can export such resources. Canada's export picture illustrates a self-sufficient country and reinforces the country's status as a developed country.

Before it attained independence, Canada was first colonised by the Europeans in the 16th century.[853] Both England and France vied for global supremacy, which pitted Canadian

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[850] Discover Canada, available at https://www.canada.ca/en/immigration-refugees-citizenship/corporate/publications manuals/discover-Canada/read-online/canadas-regions.html, accessed on 13 April 2021.

[851] Fong F *Income inequality in Canada* (2017) 5.

[852] Statistics Canada, available at https://www150.statcan.gc.ca/n1/daily-quotidien/210205/dq210205b-eng.htm, accessed on 13 April 2021.

[853] Blakemore, E 'Canada's Long *Gradual Road to Independence,* available at https://www.history.com/news/canada-independence-from-britain-france-war-of-1812, accessed on 13 April 2021.

colonists against one another. However, in 1759, the British had roundly defeated France, and the French and the Indian War ended soon after.[854] In 1763, France ceded Canada to England through the Treaty of Paris.[855] Thereafter, Canadian colonies were under British rule.[856] In 1931, England put Canada on equal footing with other commonwealth countries, giving its dominions the powers to fully and legally make amendments to the Canadian Constitution. Canada took time to cut its legal ties to England.[857] In 1982, it adopted its own constitution and became completely independent.[858] Moreover, Queen Elizabeth II is the Queen of Canada, although her role is ceremonial, and as such, she does not interfere in Canadian self-governance.[859]

Section 15 of the Canadian Constitution guarantees everyone equal protection before the law and prohibits discrimination. Furthermore, the constitution provides for affirmative action with the primary objective of bringing about transformation.

This chapter explores the Canadian company law, and specific principles relating to employee share-ownership that can guarantee transformation.

6.2 Historical Underpinning of ESOPs

The "Deferred Profit-Sharing Plans" (DPSPS) were introduced in Canada in 1968.[860] In terms of DPSPS, the employers make profit-sharing payments to a trust that is referred to as the 'employee trust'.[861] This payment is made within the prescribed period and is subject to limits set by the corporation.[862] The employee income received as a result of DPSPS is taxable but deferred until the actual income is received.[863] The tax laws underwent modifications to provide employees with a more attractive means of sheltering

[854] Ibid.
[855] The Treaty of Paris was signed on 10 February 1763 by the kingdoms of Great Britain, France and Spain, with Portugal in agreement, after Great Britain and Prussia's victory over France and Spain during the Seven Years' War.
[856] Blakemore Op cit note 850.
[857] Ibid.
[858] Ibid.
[859] Ibid.
[860] OECD, available at http://www.oecd.org/employment/emp/2409883.pdf, accessed on 28 June 2021.
[861] Ibid.
[862] Ibid.
[863] Ibid.

a portion of their income for pension purposes with the introduction of employer-sponsored registered retirement savings plans.[864]

On the holistic corporate front, the discussions surrounding the history of company law in Canada commenced with the Ontario Business Corporations Act (hereinafter OBCA) which was passed in 1970. One of the noticeable features of OBCA is insolvency. Thus, Section 7 of the OBCA defined insolvency as a scenario where the firm's liabilities are more than the realisable value of its assets or the firm's inability to settle its debts as they become due. Insolvency plays a crucial role in Corporate Law when corporations plan to finance ESOPs. Normally, corporations that are declared insolvent are prohibited from financing ESOPs, by law. However, this was not expressly provided for by OCBA. Another important feature found in OBCA relates to the powers given to corporations for the establishment of ESOPs. Ideally, Section 15(8) authorises corporations to provide aid to establish institutions or trusts for the benefit of employees or former employees of the corporation. There is no express mention of ESOPs made in OBCA, but the interpretation of OBCA leads to only one logical conclusion, which is to promote the wealth fare of employees and former employees through financial and other means.[865] Ultimately, the legislature deemed it necessary for firms to provide financial aid to employees to purchase employee shares.

In 1985, the Federal Government enacted Canada's Business Corporations Act, hereinafter referred to as CBCA.[866] Section 25(3) makes reference to shares and states that shares are issued upon receipt of a consideration. Apart from the payment of a consideration, shares will also be issued in exchange for property or past services that are not less than the fair equivalent of the cost of the shares.[867] Additionally, as explained

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[864] Ibid.

[865] Section 15(8) states that: 'A corporation has power as incidental and ancillary to the objects set out in its articles, to establish and support of associations, institutions, funds or trusts for the benefit of employees or former employees of the corporation or its predecessors, or the dependents or connections of such employees or former employees, and grant pensions and allowances, and make payments towards insurance or for any object similar to those set forth in this paragraph, and to subscribe or guarantee money for charitable, benevolent, educational or religious objects or for any exhibition or for any public, general or useful objects.'

[866] RSC 1985, c. C-44.

[867] See section 25 (3) of Canada Business Corporations Act, 1985. Section 25(4) provides further determinants in relation to consideration other than money, which are the reasonable charges and

in chapter 3 of this thesis, liquidity and solvency tests also feature in terms of the CBCA. A corporation shall acquire shares issued by itself, provided that it will remain liquid and solvent after issuing such shares. A company may not acquire its own shares for any particular purpose if itis unable to pay its debts as they become due[868]; or if the value of the company's assets will be less than the aggregate of its liabilities.[869] In a nutshell, if a company decides to acquire shares for the benefit of its employees, it is required to pass the solvency and the liquidity test.

The corporate laws of Canada have evolved over the years. [870] One significant development that came with such evolvement is clarifying the distinction between the roles and functions of shareholders and directors.[871] Under the notion of separate legal personality, it is clear that shareholders are owners and directors are managers of the shareholders' interests in the company. However, the lines have for long been blurred regarding the extent to which shareholders and directors exercise their rights and perform their obligations. Hence, the CBCA has taken the statutory route to bring out a clear demarcation between the shareholders and directors. This is visible regarding the oppression remedies of the minority[872], derivative action for corporate wrong[873] and the statutory duties of directors. In the case of *BCE v 1976 Debentureholders,[874]* the court held that directors as managers of the corporation are responsible for acting in the company's best interest, which includes the interests of shareholders, employees, creditors, government and the broader environment. Hence, the court ruled that there is no set of stakeholders whose interests should prevail at the expense of the other. These aspects are discussed in more detail later in this chapter. What is worth noting is that both Canada's legislation and case law moved into grey areas to clarify uncertain issues

expenses of the organization and reorganization and payments for property and past services reasonably expected to benefit the corporation.'

[868] Section 34(2)(a) of Canada Business Corporations Act, 1985.

[869] Ibid, section 34(2)(b)

[870] Vanderpol S & Waitzer E 'Addressing the Tension between Directors' Duties and Shareholder Rights-A Tale of Two Regimes (2012) (50) (1) 179.

[871] Ibid.

[872] Section 241 of Canada Business Corporations Act, 1985.

[873] Section 239 (1) of Canada Business Corporations Act, 1985.

[874] *2008 SCC 69*.

pertaining to corporate law. This unique approach followed by Canada has to a certain extent, made Canada a suitable comparative jurisdiction in this thesis.

The Employee share ownership schemes came under express governance and control under the Employee Share Ownership Plan Act, 1988, until it was repealed on 10 October 1997. In terms of this Act, employee share plans were governed by the employee share purchase agreement.[875] In terms of this agreement, all employee shares to be purchased in terms of the agreement were to be offered to all eligible employees.[876] It was a requirement that the subscription price for the employee shares had to be specified.[877] Furthermore, all aspects of the purchase, sale, redemption and transfer of the employee shares were also to be specified.[878] In other words, just like any other commercial agreement, the share purchase agreement sets out the rights and obligations of the parties to the agreement. The employee-shareholders are required to execute duties attached to a shareholder while enforcing their rights to dividends. Thus, for ownership of employee shares to take place, the employee shares were to be issued and recorded on the share register in the name of the eligible employee to be held in escrow by the administrator under the escrow agreement.[879] The corporation was further required in terms of the Act to provide all information, financial and otherwise, to enable the eligible employee to participate in such schemes.[880] The provision of information is important as it places the employee-shareholders in a position to make well-thought-through and financially sound decisions.

In terms of the 1988 Act, a corporation had to meet various requirements before it was eligible to register an employee share ownership plan. Firstly, it was required that such a corporation was incorporated in Canada.[881] Secondly, the aggregate of all wages and

[875] Section 2(1) of the Employee Share Ownership Plan Act, 1988.
[876] Ibid.
[877] Ibid, section 2(1) 3 of the Employee Share Ownership Plan Act, 1988.
[878] Ibid, section 2(1) 4 of the Employee Share Ownership Plan Act, 1988.
[879] Ibid, section 2(1) 5 of the Employee Share Ownership Plan Act, 1988.
[880] Ibid section 2(1) 6 of the Employee Share Ownership Plan Act, 1988.
[881] Section 3(1) (a) of the Employee Share Ownership Plan Act. A corporation is said to be incorporated when it complies with all the legislative and regulatory requirements. According to section 5 of the Canada Business Corporations Act, an individual, group of persons or bodies, or corporate may incorporate a corporation by signing articles of incorporation and complying with section 7. Articles of incorporation is a legal document which contains important information about the corporation such as

salaries paid in the last taxation year was not less than 25 per cent of all wages and salaries paid in the year by the corporation; [882] Thirdly, its gross revenue, together with the gross revenue of all the associated corporations does not exceed $ 50 000 000 or such other amount as is prescribed.[883] The Act also imposed punishment on persons or organisations that were found guilty of an offence in respect of the Act, where such persons were liable on conviction of a fine, not more than $ 25 000.[884] It is submitted that attaching penalties to violations of the law is important as it deters persons and organisations from violating the law. It thus guarantees adherence to the law and policies.

On the development front, Canada's government policies were increasingly redistributive from about 1980 until the mid-1990s (meaning the difference between the Gini coefficient for market income distribution and post-tax and transfer income distribution grew larger). During the late 1990s, there was a considerable reduction in the level of redistribution. Taxes and transfers reduced inequality, but the impact is now smaller. Thus, in this thesis, the principle of increasing the pie and the fact that you cannot distribute what you do not have is argued and explained. For those at the bottom of the chain to benefit from the country's economic advancement, all efforts must be levelled towards improving the economy. This will ensure that everyone benefits from the 'pie'.

6.3 Methods for Effecting ESOPs in Canada

After the repealing of the 1988 Act, Canada has no specific federal legislation that regulates employee ownership plans; however, certain situations of ESOPs are regulated by the tax legislation, and several provinces provide supporting grants or tax breaks.[885] Additionally, emphasis is placed on the most popular ESOP – the Share Equity Plan – the major tax benefits are related to privately held companies. Thus, in Canada, an

business name and address. In some jurisdictions, a distinction is made between memorandum of incorporation and articles of incorporation. Whilst in other jurisdictions where the information contained in these two documents is lumped into one document, called a memorandum of incorporation.

[882] Section 3(1)(c) of the Employee Share Ownership Plan Act 1988.

[883] Section 3(1)(c) of the Employee Share Ownership Plan Act 1988.

[884] Section 24(1) (d) of the Employee Share Ownership Plan Act 1988.

[885] Luffman J 'Taking stock of equity compensation' *Perspectives on labour and income* (2003) 4(3), available at https://www150.statcan.gc.ca/n1/p_ub/75-001-x/00303/6489-eng.html, accessed on 13 April 2021.

employee investing in a qualified small business can be eligible for a lifetime capital gains exemption, as defined in the Income Tax Act.

Accordingly, Philips holds that such a benefit implies that the sale of the shares to a third party requires that no income tax is payable on the capital gains portion.[886] However, this exemption changes yearly with inflation adjustments. Furthermore, this is the only tax-free exemption available for Canadians, other than a person's personal home. In addition, the interest incurred to finance the investment may be deductible against other income, thus reducing the personal income payments of the employee. This is not the only benefit employees are subjected to. Another potential benefit is in the area of bonuses. Primarily, a company can pay employees shares in lieu of cash. However, if the company qualifies, then the employee pays no income taxes on the shares until they sell those shares. Nonetheless, there are several important restrictions on this benefit and some downsides from a tax perspective.[887]

The Canada Business Corporations Act, the main piece of legislation that provides for the administration and governance of corporate affairs, also contains provisions that may have a bearing on employee share ownership plans. As stated in chapter 3 of this thesis, a share must be issued before acquisition. An employee-shareholder or non-employee-shareholder can take ownership of the shares and exercise rights attached to such shares. Shares may be issued at such times and to such persons as the directors may determine.[888] The issue of shares must be preceded by the payment of money to purchase shares, and this process is referred to as consideration.[889] It is not permissible to issue shares before the consideration for the share is fully paid in money or property or past services.[890] When consideration is made in the form of property or past services, the value of the property or past services must be at least equivalent to the money that the corporation would have received if the shares were paid in money.[891] Although the

[886] Philips P Canadian Tax Issues for ESOPs (2017) available at http://esopbuilders.com/canadian-tax-issues-for-ESOPs/, accessed on 11 April 2021.
[887] Ibid
[888] Section 25(1) of the Canada Business Corporations Act, 1985.
[889] Section 25(1) of the Canada Business Corporations Act, 1985.
[890] Ibid, section 25(3) of the Canada Business Corporations Act, 1985.
[891] Ibid, section 25(3) of the Canada Business Corporations Act, 1985.

general practice is that directors may determine when and to whom shares may be issued, the articles, the bylaws and the unanimous shareholder agreement may provide otherwise.[892]

The Canadian economy is based on a mixed economic system, where private citizens have the power to influence the economic direction in which the country will move, as opposed to a command economy where absolute government regulation is key. All stakeholders, including the businesses, government and consumers, all play a part in Canada's economy.[893] All these sectors have the power to influence the production and consumption of goods and services.[894] One of the themes advocated for throughout this thesis is the aspect of 'all stakeholders playing their role' in driving the economy. This status quo makes Canada's affairs with regard to corporate law and the economy so attractive and worth emulating. Leaving the duty of growing the economy to one stakeholder and expecting it to grow is like planting a seed without watering it and expecting it to grow.

Even though Canada is based on a mixed economy system, it closely follows a free market system with minimal government regulation. This allows businessmen and women to organise their activities to act in the best interest of their corporations. Ultimately, the aim is to maximise profits. The objective of maximising profits is central to the private sector, and this is, beneficial to the country at large, as both the government, employees and consumers can benefit from this. Free trade increases access to better-quality and lower-priced goods.[895] In other words, the fair competition gives consumers various options to choose from, ending up purchasing high-quality goods at lower prices. Free trade substantially leads to economic growth, particularly because it reduces imports and import-related costs while increasing production.[896] However, one must understand that importing goods into one's country is not necessarily anti-economy growth. Sometimes

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[892] Ibid, section 25(1) of the Canada Business Corporations Act, 1985.
[893] Canadian Centre for the Purpose of the Corporation, available at https://www.newswire.ca/news-releases/canadians-want-capitalism-reformed-and-demand-that-businesses-step-up-on-fairness-and-sustainability-853347128.html, accessed on 13 April 2021.
[894] Ibid.
[895] Donald J Boudreaux *Globalization* 2008 55–67.
[896] Ibid.

the cost of production may be higher than the cost of importing finished products. Thus, a balance should be achieved between producing goods on the one hand and the importing of finished products on the other hand.

Canada's free-market economy consists of three main industries: the service industry, the manufacturing industry, and the natural resources industry.[897] Furthermore, the service industries provide thousands of different jobs in transportation, education, health care, banking, communication services and government.[898] The manufacturing industries make products to sell in Canada and around the world. Manufactured products include paper, high technology equipment, aerospace, technology, automatics, machinery, food, clothing and many other goods.[899] Natural resources industries include forestry, fishing, agriculture, mining and energy. As in the case of South Africa, these industries have played an important role in the country's history and development. Today, many areas of the economy still depend on developing natural resources, and a large percentage of Canada's exports are natural resource commodities like oil, gas and minerals.[900]

6.3.1 The Availability of Sufficient Share Capital to Effect ESOPs

(a) Rules Affecting Issuing of Unissued Share Capital and ESOPs

Articles of incorporation is a founding document of any company formed in Canada.[901] The articles of incorporation (hereinafter the AOI) contain essential information regarding the company. Hence, it provides the company's name,[902] the province in Canada where the registered office is to be located[903] and most importantly, the classes and the maximum number of shares that the company is authorised to issue.[904] For example, if the company is solely established to deal in ESOPs, this will be clearly stated in the AOI

[897] Available at https://www.canada.ca/en/immigration-refugees-citizenship/corporate/publications manuals/discover-Canada/read-online/canadas-regions.html, accessed on 13 April 2021.
[898] Ibid.
[899] Ibid.
[900] https://www.canada.ca/en/immigration-refugees-citizenship/corporate/publications manuals/discover-Canada/read-online/canadas-regions.html, accessed on 13 April 2021.
[901] See section 5(1) of the Canada Business Corporations Act, 1985.
[902] Section 6(1)(a) of the Canada Business Corporations Act.
[903] Section 6(1)(b) of the Canada Business Corporations Act, 1985.
[904] Section 6(1)(c) of the Canada Business Corporations Act, 1985.

of the company, and all shares will be authorised to be issued as such. If, the company is to contain a class of shares in the form of employee shares, this has to be evident from the AOI, as there has to be a class of shares designated as employee shares.

The company may also set additional conditions such as restricting the issue or transferring the ownership of shares. These additional conditions must be outlined clearly in the AOI.[905] It is important to have the matters relating to the ownership of shares catered for in the AOI for many reasons. Firstly, the directors of the company will have clear guidance when administering the issue and transfer of shares, and it also allows for accountability of directors to the shareholders. Hence, it limits the chances of maladministration. Secondly, it ensures transparency amongst the shareholders. In the case of *Maple Leaf Foods v Schneider Corp. et al.*[906] , the Ontario Court of Appeal stated that directors are obligated to act honestly and in good faith, promoting the interests of the corporation. The proper adherence to the law and meticulous exercise of the duty of honesty and good faith will limit any issues relating to maladministration. Hence, even if the law is clear on the role and duties of directors, if directors fail to adhere to the law, the corporation will suffer financially. Hence, during the authorisation and issue of shares, directors must act honestly and in the bests interests of the company.

The company's directors determine the time when and the persons to whom shares may be issued.[907] In addition, the directors also determine the consideration which must be offered in respect of the shares so issued.[908] These powers of the directors may be limited in the AOI. When persons subscribe to shares and become shareholders, they are entitled to enjoy statutory rights attached to such shares. Thus, a shareholder has a right to vote at any meeting called for the company's shareholders.[909] The shareholders also have the right to enjoy dividends declared by the company and to receive the company's remaining property if the company is dissolved.[910] Shareholders provide some form of consideration to the company as a form of investment. Therefore, it is appropriate for

[905] Section 6(1)(d) of the Canada Business Corporations Act, 1985.
[906] (1998), 42 O.R (2 ed) 177 (C.A).
[907] Section 25 (1) of the Canada Business Corporations Act, 1985.
[908] Section 25(1) of the Canada Business Corporations Act, 1985.
[909] Section 28 (3) (a) of the Canada Business Corporations Act, 1985.
[910] Section 28 (3) (a) and (b) of the Canada Business Corporations Act, 1985.

them to enjoy the benefits linked to their investment, especially where such benefits involve monetary rewards.

(b) Necessity of and Rules Affecting the Increase of Authorised Share Capital for ESOP Purposes

An existing company that does not offer ESOPs to its employees may wish to increase its capital for ESOP purposes. Alternatively, a company that already offers ESOPs to employees may wish to increase its capital to cast its net wider in providing ESOPs to its employees. Both these scenarios will call for increasing capital.

The company laws of Canada allow for retroactive validation of the over-issue of shares. Shares should be authorised before they are issued. However, if the party issues shares in excess of the authorised shares, this over-issue can be authorised by amending the AOI or a trust indenture to which the company is a party.[911] Once the over-issue of shares is authorised in an aforesaid manner, it becomes valid from their issue date.[912] The amendment of articles can be done by special resolution, particularly to increase the company's stated capital.[913] The Act also refers to class vote, to the effect that the holders of shares of a particular class are entitled to vote separately as a class to amend the articles to increase or decrease any maximum number of authorised shares of such class.[914] There seems to be a conflict between section 173(1)(f) and section 176(1)(a). The former requires that the decision to amend the articles be taken through a special resolution. In contrast, the latter requires shareholders of a particular class to decide on the amendment of the article through a class vote to increase the maximum number of authorised shares. At face value, there seems to be a conflict, but the meticulous reading of section 173(1)(f) contains an exception and states that the power to amend the articles by special resolution is subject to a class vote under section 176 (1). Therefore, this

[911] Section 52 (2) of the Canada Business Corporations Act, 1985.
[912] Section 52 (2) of the Canada Business Corporations Act, 1985.
[913] Section 173 (1) (f) of the Canada Business Corporations Act, 1985.
[914] Section 176 (1) (a) of the Canada Business Corporations Act, 1985.

means that a special resolution cannot amend the articles for increasing authorised capital without a class vote.

In summary, the authorised capital can be amended to provide for the implementation and administration of ESOPs in Canada. This can be done by complying with the requirements for such amendment, that is, by obtaining permission to amend by special resolution and class vote.

(c) Share Buy-Backs and ESOPs

As stated previously, a company is prohibited from acquiring its shares, as a general rule. However, there are certain circumstances in which a company may be allowed to acquire its shares. One such circumstance is when the company is obliged to purchase shares owned by its director, an officer or an employee in terms of a non-assignable agreement.[915] A share repurchase helps the company to guard against a hostile takeover.[916] Companies also attempt to increase the market value and directly remunerate shareholders from whom the shares are repurchased without increasing dividends.[917]

Furthermore, article 36(1) of the Act permits a company to purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price. Redeeming the redeemable shares must be preceded by the solvency and the liquidity test. In other words, the company must conduct an inquiry into the company's financial affairs and determine whether the company will be able to pay its liabilities when they become due and whether the company's assets are sufficient to cover liabilities.[918] Interestingly, the Act provides a further requirement. Before any repurchase of shares is made, the company must also ensure that it will have enough funds to pay shareholders any benefits

[915] Section 35 (1) (c) of the Canada Business Corporations Act, 1985.
[916] Priscariu M Parascu D 'The repurchase of shares-Another form of rewarding investors-A theoretical approach' (2013) 3 *Journal of Public Administration, Finance and Law* 76.
[917] Ibid.
[918] Section 36 (2) of the Canada Business Corporations Act, 1985.

they will become entitled to after such as repurchase is made.[919] Only once the aforementioned inquiry is made, and on reasonable grounds, the company believes that it can meet its financial obligations towards the creditors and the shareholders can it proceed to redeem shares previously issued by it and held by persons in its employment.

Redeemable shares become necessary in the implementation and administration of ESOPs. If a company solely or partly deals in ESOPs, conditions relating to the repurchase of shares could be set in the founding document of the company so that employees can sell their shares to the company.

(d) Mandatory Offer Rules and Implementation of ESOPs Through Empowerment Deals

In corporate law, legal rules can take one of three forms: mandatory rules that all corporate actors must follow and cannot be avoided; enabling rules that give legal force to the rules or agreements that corporate actors adopt or reach; and default rules that provide standard-form rules that govern corporate actors' dealings unless they expressly or implicitly decide to opt-out and adopt their own.[920] The introduction of mandatory corporate rules helps to achieve economic efficiency and prevent market failures.[921]This section of the thesis deals with mandatory offer rules and the extent to which these rules allow for the implementation of ESOPs in Canada.

The Canada Business Corporations Act of 1985 sets out extensive procedural rules in terms of mandatory rules as follows:

Firstly, for the offeror to be entitled to acquire shares held by the dissenting offerees, the takeover bid must be accepted by the holder of at least ninety per cent of the shares to which the takeover relates. This amount excludes the shares held by or on behalf of the

[919] Section 36 (2)(b)(ii) of the Canada Business Corporations Act, 1985.
[920] Poonam P ‘’The Hallmarks of Good Corporate Law: A Performance Evaluation of the Canadian Business Corporations Act’’ (2004). Commissioned Reports and Studies. Paper 115.
[921] Ibid.

offeror or an affiliate or associate of the offeror. The take-over bid must be accepted within one hundred and twenty days after the take-over bid.[922]

Secondly, the offeror must send a registered mail to the dissenting offeror to acquire the shares held by the latter. This said mail must be sent within sixty days after the take-over bid's termination date.[923] Furthermore, the offeror's notice must be sent by registered mail within one hundred and eighty days after the take-over bid, to each dissenting offeree and the Director.[924] The said notice must contain the following information, the offerees holding at least ninety per cent of the shares to which the bid relates accepted the take-over bid; the offeror's obligation to acquire and pay for or acquire and pay for the shares of the offerees who accepted the take-over bid; the dissenting offeree's right to elect to either transfer their shares to the offeror on the terms on which the offeror acquired the shares of the offerees who decided to accept the take-over bid, or to demand payment of the fair value of the shares in accordance to the applicable law.[925] In the latter situation, the offeree should notify the offeror within twenty days after receiving the notice from the offeror. If the dissenting offeree fails to notify the offeree as required, it is deemed to have elected to transfer the shares to the offeree on the same terms that the offeror accepted the shares from the offerees who accepted the take-over bid.[926] Furthermore, a dissenting offeree must send their shares concerned to the mandatory offer transaction to the offeree corporation within twenty days after receiving the offeror's notice.

The third rule relates to the share certificates. It calls upon a dissenting offeree to send the share certificates of the class of shares to which the take-over bid relates to the offeree corporation.

The fourth rule relates to payment and states that the offeror is required to pay or transfer to the corporation the amount of money or other consideration to the dissenting offeree who has accepted the take-over bid as proposed in accordance with the law. This

[922] Section 206 (2) of the Canada Business Corporations Act, 1985.
[923] Section 206 (3) of the Canada Business Corporations Act, 1985.
[924] Section 206 (3) (a) and (b) of the Canada Business Corporations Act, 1985.
[925] Section 206 (3) (c) of the Canada Business Corporations Act, 1985.
[926] Section 206 (3)(d) of the Canada Business Corporations Act, 1985.

payment or transfer must be made within twenty days after the offeror's notice is sent to the offeree.

Fifthly, the offeror is required to apply to the court to fix the fair value of the shares of dissenting offeree in the situation where the dissenting offeree has elected to demand the payment of the fair value of the shares. The offeree is not precluded from applying to the court if offeror fails to make such an application within the prescribed period.[927] To ensure that the offer is of a fair value, the court may, upon such application, appoint one or more appraisers to assist in determining or fixing the fair value of the shares of the dissenting shareholders.[928]

The last rule relates to the court order in respect of the mandatory offer transaction. The court order made against the offeror in favour of the dissenting offeree, including the amount for the shares as fixed by the court, is final and binding. The court may make any other order as it deems fit.

A number of observations can be made about the mandatory offer rules in Canada. The approach followed by Canada, which South Africa adopted, involves a court free statutory merger procedure.[929] The Canadian Corporate Law on mandatory offer rule also permits the payment of a cash consideration as explicitly provided for in the Act.[930] The legislative rule calling on the offeror to pay the money or other consideration in advance promotes the efficiency of the transaction.[931] Hence, the minority shareholders will not be robbed of their monetary value along the process. The call for the offeree to first make its application before the offeree's application is a well-designed and thought-through approach and arrangement of mutual restraint, which helps parties to arrive at a fair value price.[932]

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[927] Section 206 (9) of the Canada Business Corporations Act, 1985.
[928] Section 206 (16) of the Canada Business Corporations Act, 1985.
[929] Davids (2008) op cit 384.
[930] Ibid at 345.
[931] Ji J, '*Protecting Minority Shareholders in Private Corporations: A Comparative Study from Canadian and Chinese Perspectives'* (LLM thesis, University of British Columbia) 141.
[932] Ibid.

Furthermore, the Canadian company law allows the minority shareholders use Corporate Law remedies such as the oppression remedy,[933] derivative action[934] and the right to dissent[935] to have their rights protected. The primary purpose of the oppression remedy is to safeguard the interest of vulnerable parties.[936] Where it is possible to use oppression remedy against a wrong that is purely derivative in nature, a party is then entitled to use derivative action to recover their losses. In the case of *Rea v. Wildeboer*[937], the court was called upon to decide whether a complainant can succeed on a claim of an oppression remedy, where a claim is derivative in nature. In other words, in terms of a wrong done solely to the corporation. The court, in this case, outlined the requirements that must be complied with before successfully relying on an oppression remedy. The court said that the impugned conduct must be "oppressive" of or "unfairly prejudicial" to or "unfairly disregard" the interests of the complainant. The oppression remedy and derivative action are two different remedies founded on different statutory requirements. The court concluded that whilst the oppression remedy is a personal remedy; derivative action is a corporate remedy. This case illustrates that while several remedies can be available for one to choose from, the facts of each particular case will dictate the suitable remedy to rely on for a successful claim. In another locus classicus case of *Re Ferguson and Imax System Corp.,*[938] the court made an important observation. It stated that the oppression remedy must be applied to balance stakeholder protection with management's ability to do business efficiently. Hence, though oppression remedy is a form of protection for minority shareholders, it is an extreme form of judicial intervention and must be relied on or claimed only in extreme situations.[939]

[933] Section 241 of the Canada Business Corporations Act, 1985.
[934] Section 239 of the Canada Business Corporations Act, 1985.
[935] Section 190 of the Canada Business Corporations Act, 1985.
[936] Poonam P ''The Hallmarks of Good Corporate Law: A Performance Evaluation of the Canadian Business Corporations Act'' (2004). Commissioned Reports and Studies. Paper 115.
[937] 2015 ONCA 373.
[938] (1983), 43 O.R (2 ed) 128 (C.A).
[939] *Catalyst Fund General Partner I Inc. v. Hollinger Inc.* (2004), 1 B.L.R (4th) 186. (Ont. Sup. Ct.J.).

6.4 Financial Assistance to Implement ESOPs

6.4.1 Compliance with Financial Assistance Requirements

It has become a customary practice for companies to provide financial assistance to persons under their employment to acquire shares or to partake in employee ownership. Canada is no exception to this practice. The standard practice is for companies not to extend financial assistance to employees unless it is in a financially healthy position. This position is endorsed in various provisions in the Canada Business Corporations Act. But before discussing the new provisions, it is important to reflect on the situation before the amendment.

Section 34 deals with the company's powers to acquire its shares and places a condition on the company, which condition must be met before the company could acquire its shares. This requirement relates to the liquidity and the solvency test. The condition calls for the company to conduct a financial inquiry guaranteeing that it would be able to pay for its liabilities as they become due or that the realisable value of the assets would be sufficient to finance its liabilities and the capital of all classes. What is interesting about section 34 (2) is the use of the word ‘or’ separating paragraphs (a) and (b). The general interpretation and understanding of the solvency and liquidity provisions found in Corporate Laws are that both the solvency and the liquidity tests must be met before the company can engage in a financial transaction that calls for compliance with such tests. But the language of section 34 of the Act somehow suggests that a company would acquire shares if one of the tests is met. Thus, the company is required to ensure that it would either pay its liabilities as they become due (the liquidity test) or that its realisable value of the assets would be sufficient to pay for the liabilities and the capital of all classes (the solvency test).

Furthermore, a company is entitled to declare and payout dividends as long as one of the two tests has been complied with. As stated above, though section 42 does not deal with the acquisition of shares, making reference to it and outlining any observations

surrounding its wording becomes essential. It is centred around the solvency and liquidity test and the latter being important for the financial assistance for ESOPs.

Although Section 42 does not deal directly with the acquisition of shares it deals with the payment of dividends to shareholders and speaks the similar language used in section 34. The section states that for a company to declare or pay dividends, it must be established that there are reasonable grounds for believing that the company will be able to pay its liabilities as they become due, or the realisable value of the company's assets will be sufficient to pay for liabilities and cover the stated capital of all classes.[940]

Legislative provisions of the solvency and liquidity test, as outlined above, do not make reference to the financial statements normally used in determining the financial results and the company's financial position. The only reference to the financial statement is provided for in section 155 (1), which mandates directors to disclose financial statements to the shareholders and provide any other information relating to the company's financial position. There is no direct correlation between the two provisions, namely section 34 and section 155 (1). To bring the correlation between the two sections, one could conclude that the solvency and liquidity test mentioned in reference to section 34 would only be determined in terms of the financial statements mentioned in section 155 (1). Be that as it may, one would have expected that a statute of this nature makes some form of reference to express elements of financial statements such as fixed assets, current assets, current liabilities, income and expenditure. This would have given some form of guidance to directors responsible for interpreting the financial statements and ensuring compliance with the solvency and liquidity test before financial assistance for the acquisition of shares.

Another important feature that has been omitted from both sections 34 and 42 of the Act is the reference made to the 'ordinary course of business'. In other words, the application of the solvency and the liquidity test must relate to the assets of the business and the debts and liabilities to be incurred in the ordinary course of business of the company. One could assume that the reason for this omission is based on the fact that dealing with the

[940] Section 4 of the Canada Business Corporations Act, 1985.

financial position and result of the entity solely involves the business transactions of the company entered into in respect of its ordinary business course. Although this interpretation would be correct, it leaves much to be desired. Gaps in the law may create uncertainty in determining the company's financial position and result, post-financial assistance. Canada's status quo may invite possible lawsuits to establish the legislature's intention, which could be costly for the company and any other interested litigant in issues of this nature.

6.4.2 The 'Adequacy of Consideration' Requirement and Methods of Financing the ESOP Transaction

(a) Provision of Services as Consideration for the Purchase of Shares

In the Canadian context, a potential shareholder must be fully paid for the shares before these can be issued to him or her.[941] Hence, the issuing company must receive some form of consideration before the shares can be issued and taken up by the potential shareholder. Considerations may be in the form of money, property or past services, provided that such consideration must not be below the fair value of the shares.[942] Any consideration received by the company in respect of the shares issued is stated in the capital account kept by the company.[943] The capital account must be regularly updated to reflect the considerations received by the company.[944]

When shares are paid in money, it is easy for a company to determine the adequacy of the shares. In other words, the purchaser of the shares, in this case, makes the payment of the shares in the exact amount that has been fixed on the shares. For example, if one unit of the shares costs one dollar and the subscriber wants to purchase five units, he/she has to pay five dollars to receive the five units or have the five units issued to him/her.

[941] Section 3 of the Canada Business Corporations Act, 1985.
[942] Section 3 of the Canada Business Corporations Act, 1985.
[943] Section 26(1) of the Canada Business Corporations Act, 1985.
[944] Section 26 (2) of the Canada Business Corporations Act, 1985.

Determining the adequacy of a consideration becomes more complex when consideration is given in a form other than money.

(b) Other Methods Relevant to ESOPs Recognised in Law as Consideration

Apart from providing consideration for shares in the form of money or services, a potential shareholder may provide property to acquire shares in a company.[945] A promissory note or a promise to pay does not constitute property to subscribe for shares.[946]

6.5 The Influence of Labour Law on ESOPs

Labour law generally influences the labour relations between an employer and an employee. Hence, any discussions relating to the employment relationship cannot exclude the reference to labour law. Furthermore, employee-shareholders are first and foremost employees before they are shareholders. Therefore, it is natural to discuss the principles that affect the employment status of employees at the workplace and how such factors may impact the implementation and continued operation of ESOPs.

Discussing the employees of Canadian law on ESOPs is important for two reasons. Firstly, such a discussion will aid in determining how the Canadian labour laws either promote or hamper the introduction and operation of ESOPs within a company. Secondly, as the thesis aims to look at ESOPs from a South African perspective, it is well fitted to use Canadian law to draw a comparative study because the South African labour law, especially the EEA, is based on the Canadian jurisdiction.[947]

[945] Section 25 (3) of the Canada Business Corporations Act, 1985.
[946] Section 25 (5) of the Canada Business Corporations Act, 1985.
[947] Horwitz (2011) Op cit note 479.

6.5.1 Employment Equity Act sc 1995

The purpose of this Act is to achieve equality in the workplace so that no person shall be denied employment opportunities or benefits for reasons unrelated to ability and, in the fulfilment of that goal, to correct the conditions of disadvantage in employment experienced by women, Aboriginal peoples, persons with disabilities and members of visible minorities by giving effect to the principle that employment equity means more than treating persons in the same way but also requires special measures and the accommodation of differences.[948]

Every employer shall implement employment equity by identifying and removing employment barriers imposed on members of designated groups due to the employer's employment systems, rules, and practices not authorised by law. Furthermore, establishing such positive policies and practices will ensure that persons in designated groups achieve a level of representation in each occupational group in the employer's workforce that reflects their representation in the Canadian workforce or those segments of the Canadian workforce that are identifiable by qualification, eligibility, or geography and from which the employer may reasonably be expected to draw employees.[949]

Bearing in mind the colonisation and colonial laws and policies that existed before Canada attained its freedom and independence, laws such as the employment Equity Act are important and much-needed legislative development. It ensures that all persons are treated equally, and where there is differential treatment, it must comply with the affirmative action principles laid down in section 15 (2) of the charter on the rights and freedoms of the Canadian Constitution.

There are certain gaps in terms of the Canadian Employment Equity Act. Firstly, the Act does not provide concise definitions of unfair discrimination and employment equity,

[948] Section 2 of Employment Equity Act, SC 1995.
[949] Section 5 of the Employment Equity Act, SC 1995.

respectively.[950] This is despite the fact that the Act aims to achieve equality in the workplace through employment equity.[951]

There are two common features between the labour legislation of Canada and South Africa. Firstly, both these statutes seek to promote equal opportunities for disadvantaged groups.[952] The difference lies in the composition of the groups because of the historical trajectories.[953] The two countries do not share the same history. Furthermore, both the Canadian and South African legislation on employment equity recognise the need for employers to eliminate barriers to employment and develop employment equity plans, both on a short-term and long-term basis.[954]

6.6 The Role of the Constitution Towards Economic Transformation

Akin to the South African position, the Constitution of Canada is the supreme law of Canada, and any law that is contrary to provisions of the constitution is of no force or effect to the extent of the inconsistency.[955] All laws trace their legitimacy from the constitution, and such law or policy must pass the test of correctness when weighed against the constitution: to be valid, have an effect and enforceable.

The Canadian Constitution guarantees the protection of rights and freedoms set out therein. These rights include the enjoyment of freedom of consciousness and religion,[956]

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[950] Reference is however made to the procedure to be followed in achieving employment equity. See section 5 of the Employment Equity Act, sc 1995, which has also been outlined earlier in this chapter. One can draw inference from the provisions of section 5 in coming up with a definition of employment equity. However, one expects a statute of this magnitude to provide a definition of employment equity under the section that deals with definitions, in this case, section 4. This will avoid any possible problems that may arise when there is a dispute with regard to the employer's conduct in failing to ensure compliance with employment equity within the workplace. It would be argued that the answer to whether or not the employer has implemented employment equity, will be found by applying the provisions of section 5. Although section 5 provides the test for compliance with employment equity requirements, it is natural that each legislation provides the definitions of key terms in the legislation. Hence, section 5 does not provide the definition of employment equity, but rather the test for employment equity. The courts will still be required to establish the definition of employment equity if the issue relating to employment equity finds itself on the court's doorsteps.

[951] Preamble of Employment Equity Act, sc 1995.

[952] Jain H & Wikin C (2012) Op Cit note 30'at 7.

[953] Ibid.

[954] Ibid.

[955] Section 52 (1) of the Employment Equity Act, SC 1995.

[956] Section 2(a) of the Canadian Constitution.

the freedom of thought, belief, opinion and expression,[957] freedom of association;[958] the enjoyment of democratic rights;[959] and the enjoyment of mobility rights.[960] In Canada, the constitution expressly entitles citizens the right to move and gain a livelihood. Section 6 (2) of the Canadian Constitution states that every Canadian citizen and permanent resident has the freedom to live and work in any province.

The Oxford dictionary defines 'livelihood' as means of earning money in order to live.' In other words, gaining a livelihood means actively doing something to gain money, which is used to sustain and take care of yourself and your dependents. In this regard of promoting mobility to gain a livelihood, the drafters of the Canadian Constitution were Cognisant of two things, firstly, a citizen or permanent resident of Canada may not always get an opportunity to gain a livelihood where he or she is born or resides at a particular point in time Secondly, it is possible to find an opportunity of earning a better livelihood elsewhere in Canada. On this basis, Canada has deemed it important to include mobility rights in the constitution. This constitutional provision is very interesting, particularly when a comparative analysis is performed with regard to mobility rights. Although moving around in one's jurisdiction to find employment or conduct a business is common in most jurisdictions, the express provision of mobility rights in a constitution is unique.

In Canada, every individual is equal before and under the law and is entitled to equal protection without discrimination based on the grounds set out in section 15 of the Constitution.[961] In addition to the constitutional provision on the protection of equality rights, the Canadian Human Rights Act prohibits discrimination on the grounds of race, national or ethnic origin, colour, religion, age, sex, sexual orientation, gender identity or expression, marital status, family status, genetic characteristics, disability and conviction for an offence for which a pardon has been granted or in respect of which a record suspension has been ordered. The enactment of any law, policy, programme or activity aimed at promoting and advancing individuals or groups will not result in prohibited

[957] Section 2(b) of the Canadian Constitution.
[958] Section 2(d) of the Canadian Constitution.
[959] Section 3 of the Canadian Constitution.
[960] Section 6(2) of the Canadian Constitution.
[961] Section 15(1) of the Constitution.

discrimination provided that such preferential treatment is meant to ameliorate the conditions of the disadvantaged because of their race, national or ethnic origin, colour, religion, sex, age, and mental or physical disability.[962] In other words, the enactment and implementation of affirmative action laws, policies, and programmes are permitted in terms of Canadian law, provided they aim to redress inequality and past discriminatory practices.

On the developmental front, the Canadian state and its provincial governments have a constitutional mandate to promote equal opportunities for Canadians' well-being, further economic development, reduce disparity in opportunities; and provide essential public services of reasonable quality to all Canadians.[963] Enforcing socio-economic rights potentially to promote equal access to resources and services came under scrutiny in the *Manitoba Keewatinowi Okimakanak Inc v Manitoba Hydro-Electric Board.*[964] According to the court, section 36 may have been intended to create enforceable rights. The fact that the constitutional drafters of Canada deem it necessary to include a provision in the constitution which aims to reduce disparities in opportunities indicates that prior to this constitutional enactment, some inhabitants of Canada were denied opportunities. Even with the enactment of the constitution, it is possible for disparities in opportunities to exist if the law and its application are not followed to the latter. Thus, the constitutional mandate of Canada indicates the seriousness with which Canada approaches the issue of reducing disparities in opportunities.

As shown above, the interpretation of the constitutional provisions indicates that the Canadian Constitution advocates for transformative constitutionalism. However, transformative constitutionalism can only work properly in a country with a continuously growing economy. Statistics, especially with regards to exports from Canada, give a clear indication that the Canadian economy is growing. Therefore, it is possible to apply economic principles allowing for the distribution of resources.

[962] Section 15 (2) of the Constitution.
[963] Section 36(1) of the Constitution.
[964] (1992), 91 DLR (4th) 554, 78 Man R (2d) 141.

6.7 Policies Regulating Development

6.7.1 The 2030 Agenda for Sustainable Development

In September 2015, Canada and 192 other UN member states adopted the 2030 Agenda for Sustainable Development.[965] The 2030 Agenda is a 15-year global framework centred on an ambitious set of 17 Sustainable Development Goals (SDGs), 169 targets and over 230 indicators.[966] The 2030 Agenda envisions a secure world free of poverty and hunger, with full and productive employment, access to quality education and universal health coverage, the achievement of gender equality and the empowerment of all women and girls, and an end to environmental degradation.[967]

The 2030 Agenda is a global framework of action for people, the planet, prosperity, peace, and partnership. It integrates social, economic, and environmental dimensions of sustainable development and peace, governance, and justice elements. It is universal, meaning that developing and developed countries will implement the 2030 Agenda. Furthermore, the Agenda includes an overarching principle of ensuring that no one is left behind in achieving the SDGs.[968]

For Canada, the 2030 Agenda calls for concerted efforts to build an inclusive, sustainable and resilient future, a secure world founded on human rights and the rule of law, free from poverty and hunger. One with full and productive employment and access to quality education and universal health coverage, where gender equality has been achieved, culture and diversity are celebrated, and the environment is protected.[969]

[965] Hagen-Zanker J Mosler Vidal E & Sturge G *Social protection immigration and the 2030 Agenda for Sustainable Development* (2017) 2-14.
[966] Ibid.
[967] Ibid.
[968] Ibid.
[969] Ibid.

6.7.2 Federal Sustainable Development Act (S.C. 2008, C. 33)

This Act requires the development and implementation of a Federal Sustainable Development Strategy and the development of goals and targets with respect to Canada's sustainable development and to make consequential amendments to another Act.[970]

This Act aims to provide the legal framework for developing and implementing a Federal Sustainable Development Strategy that will make environmental decision-making more transparent and accountable to Parliament.[971]

A committee of the Queen's Privy Council for Canada, consisting of a Chairperson and other members of the Queen's Privy Council for Canada, shall oversee the development and implementation of the Federal Sustainable Development Strategy.[972]

The Government of Canada accepts the basic principle that sustainable development is based on ecologically efficient use of natural, social and economic resources and acknowledges the need to integrate environmental, economic and social factors in making all decisions by the government.[973]

6.7.3 An Act to Eliminate Poverty in Canada

The preamble of this Act states that the government has direct involvement in reducing poverty and plays a central role in programmes providing social protection and income security.[974] Due to the pivotal role played by the government in reducing poverty in Canada, an Act to eliminate poverty in Canada was enacted to impose on the federal government the obligation to eradicate poverty and promote social inclusion.[975] This is to be done by establishing and implementing a strategy for poverty elimination in consultation with the provincial, territorial, municipal and Aboriginal governments.[976] The

[970] Preamble of Federal Sustainable Development Act (S.C. 2008, c. 33).
[971] Section 3 of Federal Sustainable Development Act (S.C. 2008, c. 33).
[972] Section 6 of Federal Sustainable Development Act (S.C. 2008, c. 33).
[973] section 5 of Federal Sustainable Development Act (S.C. 2008, c. 33).
[974] The Preamble of An Act to eliminate Poverty in Canada.
[975] Section 2 of An Act to eliminate Poverty in Canada.
[976] Ibid.

primary focus of the strategy is all persons living in poverty.[977] The strategy must aim to strengthen the social and economic safety nets; promote the participation of residents; respect human rights, and, most importantly reflect on the needs of the local communities.[978] The needs of persons in different jurisdictions, provincial, territorial and/or municipal areas differ, and strategies and policies that are developed are developed are required to bear the needs of the people in a particular area in mind. The strategy and policy must speak to the needs of the people.

Apart from referring to the focus area and objects of the strategy, an Act to eliminate poverty in Canada further sets out provisions that relate to the content[979] of a strategy and factors.[980] What is most outstanding with regards to this legislation are the measures to be taken. The government of Canada is required to make use of all relevant poverty measures to prepare, monitor and report on the strategy, including the measures of low income and indicators of social exclusion.[981]

Various strategies have been introduced in Canada with the purpose of addressing poverty. These are the Low-Income Cut-off, Low Income Measure and the Market Basket Measure.[982]The Statistics for Canada's Low-Income Cut-Off (LICO) is most commonly referred to as the measure of poverty. To address and deal with poverty, it is important to first measure poverty.[983] The measure of poverty will help one to come up with ways to address poverty. Therefore, LICO was adopted to measure poverty as there was no official measure of poverty in Canada prior to its adoption.[984] The LICO defines an income threshold below which a family is likely to spend significantly on food, shelter and clothing than the average family. A family with an income below the cut-off is considered low income.[985] LICO provides a table which shows the poverty line in urban areas of Canada with a population of 500 000 or more, with the result that if your income is below LICO,

[977] Ibid.
[978] Section 4(3) of An Act to eliminate Poverty in Canada.
[979] Section 5(1) of An Act to eliminate Poverty in Canada.
[980] Ibid, section 5 (2) of An Act to eliminate Poverty in Canada.
[981] Ibid.
[982] Smith CT, Andrea L 2017 *Critical Social Policy* 127.
[983] Ibid.
[984]Ibid.
[985] Ibid.

you are poor.[986] As previously stated, no effective policies can be designed to combat poverty with the proper means to detect and measure poverty.

Apart from LICO Canada, Ontario has introduced the Low-Income Measure (LIM) through Statistics Canada. Whilst both LICO and LIM focus on the measure of poverty, LIM is generally reserved for international comparisons. The LIM is equal to one-half of the median income of Canadian families, adjusted for family size and composition. Unlike the LICO, where poverty is measured considering the community size, LIM concludes that one is poor if your income falls below 50 per cent of the median income. It does not take into account community size. Using this definition, people live in poverty if their income falls below 50 per cent of the median income.[987]

Human Resources Development Canada developed the Market Basket Measure (MBM), after due consultation with a federal/provincial/territorial working group of officials on Social Development Research and Information.[988] The purpose of MBM was not to replace LICO and LIM but to complement it.[989] Thus, the Market Basket is a specified basket of goods and services that a family of two adults and two children require for a decent standard of living.[990] The basket can be adjusted to reflect various family sizes. This basket includes basic needs such as food, clothing, shelter and shelter-related costs, and other items deemed necessary for social inclusion (e.g., transportation, furniture, reading material, Internet, phone and entertainment). A person has a low income if their family income falls below the cost of a predetermined basket of goods and services for their community. While this measure may increase the number of people identified as living in poverty, it can be a useful tool to track progress made on specific poverty reduction targets.[991]

6.7.4 Economic Development Agency of Canada for the Regions of Quebec Act

[986] LICO Table 2020 – Low Income Cut-Off Canada, available at https://www.settler.ca/english/lico-2020-canada/, accessed on 12 June 2021
[987] Smith CT, Andrea L Op cit note 979 at 122.
[988] Ibid.
[989] Ibid.
[990] Ibid.
[991] Ibid.

The primary purpose of the Economic Development Agency of Canada for the Regions of Quebec Act is to promote the development and diversification of the economy of the regions of Quebec.[992]

To achieve the objectives set out in the Act, the Minister is required to exercise his or her powers and perform his or her duties and functions in a manner that: (a)promote economic development in Quebec regions with low incomes, slow economic growth, or insufficient opportunities for productive employment, (b) emphasise economic development on a long-term basis and sustainable employment and income creation; and (c) concentrate on small and medium-sized businesses and the development of entrepreneurial talent.[993]

Section 8 of the Act establishes the Economic Development Agency of Canada for the regions of Quebec. Section 10 provides for the object of the agency. It states that the objective of the Agency is to promote the long-term economic development of the regions of Quebec by giving special attention to those where slow economic growth is prevalent or where opportunities for productive employment are inadequate. The agency may establish, implement, direct and manage programmes and projects or offer services intended to contribute directly or indirectly: to the establishment, development, and promotion of businesses in Quebec, to the development of entrepreneurial talent in Quebec, to economic success in Quebec, and community development in Quebec.[994]

6.7.5 Investment Canada Act

The Canadian legislature places emphasis on recognising that increased capital and technology benefit Canada and protect national security. Therefore, the government, through legislative means, seeks to provide for the review of significant investments in

[992] Section 3 of the Economic Development Agency of Canada for the Regions of Quebec Act.
[993] Section 6 of the Economic Development Agency of Canada for the Regions of Quebec Act.
[994] Section 11 of the Economic Development Agency of Canada for the Regions of Quebec Act.

Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities and provides for the review of investments in Canada by non-Canadians who could be injurious to national security.[995]

A possible application of this Act that was seen to have an overriding impact on SOEs was observed in 2007 when the government released guidelines for reviewing foreign investments made by state-owned enterprises (SOEs) to determine if they are likely to be of net benefit to Canada. According to Assaf and Mcgillis, an investor is an SOE if the government of a foreign state or an entity controlled or influenced, directly or indirectly, by a government or agency of government is the investor.[996]

Marchik and Slaughter,[997] hold that the new guidance clarifies that the Canadian government when reviewing investments by SOEs, will consider whether they adhere to Canadian standards of corporate governance. Furthermore, it also assesses the impact of the acquisition on a company's exports, the location of its manufacturing and research and development facilities, and whether the acquirer will provide an appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.[998]

A classic case study was observed when two controversial proposed acquisitions of Canadian oil companies in 2012 led to an additional guideline for investments by SOEs in Canada's oil sands. One acquisition involved the takeover of Progress Energy Resources by Petronas, the Malaysian government's national oil company. According to Assaf and Mcgillis, Petronas' proposed acquisition was initially rejected by the federal government but was ultimately approved after the revision of Petronas' undertakings. The second acquisition involved the Canadian company Nexen, which was acquired by the state-owned China National Oil Company (CNOOC). Generally, in the aftermath of these two controversial acquisitions, the federal government announced as an executive override that acquisitions of Canadian-owned oil sands companies by SOEs would be

[995] Section 2 of the Investment Canada Act.
[996]Assaf D & McGillis R *Foreign Direct Investment and the National Interest* (2013) 11.
[997] Marchik D & Slaughter M "*Global FDI Policy: Correcting a Protectionist Drift" CSR* 2008 8.
[998]Globerman S '*An Economic Assessment of the Investment Canada Act' (*2015) 7.

approved only in exceptional circumstances, although each case would be examined on its own merits.[999]

6.7.6 Canadian Income Tax Act RSC, 1985

The Canadian Income Tax Act is very important in poverty reduction and employee ownership schemes. Imposing high taxes on the little income of the poor and further imposing high taxes on income through employee share schemes goes against the principles of poverty reduction and improving the wellbeing of the poor. In this context, no tax is payable by a trust on the trust's taxable income for a taxation year throughout which an employee's profit-sharing plan governs the trust.[1000]

6.8 Practical Aspects of Employee Share-Ownership Schemes

The ESOP Association in Canada is a not-for-profit organisation, formed in November 1990, which chiefly focuses on promoting the idea of employee share ownership plans (ESOPs) for business in Canada. The Association hosts educational events, share research and convenes a community of employee-owned companies.[1001]

The Association believes that the key aspect pertaining to the employee share ownership plan is that employees have an ownership stake in the company they work for and share in the risks and rewards that accrue to it.[1002]

The ESOP Association Canada offers individuals and companies interested in employee ownership a free membership lasting over a year.[1003] After joining the association as a member, an individual or a company may be entitled to free ESOP Association Canada webinars (quarterly) and gain access to the volunteer ESOP community mentors.[1004]

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[999] Ibid.
[1000] Section 144(2) of the Canadian Income Tax Act (RSC 1985).
[1001] ESOP Association of Canada, available at https://www.esopcanada.ca/,accessed on 13 April 2021.
[1002] Ibid.
[1003] Ibid.
[1004] Ibid.

There are many companies that have introduced employee share-ownership schemes in Canada and are thus owned wholly or partly by employees. Some examples of companies which make use of ESOPs are outlined below.

6.8.1 West Wind Aviation

West Wind Aviation was established in 1983, offering a diverse range of aviation solutions to safely meet corporate or leisure travel needs.[1005] West Wind Aviation is employee owned. Athabasca Basin Development, which represents the seven communities in the Athabasca Basin, is the majority shareholder with 65% of the organisation. This alliance, along with employee ownership, has offered West Wind an opportunity for growth and expansion while continuing to build on the company's strengths.[1006]

In the front of community involvement, West Wind Aviation operates by providing donations, volunteer programmes and charitable contributions to support organisations that help address the critical healthcare, educational, cultural and economic needs of communities.[1007]

6.8.2 Rogers Insurance Ltd

Once a small insurance brokerage, Rogers Insurance is a national organisation with over 400 employees. Today, Rogers Insurance Ltd is one of the largest and most diversified brokerages in Canada, with a portfolio of thousands of individual and corporate clients representing virtually every sector of the North American economy.[1008]

[1005] West Wind Aviation, available at https://www.westwindaviation.ca/about-us/, accessed on 13 April 2021.
[1006] Ibid.
[1007] West Wind Aviation, available at https://www.westwindaviation.ca/about-us/community-involvement/, accessed on 13 April 2021.
[1008] Rogers P, Rogers Insurance available at https://www.rogersinsurance.ca/about-us/, accessed on 13 April 2021.

Rogers Insurance always puts its clients first as an employee-owned and independent Canadian insurance company.[1009] As one of Canada's top brokerages, Rogers Insurance has access to over 90 global insurers and underwriting facilities.[1010]

6.8.3 Admiral Insurance Halifax

Admiral Insurance Halifax, yet another corporation which specialises in insurance, has been sharing the wealth with its employees since its initial public offering on the London Stock Exchange in 2004. Bi-annually, Admiral purchases £1,800 (approximately $3,000 CDN) of its shares on behalf of every staff member who has been with the company for over a year.[1011]

After a three-year vesting period, shares and any accompanying profits are paid out bi-annually to the beneficiaries.[1012] Admiral employees are shareholders, and they enjoy the rights and benefits attached to being a shareholder. The company has an employee shares programme and, as such, takes its fiscal responsibility towards its employees seriously. In any corporation, the corporation's success is dependent on employee satisfaction and keeping shareholders happy. Thus, investing in one's employees is a worthy investment.[1013]

The share programme paid out over $1.2 million in share rewards between 205 employees at its Halifax office in 2019. This is a noticeable achievement towards ensuring taking care of the employees' needs, and as such, this programme sets Admiral apart from other employers.[1014]

What is noticeable about Admiral Insurance Halifax is that each employee owns a piece of Admiral through the corporation's free share scheme. Its employees are awarded £3,600.00 worth of shares annually and receive dividends on their shares. Employees

[1009] Ibid.
[1010] Ibid.
[1011] Smith S 2019, available at https://haligonia.ca/admiral-rewards-employee-loyalty-with-ownership-271593/ ,accessed on 13 April 2021.
[1012] Ibid.
[1013] Ibid.
[1014] Ibid.

are entitled to receive shares once they have completed at least one full year of employment and share awards are subject to the company meeting certain performance targets.[1015]

6.8.4 Cando Rail Services Ltd

Cando Rail Services Ltd is another employee-owned company, offering stock purchase and incentive programmes to all employees. The Corporation's Employee Ownership Programme is more than just an ownership structure. Its teams of employee-owners take the duties and opportunities of ownership seriously, thereby ensuring that the company consistently does the best job possible for its customers.[1016]

Cando Rail Services facilitates the safe and efficient movement of products across the entire supply chain. Cando is the crucial linchpin between the industrial customers and the Class 1 railways.[1017]

Even though the corporation's primary objective is to provide a complete rail solution, some of the corporation's service offerings comprise material handling, terminal and trans load services, logistics, engineering and track services, industrial switching, railcar storage, locomotive and railcar mechanical services and short line operations. All these on an individual basis.[1018]

6.9 Canada's Approach to Economic Growth to Date

The Canadian government follows a free market system. In such a system, the individuals, to a larger extent, control the economy and the government's role is to foster development by ensuring free trade, competition and investment. Capitalism advocates for the free market economy. The basis of this theory is that when the welfare of individuals increase, the welfare of the nation also increases. Inclusivity is an important factor in economic growth. Inclusive growth promotes broad sharing of benefits and leads

[1015] Admiral, available at https://joinadmiral.ca/employee-benefits/, accessed on 13 April 2021.
[1016] Cando Rails and Terminals, available at https://www.candorail.com/, accessed on 13 April 2021.
[1017] Ibid.
[1018] Ibid.

to further opportunities for economic growth.[1019] Furthermore, it promotes productive employment across the employment sector, embodying equal opportunities to access markets and resources and protecting vulnerable segments of society.[1020] Governments such as the Canadian government that assist companies to have smooth income fluctuations help foster inclusivity, which benefits the broader public[1021] Furthermore, it is crucial for corporations to be able to expand their business opportunities.

The Canadian government has taken proactive measures towards inclusive growth, such as encouraging private sector investment and co-financing to reduce poverty. [1022] It acknowledges the private sector's key role in driving the economy through trade and investment.[1023]

Fair competition is essential in any jurisdiction. Poor people normally do not have enough money to spend on necessary goods and services. Hence, when fair competition is introduced and continuously practised, it forces businessmen and suppliers to sell their goods at competitive prices. This allows poorer members of the society to afford basic goods and services, entitling them to live a dignified life.

6.10 The Application of the Bill of Rights in the Canadian Context

Discussions around socio-economic rights and the application of the Bill of rights are necessitated by the fact that poverty-stricken persons struggle to access basic resources and services such as food, water, health care and housing. Maybe ESOPS can be the solution to the inability to exercise one's socio-economic rights? As stated in chapter 4, no discussion on expounding the plausibility of using a particular measure to reduce

[1019] Schwanen D "The G20 Framework for Strong, Sustainable and Balanced Growth: A study in credible cooperation" (2010) available at https://www.cigionline.org/publications/g20-framework-strong-sustainable-and-balanced-growth-study-credible-cooperation, accessed on 13 April 2021.
[1020] Ibid.
[1021] Ibid.
[1022] Global Affairs Canada, available at https://www.international.gc.ca/world-monde/issues_development-enjeux_development/inclusive_growth-croissance_inclusive/index.aspx?lang=eng, accessed on 13 April 2021.
[1023] Ibid

poverty will be complete without providing an evaluation of socio-economic rights.[1024] Thus, the section below outlines the crucial socio-economic rights according to the Canadian Constitution. Any failure by the constitution and any other legislation to make provisions for socio-economic rights will indicate that development is not on the agenda of Canada. However, any attempt by the constitution and other legislation to entitle the citizens to enjoy socio-economic rights will indicate that development is at the centre of Canada's policies.

6.10.1 The Right to Food

With jurisdictions within the written constitution, the language used in the constitution sets the tone for all the other legislations enacted in a particular jurisdiction. In the case of Canada, there is no express mention of the right to food in the constitution as in the case of South Africa. However, the Government commits in terms of section 36(1) of the Constitution to promote equal opportunities for the welfare of Canadians. This means that although the right to food is not expressly stated in the constitution, Canada's provincial and/or territorial government must continuously enact laws to promote the right to food. As previously mentioned, one such law is the Act to Combat Poverty and Social Exclusion.

Canada is seen as a 'successful welfare state and a beacon of human rights.'[1025] Human rights play a key role in Canada's legal and political landscape and influence the majority of government laws, policies and programmes.[1026] Canada has heeded the call of international obligations to recognise and implement the right to food.[1027]

Canada has a very comprehensive Charter of Rights and Freedoms, and it has shown strong economic growth over the years. However, it has not managed to achieve food security.[1028] An increasing number of people across Canada cannot meet their needs

[1024] Chapter 4, Para 4.9.
[1025] Rideout K Riches G Ostry A Buckingham D et al., 'Bringing home the right to food in Canada: challenges and possibilities for achieving food security' 2007 *Public Health Nutrition* 567.
[1026] Ibid.
[1027] Ibid.
[1028] Ibid.

associated with food.[1029] This means that they either do not have access to food or do not have access to quality food which is essential for a healthy life. Notwithstanding its healthy economy and wealth of natural resources, Canada experiences food poverty.[1030]

To effectively guarantee and protect the right to food in Canada, it is recommended that legislation that explicitly sets out this aim be enacted at the provincial and federal levels rather than waiting on courts to set the legal precedent.[1031] In the absence of a legislative framework explicitly guaranteeing the right to food and legal enforcement thereof, judicial pronunciation through case law is yet to explicitly recognise the right to food.[1032] This is undesirable as the courts' function is mainly to interpret the law, and thus, the key function of the law-making body of the government cannot be shifted to the courts.

6.10.2 The Right to Water

The constitution is the yardstick against which all other legislations are mentioned, and thus, in the fight against poverty, it is important for the constitution to provide for both human and socio-economic rights. The Canadian Constitution has failed to provide for the socio-economic right, the right to water being one of such rights through setting out human rights under the charter on rights and freedoms. The closest provision to the right to water in the Canadian Constitution is the provision setting out Canada's commitment to promote equal opportunities, particularly, providing essential public services of reasonable quality to all Canadians.

In line with the constitutional commitment to provide public services of reasonable quality to all Canadians, Canada has enacted an Act which provides for the management of the water resources of Canada, including the development and utilisation of water resources, referred to as the Canada Water Act (R.S.C., 1985, c. C-11). As seen from the preamble and its provisions, the Act, to a larger extent, focuses on the management of the water resources and the implementation of programmes that relate to the conservation,

[1029] De Schtter O 'Report of the Special Rapporteur on the right to food on his mission to Canada' (United Nations General Assembly 2012) 2.
[1030] Rideout (2007) op cit note 861.
[1031] Ibid.
[1032] Ibid.

development and utilisation of water resources. There is no express mention of one right to water or how the provision of water to the poor and less privileged can be made. Thus, revisiting the laws regarding water rights is important with the aim of a clear legislative and policy framework ensuring that all persons, particularly the poor, have access to quality and affordable water services.

6.10.3 The Right to Accommodation

As in the case of the right to food, no explicit provision is contained in the constitution regarding the right to housing. However, reading the decision made in the case of *Alcoholism Foundation of Manitoba et al. v Winnipeg (City),* [1033] it is clear, according to the interpretation of the Court, that the Canadian Charter of Rights and Freedoms was enacted to protect disadvantaged minorities against being treated differently from others with respect to their right to the use and enjoyment of land. In this case, the Court was referring to section 15(1) of the Canadian Charter of Rights and Freedoms, which outlaws discrimination on grounds stated in this particular provision.

Canada has enacted the National Housing Act SC. 2019, c. 29, s. 313. In terms of this Act, Canada recognises that housing is essential to the person's inherent dignity and well-being and building sustainable and inclusive communities.[1034] Furthermore, the housing strategy is meant to contribute towards meeting the Sustainable Development Goals of the United Nations.[1035] The key feature of the Act is the National Housing Strategy which, amongst others, must "provide for participatory processes to ensure the ongoing inclusion and engagement of civil society, stakeholders, vulnerable groups and persons with lived experience of housing need, as well as those with lived experience of homelessness."[1036] The Act also establishes the National Housing Council, whose purpose is to further the housing policy.[1037] The extent to which Canada has gone is legislating for the right to housing shows the seriousness with which Canada approaches one's human rights and,

[1033] *Alcoholism Foundation of Manitoba et al lv Winnipeg (City)* (1990) 65 Man. R. (2d) 81 (CA).
[1034] Preamble of the National Housing Act SC. 2019, c. 29, s. 313.
[1035] Ibid.
[1036] Section 5(2)(d) of the National Housing Act SC. 2019, C.29, s. 313.
[1037]Section 6 of the National Housing Act SC. 2019, C.29, s. 313.

in particular, the mandate to reduce poverty. Although having a house or land does not entirely remove a plight resulting from poverty, it is a progressive step towards reducing poverty, and because of this, Canada's legislative move in this regard is commendable.

6.10.4 The Right to Health Care

The health laws in Canada are founded on section 15(1) of the Charter on the rights and freedoms contained within the constitution. This provision, as shown in the earlier discussions on the right to food, water and housing, focuses on the equality of persons before the law and the prohibition of discrimination based on any of the grounds mentioned in the charter. Though no express mention is made about the right to health care in the charter itself, reference is made to one right to equality as contained in the charter when the right to health becomes an issue of discussion.

The Canada Health Act (RSC, 1985) (hereinafter referred to as the Health Act) is the principal legislation that deals with the health-related laws in Canada. The primary purpose of the Health Act is to establish criteria and conditions in respect of the insured health services and extend health care services provided under the provincial law that must be met before a full cash contribution is made. In terms of section 22 of the Health Act, the Governor of the Council may make regulations for the administration of the Health Act, including prescribing the services excluded from hospital services.

Certain services provided by hospitals are not considered medically necessary, and they are not insured under the provincial and territorial health insurance legislation.[1038] These uninsured services which the hospital provides may include preferred hospital accommodation, a physician, private duty nursing services and the provision of telephone and television.[1039]

All persons in Canada have the right to 'general' health care services, which the Canadian government provides through health insurance. Thus, in terms of the Charter of rights

[1038] Minister of Health *Canada Health Act – Annual Report 2014–2015,* available at https://www.canada.ca/content/dam/hc-sc/migration/hc-sc/hcs-sss/alt_formats/pdf/pubs/cha-ics/2015-cha-lcs-ar-ra-eng.pdf, accessed on 13 April 2021.
[1039] Ibid.

and freedoms contained in the constitution, discrimination is not allowed in the provision of health care services. However, when it comes to 'special' services, there may be some form of differential treatment, where those that afford more can enjoy better services and such 'special' services. The question that this may raise is: whether this amounts to prohibited discrimination as contained in article 15 (1) of the constitution? In the case of *Chaoulli v Quebec,*[1040] the Supreme Court of Canada had to decide whether or not the Quebec Health Insurance Act and the Hospital Insurance Act, which prohibited private medical insurance, violated the Quebec Charter of Human Rights and Freedoms.

6.11 Possible Avenues for Guaranteeing the Success of ESOPs in Canada

6.11.1 Financially Healthy Companies

Companies are essential for economic stability and growth and positively contribute to employment and job creation.[1041] The company's financial health is very important not only for the company but for all the relevant stakeholders of the company. Hence, the company's success is beneficial for all the stakeholders of the company. A company is financially healthy if the company is solvent and liquid. As has been pointed out throughout this thesis and also evident from the legislative provisions of the company law of Canada, a company must have sufficient cash to finance its liabilities as it becomes due and payable. To achieve this, it is crucial that the company is financed largely through its assets when compared to liabilities. The moment the assets are equal to the liabilities, the company will run the risk of becoming insolvent in the near future. The second leg that has to do with the company's financial health is found in the company's liability to pay its debts. If the company is solvent and liquid and can operate profitably for a considerable time, such a company can make use of the Corporate Law provisions in terms of the Canadian company law, i.e., the Canada Business Corporations Act, to effect ESOPs.

[1040] *Chaoulli v Quebec* [2005] 1 S.C.R. 791, 2005 SCC 35.

[1041] Kucher A Mayr S Mitter C, *et al* ''Firm age dynamics and causes of corporate bankruptcy: age dependent explanations for business failure'' (2020) 14 *Rev Manag Sci,* available at http://doi.org/10.1007/s11846-0-018-03032, accessed on 23 June 2021.

A financially healthy company can authorise share capital to be issued for ESOPs. If the shares that have been authorised for issue to effect ESOPs are not sufficient, the provisions relating to increasing share capital can be employed to effect ESOPs. The Corporate Law provisions aid the company to organise its affairs in a manner to function properly, and also assists employees to organise themselves and derives some benefits from their employers' business. To this end, employees can acquire shares in the company they are employed. To enable this, a company must authorise and issue shares under the group of shares known as 'employee shares'. Once this is done, shares can easily be taken up by employees. However, in instances where the employees cannot finance the subscription of shares, the company, after complying with financial assistance requirements, can assist employees in acquiring shares.

6.11.2 Financially Distressed Companies

A financially healthy company can fall into financial distress due to factors such as poor managerial abilities, the inability to adapt to the changing business environment and market failure.[1042] If the company finds itself in a situation where it is no longer profitable, it needs to make some operational changes. Thus, a financially distressed company must undergo reorganisation, also referred to as business rescue in some parts of the world. The Canada Business Corporations Act permits reorganisation due to financial distress and also regulates the process of reorganisation. Loosely defined, the reorganisation would mean that the business operations of a financially distressed company are adjusted to the extent that a company which could have otherwise been liquidated and dissolved is allowed to continue with its business operations. Reorganisation occur by means of the court order either in terms of section 241; approval of a proposal made in terms of the Bankruptcy and Insolvency Act; or any other legislation that affects the rights of the corporation, its shareholders and creditors.[1043]

[1042] Section 191 (1) of Canada Business Corporations Act, 1985.
[1043] Section 3(1) of the Canada Business Corporations Act, 1985.

Section 241 (2) states that the court may, upon application, make an order as it thinks fit. Although section 241, in principle, deals with the liquidation and dissolution of a company, the narrow interpretation of subsection 2 clarifies that it does not speak to the order of liquidation. This is because the heading of subsection 2 reads “alternative order”, and the provision under subsection 2 makes reference to an alternative order. Furthermore, section 191 (1), which deals with reorganisation, makes reference to section 242(2). If one considers all these factors, it is clear that section 242(2) deals with the order of reorganisation, which is commonly known as a business rescue in some parts of the world, such as South Africa. This thesis considers this interpretation correct and the said section cannot be afforded any other legally correct interpretation. Despite this being the case, it could be proper to explicitly mention the concept of reorganisation as this will avoid the possible misinterpretation of the law, which, if it happens, can distort the intention of the law-markers.

As stated earlier, restructure may take place in terms of section 191 read together with section 242(2) of the Canada Business Corporations Act. The very first step is the stay of proceedings. The stay of proceedings, especially under the Canada Business Corporations Act, prevents any commencement or continuation of legal proceedings against the insolvent company.

The decision to restructure the company in terms of the BIA is automatically followed by the stay of proceedings.[1044] The stay of proceedings allows the insolvent company the opportunity to develop a proper plan of compromise for approval by creditors. The creditors are required to decide convincing the court to have the company either restructured or liquidated.

A company in financial distress, in terms of section 50 (1.2) of the Bankruptcy and Insolvency Act, hereinafter the BIA, may propose to the creditors to restructure the business. The powers to propose restructuring are vested in the registered holder of the beneficial owner of the prescribed number of shares or the company. In the alternative, the proposal may also be made by persons who have been granted the powers by the

[1044] Section 69 (1) of the Bankruptcy and Insolvency Act No.14, 112/20. See also Kruger JGD, ‘’Restructuring of insolvent corporations in Canada’’ (2010) 13 (3) *PER* 5.

registered owner or beneficial owners of the shares.[1045] When it comes to making proposals for restructuring, the BIA does not impose any financial threshold on the value of outstanding claims against the debtor.[1046] The creditors may respond to proposals by filing a proof of claims with the trustee. The court has the power to accept or reject the claim before the same can be binding on creditors.[1047] However, the court may not approve the plan if the creditors have rejected it.[1048] When deciding whether to approve or reject the plan, the court takes two important considerations into account, namely the reasonableness and the fairness of the plan.[1049]For example, the court may look at any financial or other loss that may be suffered by the stakeholders of the company. If the approval of the claim may, for instance, lead to severe negative financial consequences for a stakeholder, the court may not approve the plan.

The restructuring plan will normally include clauses on how the company wishes to reorganise its affairs and continue functioning without being dissolved. In such a plan, a company may include the need to have the company sold to its employees. This approval will require the need to rely on the Corporate Law principles of authorisation and issue of shares. Considering that the company is to be restructured, some of the provisions relating to the incorporation of a company need to be complied with. Once all the provisions relating to effecting ESOPs are followed, employees can become the company's new owners.

6.11.3 Terminally ill Companies

In some instances, it would be impossible to restructure the company to continue business operations. In such a situation, the only solution is to have the company liquidated and subsequently dissolved. In Canada, creditors may file an application for

[1045] Section 137 (1) (1.1) of the Bankruptcy and Insolvency Act No.14, 112/20.
[1046] Kruger J G D, 'Restructuring of insolvent corporations in Canada' (2010) 13 (3) *PER* 7.
[1047] Ibid at 9.
[1048] Ibid at 6.
[1049] Ibid.

bankruptcy in court against the debtor.[1050] In order to bring such an application properly before the court, an applicant, i.e. the creditor, must ensure that the debtor owes the applicant creditor at least one thousand dollars and that the debtor has committed an act of bankruptcy.[1051] This act of bankruptcy must be committed within six months before the application of bankruptcy is filed.

Three pieces of legislation govern the process of liquidation in Canada, namely the Canada Business Corporations Act (CBCA), the Bankruptcy and Insolvency Act (BIA), and the Companies Creditors Arrangement Act (CCAA).[1052] In Canada, the company can voluntarily initiate the liquidation of businesses. The process involves making an inventory by the trustee of the property owned by the bankrupt company and listing all the assets.[1053] The property is thereafter divested and placed in the hands of the trustee.[1054]

Alternatively, the insolvent company's creditors may also initiate liquidation proceedings by filing an application for a bankruptcy order with the court. In this application, the applicants (i.e., the creditors bringing the application) must show to the court's satisfaction that the debtor committed an act of bankruptcy. [1055] An act of bankruptcy normally happens when the company cannot meet its liabilities as they become due and payable.[1056] A second requirement for the successful application by creditors is that they must show that the company complained or owes the applicant creditor at least 1000 dollars.

[1050] Section 43 (1) of the Bankruptcy and Insolvency Act No.14, 112/20.
[1051] Section 43 (1) (a) and (b) of the Bankruptcy and Insolvency Act No.14, 112/20.
[1052] Section 222 (1) of CBCA sets out the powers of a liquidator as follows: '' liquidator may (a) retain lawyers, accountants, engineers, appraisers and other professional advisers; (b) bring, defend or take part in any civil, criminal or administrative action or proceeding in the name and on behalf of the corporation; (c) carry on the business of the corporation as required for an orderly liquidation; (d) sell by public auction or private sale any property of the corporation; (e) do all acts and execute or, in Quebec, sign any documents in the name and on behalf of the corporation; (f) borrow money on the security of the property of the corporation; (g) settle or compromise any claims by or against the corporation; and (h) do all other things necessary for the liquidation of the corporation and distribution of its property.''
[1053] Section 16 (2) of the Bankruptcy and Insolvency Act No.14, 112/20
[1054] Section 20 (1) of the Bankruptcy and Insolvency Act No.14, 112/20
[1055] Section 43 1(a) of Canada Business Corporations Act, 1985.
[1056] Section 42 (1)(j) of Canada Business Corporations Act, 1985.

If the court makes a bankruptcy order, either by voluntary surrender or compulsory sequestration, the court shall appoint a licensed trustee as the trustee of the bankrupt property. In making this appointment, the court shall have regard for the wishes of the creditors.[1057] This can be followed by stay of proceedings to enable the trustee to administer the liquidation proceedings.[1058] Section 129 (2) of the BIA provides that a property of the insolvent company may be sold at a public auction. The funds generated from the property sale are used for settling creditors' claims. It is suggested that the insolvent company must first offer its property to its ex-employees. If ex-employees successively purchase such property, they can use the same for forming a new ESOP. There is no explicit provision in the Canadian laws that mandate companies to sell the property to employees. However, if introduced in Canadian law, this will to a greater extent, encourage the creation of ESOPs and promote employee ownership.

As in the case of most jurisdictions such as South Africa and Brazil, the liquidation proceedings can be initiated voluntarily by the company or by the creditors. The reason for liquidation is to safeguard the companies against incurring more debts and liabilities. On the other hand, liquidation enables creditors to get something for the debts owed to them by the company.

6.12 Conclusion

Canada has a progressive Corporate Law system where corporate rules can foster company formation and provide companies with the flexibility to operate and run their affairs. The corporate rules of authorisation of shares and rules relating to financial assistance allow companies to assist employees in partaking in ESOPs. Hence, any company that aims to effect ESOPs will state the classes and the maximum number of shares that it is authorised to issue in the AOI for that particular purpose. Furthermore, a company has legislative powers to repurchase shares, and the shares so repurchased

[1057] Section 43 (9) of the Bankruptcy and Insolvency Act No.14, 112/20
[1058] Section 43 (11) of the Bankruptcy and Insolvency Act No.14, 112/20

may be used for effecting ESOPs. Although the Canadian rules of financial assistance are similar to those of South Africa and Brazil as far as the solvency and liquidity test is concerned, these are less comprehensive when compared to those of Brazil.

Even though the Canadian Constitution guarantees economic development and the provision of quality essential public services to all Canadians, it sadly does not make any express provisions pertaining to the right to food, water, housing and health care. However, the many domestic legislation and policy frameworks established in Canada show its strong commitment to ensuring that the country strives to guarantee that the welfare of its citizens remains a top priority. The number of companies that have introduced employee share plans in Canada and the establishment of the ESOP association indicates that a lot can be done through ESOPs towards meeting the short, medium and long-term development goals of a particular country. Although both South African and Canadian jurisdictions have companies that have implemented ESOPs, the Canadian situation supersedes South Africa's status quo. Hence, Canada's approach with regards to implementing the rules on ESOPs is worth emulating.

Choosing the right policy prescription requires an accurate diagnosis, so it is important to understand what has caused increases in inequality in Canada and elsewhere. Only then will we be able to identify measures that are likely to successfully address it. The Canadian Government introduced the Working Income Tax Benefit in 2007. It supplements the incomes of low earners and helps remove disincentives from seeking paid work instead of remaining on social assistance programmes. Moreover, the government's social assistance programmes are a liability as governments spend so much money and resources on people. Social assistance programmes seem to address the issue of poverty on a very short-term basis without delving into the deep and underlying reasons and long-term responses to poverty. It is clear that entrepreneurship and the principles of entrepreneurial law are vital in driving the country's economic development. In Canada, this seems to be the case. The fact that Canada's exports surpass its imports allows the country to depend on its natural resources and thereby contribute largely to its economic growth and development. The free-market system has been the backbone of Canada's economic growth and development. There is no doubt

that ESOPs are growing and flourishing in both number and size in the Canadian economy. Therefore, it is more plausible to implement ESOPs in a continuously growing economy.

As seen above, Canada has also enacted social justice laws and policies to address socio-economic challenges such as poverty and unemployment. However, the enactment of any law or policy without strong entrepreneurial laws and policies cannot effectively address socio-economic issues relating to poverty and inequality.

CHAPTER SEVEN

CONCLUSION AND RECOMMENDATIONS

7.1 Introduction

As one of the countries in Africa which is believed to have a fast-growing economy, South Africa has high poverty levels than one would expect in a country with its level of per capita GDP.[1059] The country is rated to be among one of the most unequal in the world despite the various measures that the government implemented in providing social grants and introducing social programmes to reduce the extent of poverty.[1060]

This research aims to influence lawmakers concerning policies pertaining to transformation in South Africa using the employee share-ownership plans. Furthermore, the research implores various stakeholders to maintain a high level of commitment to contribute to economic growth and development in South Africa. Thus, the purpose of this study was to investigate the plausibility and effectiveness of applying employee share-ownership plans as a transformation mechanism to decrease poverty levels in South Africa. ESOPs are one of the mechanisms that afford employees the opportunity to build and expand wealth not available through income alone.[1061] The income that employees receive in the form of remuneration for services performed at their employer's disposal is not sufficient to generate the wealth for the employees. As outlined in chapter 1, an employee share ownership plan is a mechanism that facilitates the holding of shares in a corporation for the benefit of the company's employees.[1062] Thus, ESOPs allow employees to generate additional income, which can help them create wealth in the long run and enjoy the benefits associated with such wealth creation.

[1059] Enaifoghe A Adetiba T 2018. 'South African Economic Development in SADC Sub-Regional Integration' *Journal of Economics and Behavioral Studies* 10, 1,138.
[1060] Ibid.
[1061] Institute for the Study of Employee Ownership and Profit Sharing (2019) Op cit note 48.
[1062] Chapter 1, Para 1.7.1.

Mongalo asserts that companies and other business structures control the economic life in South Africa as well as other countries worldwide.[1063] This implies that business owners are important stakeholders in driving the economic growth and development of South Africa. This thesis agrees with Mongalo that the resources and capital companies inject into the economy constitute a great proportion of South Africa's GDP.[1064] This calls for companies to understand their role as key stakeholders in wealth creation. Furthermore, the government should respond to the desideratum of companies through policy changes to assist companies in contributing towards wealth creation.

Chapter two dealt with the theoretical foundation of ESOPs and stated that binary economics has a special appeal for the economically disadvantaged.[1065] The proper implementation of ESOPs will help decrease poverty levels in South Africa. Distributive justice, which calls for the equitable distribution of all resources among the community members, will only be effective in a country with a growing economy. Thus, applying the principles of distributive justice in the current context in South Africa will not yield the desired results of development. Therefore, entrepreneurial policies such as capitalism, trade, inclusivity and competition must infused into an identified principle of income and wealth creation. Hence, this thesis focused on the phenomenon of employee share-ownership plans as means to address poverty and income inequality.

The South African legislature introduced the Companies Act[1066] in 2008, which aims to provide for the establishment and operation of companies in South Africa. This is not the first piece of legislation, as South Africa has had previous pieces of legislation on company law.[1067] These statutes have been amended and subsequently repealed over time as a result of the development and evolving nature of company law. Company legislation is an essential legislative tool that can be used to address economic inequality and poverty. The employee share-ownership plan finds its basis in the Companies Act, which sets out the requirements for its establishment and subsequent operations. With

[1063] Mongalo, (2003) Op cit note 319.
[1064] Ibid.
[1065] Chapter 2, Para 2.10.
[1066] Companies Act of 71 of 2008.
[1067] Chapter 3, Para 3.2.

corporate reforms, South Africa can benefit from corporate procedures of business rescue.

Another legislative instrument that was enacted to promote economic development in South Africa is the Broad-Based Black Economic Empowerment Act.[1068] Primarily, this Act aims to promote economic transformation to ensure the meaningful participation of black people in the economy.[1069] As shown throughout this thesis, implementing the Broad-Based Black Economic Empowerment Act cannot yield the desired results of transformation in its current form. Thus, chapter four concluded that entrepreneurial law and principles must be the basis of economic growth to influence social policies in South Africa.[1070] Encouraging entrepreneurship through company formation and reducing operational difficulties can contribute to employment creation and economic development.[1071]

7.2 Comparative Analysis

A comparative analysis was employed in chapters five and six, focusing on Brazil and Canada, respectively. The two comparative jurisdictions were chosen as they both have undergone substantial economic and social changes, with Brazil being a developing country and Canada as a developed country. The purpose of the comparative study was to understand and evaluate how South Africa's legislative and policy framework on ESOPs compares with these jurisdictions. Hence, the comparative analysis sought to determine how the laws and policies on black economic empowerment generally, and more specifically, on the use of ESOPs, inform the South African position. The jurisprudential analysis indicates that both Brazil and Canada have progressive Corporate Laws which make reference to the functionality of ESOPs. It is noteworthy that there is no single legislation that solely deals with ESOPs either in Brazil or Canada.

[1068] Broad-Based Black Economic Empowerment Act 53 of 2013.
[1069] Ibid.
[1070] Chapter 4, Para 4.11.
[1071] Mongalo (2010) Op cit note 173.

7.2.1 The Role of the Constitution in Fostering Economic Transformation

The constitution is at the apex of laws in the three jurisdictions that were studied. This means that the constitution drives all laws and development. Any Act of Parliament and/or policy formulated at the municipal or national level, must be consistent with constitutional principles meant to inform the national agenda. Hence, the constitution and all principles derived from it are being used in the three jurisdictions to promote and foster economic growth and poverty reduction.

The comparative analysis on the recognition and enjoyment of socio-economic rights shows that amongst the three compared jurisdictions South Africa has the most 'socio-economic rights' friendly constitution. The South African Constitution expressly sets out the socio-economic rights such as the right to food, water, health care and accommodation.[1072] This is necessarily not the case in terms of the other two jurisdictions, namely Brazil and Canada. In the case of Brazil, the constitution expressly recognises the need to eradicate poverty.[1073] One can conclude that the right to socio-economic rights is inherent in the need to eradicate poverty. In terms of the Canadian position, the closest reference made to socio-economic rights is in section 36(1) of the Constitution, which focuses on the promotion of equal opportunities for the well-being of Canadians.[1074] Another equally important constitutional provision in Canada that can be employed in the quest to ensure equitable distribution of resources is section 15, which promotes equality and outlaws discrimination.[1075]

In this context of legislating for socio-economic rights in the constitution, the drafters of the South African Constitution have done well, as they deemed it necessary to contain the socio-economic rights of food, water, housing and health care in the constitution. Over-regulation may create problems, especially in the face of ever-changing and dynamic laws. However, failure to legislate may leave courts to interpret the law in the manner they deem fit. Although the court's function is to interpret and apply the law, the

[1072] Chapter 4, Paras 4.9.1-4.9.4.
[1073] Article 3 of the Constitution of Brazil.
[1074] Chapter 6, Para 6.9.1.
[1075] Ibid.

intended purpose of the legislator may always not be achieved if a particular statute is not properly interpretated and applied. Thus, it is rather desirable to provide for socio-economic rights in the constitution. Citizens are at liberty to enforce their rights if such rights have the backing of the constitution. It is noteworthy that the proper and full enforcement of these rights can only be guaranteed in a growing economy where all citizens have an opportunity to participate in the economy of a country. Promoting capitalism, as shown throughout this thesis, is the way forward. Before citizens can have the opportunity to participate in the economy, the economy must grow to enable everyone to participate and derive some form of benefit.

The drafters of the Brazilian Constitution took a proactive approach to address poverty by recognising the need to reduce social and economic inequalities.[1076] This constitutional recognition for fighting poverty creates a legislative obligation to enact laws to fight poverty and foster economic growth.[1077]

In Canada, just as in the case of South Africa and Brazil, the drafters of the constitution deemed it fir to include provisions in the constitution aimed at promoting equal opportunities for all citizens and further promoting economic development.

It is evident from the study that drafters of the constitution in all three jurisdictions saw the need to include provisions to address poverty and promote economic development in the constitution. The approach to economic development taken in all three constitutions pertains to the government's obligation to enact laws that address inequalities and foster economic development.

7.2.2 Suggested Methods for Effecting ESOPs in South Africa

The employee share-ownership plan provides employees with ownership opportunities and various advantages for employee-shareholders, namely financial and participatory advantages. Hence, ESOPs offer an additional form of remuneration, usually tax

[1076] Article 3 of the Constitution of Brazil.
[1077] Ibid.

effective. The additional income the employee-shareholder receives allows them to live a decent and comfortable life, being able to care for themselves and their dependents. Furthermore, ESOPs can also be established to guarantee retirement security for employee-shareholders.[1078]

In addition to the financial benefits, by acquiring shares in his or her employer's business, an employee becomes a co-owner of the employer's company. This allows them to enjoy participatory benefits. Most often than not, an ESOP is linked to increased employee participation and engagement. When employees become more engaged in their employer's business affairs, the job performance and satisfaction increase. This is beneficial to the employer. Employee-shareholders can partake in the decision making of the company affairs, for example, by taking part in the annual general meeting or through other avenues established by the company. A person who is involved in the company's affairs by participating in decision-making and voting at meetings and who further receives financial gain through dividends declared and paid over by the company is a pleased person and will, meaningfully contribute towards the success of the company. Thus, in the end, it is a win-win situation. When the company's productivity and turnover increase, it can contribute to economic growth and development. Furthermore, increased productivity and turnover guarantee an increase in the employee-shareholder's individual income and wealth, which means good tax returns for the government. The money that the government receives can be used to cater for its social obligation towards its people. Consequently, ESOPs promise a healthy cycle of economic growth, poverty reduction and wealth creation.

All three jurisdictions have enacted Corporate Laws that regulate the companies' establishment, operation and dissolution. These Corporate Laws have undergone amendments and repeals to keep up with the international trends as far as company law is concerned. Some of the noticeable Corporate Law rules that impact ESOPs relate to the issue of unissued shares, increasing the issued share capital to implement ESOPs and the provision of financial assistance to acquire shares. In all three jurisdictions, the board of directors must ensure that the company complies with the financial assistance

[1078] Chapter 1, Para 1.7.1.

requirements before providing financial assistance to employees to purchase shares in their company. All three jurisdictions require companies to comply with the solvency and liquidity test for providing finance assistance to employees to implement ESOPs.[1079] One noticeable difference is found in the Corporate Law of Brazil, where the shareholders have the legislative right to oversee the company's affairs.[1080] In other jurisdictions, such as South Africa and Canada, there is no provision in the Corporate Law to the extent that the shareholders have the right to oversee the company's affairs. This right could be inferred from the fact that a shareholder's right to ownership in terms of shares has an implied right to oversee the company's affairs. The latter approach is preferred to separate powers and functions between the shareholders and the directors, especially where employee-shareholders are concerned.

7.2.3 Economic Empowerment Programmes and ESOPs

Forcing corporations to implement ESOPs in an economy that is not growing is like expecting returns without making any investments. The introduction of ESOPs can never be a matter of compulsory implementation, and the use of ESOPs should rather be a question of negotiated settlement. Adopting radical policy and regulatory mechanisms to address the attendant apartheid injustices will not succeed in a developing country such as South Africa. The first point of call is, to grow the economy through encouraging investment, continuously removing trade barriers and strong activism of entrepreneurial policies of fair competition and inclusivity.[1081]

The comparative study has shown that all three jurisdictions have enacted various pieces of legislation aimed at fostering economic growth and development. The Broad-Based Black Empowerment Act[1082] is one of the statutes enacted to promote economic growth in South Africa. The approach taken in this particular statute is not suitable for the South

[1079] Chapter 3 Para 3.4.1; Chapter 5, Para 5.3.2; Chapter 6, Para 6.4.1.
[1080] Chapter 5, Para 3.5.1.
[1081] Chapter 2, Para 2.2.
[1082] Act 53 of 2003.

African context as it serves the needs of the poor and the working class on a short-term basis and thus cannot be employed for long-term wealth creation.[1083] Furthermore, the Broad-Based Black Empowerment Act follows a Keynesian theory that depletes the state coffers without fostering economic growth.[1084] From the three jurisdictions, Canada has enacted most pieces of legislation, some of which directly fight poverty, such as the Act to Eliminate Poverty in Canada (S.C. 2019, c. 29, s. 315) and the Economic Development Agency of Canada for the Regions of Quebec Act (S.C. 2005, c. 26). Brazil and South Africa do not have legislation that is substantially similar to such pieces of legislation. The approach taken by Canada indicates the seriousness with which the country seeks to fight poverty by legislative means.

7.2.4 The Need to Have Stand-Alone Legislation to Regulate ESOPs

The concept of ESOPs is largely practised in first world countries, although some developing countries have introduced ESOPs. The decision whether a particular country enacts stand-alone legislation to regulate ESOPs or infuse the provisions of ESOPs into existing legislation will be informed by the needs of that country and the objectives for which ESOPs are required.

The South African legislature has not enacted any legislation solely regulating ESOPs. The approach that has been taken is to contain provisions in various pieces of legislation aimed at regulating various aspects of ESOPs. For example, sections 4, 44 and 97 of the Companies Act 71 of 2008 regulate various aspects of ESOPs. Furthermore, various sections in the Black Economic Empowerment Act regulate the participation of black people in the ownership of companies. A comparative analysis from Brazil and Canada determines the status quo of ESOPs in these countries, outlining possible benefits derived from having introduced ESOPs. Canada currently does not have any legislation that solely deals with ESOPs. However, references can be inferred from other legislations

[1083] Chapter 4, Para 4.6.
[1084] Chapter 4, Para 4.7.

that were enacted in the country that aim to encourage development.[1085] Previously, Canada enacted legislation which solely sought to legislate ESOPs. This Act has since been repealed, and Canada has no single legislation that only deals with ESOPs.[1086] Other legislation, in particular the Income Tax Act and Business Corporations Act, provides subsequent protection and promotion of ESOPS. Similarly, Brazil does not have any legislation solely dedicated to the purpose of administering ESOPs. However, it continues to guarantee the use of ESOPs, through its tax legislation.

There is no need to enact legislation that solely focuses on ESOPs. Canada's example is worth exploring. Since repealing its legislation, i.e., Employee Share Ownership Plan Act, Canada does not have legislation that solely focuses on the administration of employee share-ownership plans.[1087] Despite this, Canadian companies are increasingly operating in ESOPs, as illustrated in chapter 6 of this thesis. Observing these legislative changes in Canada, the thesis concluded that the Canadian government simply settled on the fact that instead of having employee share-ownership provisions in one legislation, these provisions would be placed where they are best suited, for example, in the income tax laws.[1088] South Africa must follow the example of Canada with the necessary modifications to fit into the South African situation. Thus, the South African government can use motivational tools to encourage the establishment of ESOPs by companies. The government can also extend monetary aid to companies to assist with setting up ESOPs in South Africa.

The practice of ESOP is an underdeveloped philosophy in Africa. Thus, the use of shares and benefits attached thereto to bring about transformation and poverty reduction need a serious re-thinking. In the succeeding paragraphs, the thesis recommends the way forward to help South Africa achieve the national goals of poverty reduction and economic development through ESOPs.

[1085] Chapter 6, Para 6.2.
[1086] Ibid.
[1087] Luffman, J. (2003) Op cit note 885.
[1088] Chapter 6, Para 666.

Strong and continuous economic growth has proven to help reduce poverty and the inequality gap between the rich and the poor. This scenario can also be seen in Canada. The establishment of the ESOP Association in Canada has extremely assisted Canadian companies in introducing and administering ESOPs.[1089] Following this example will help South Africa to ensure that employees and employers enjoy the benefits attached to ESOPs. The ESOP Association of Canada believes that employee ownership is a workable means for fostering economic growth and restructuring business.[1090] Looking at the Canadian economic landscape and the progress made in Canada through entrepreneurship, one cannot disagree with this philosophy.

7.3 Findings of the Research Questions and Hypothesis

7.3.1 How Can Employee Share Ownership Plans be Utilised as a Means to Decrease Poverty Levels in South Africa?

The business community has to understand its role in contributing to South Africa' economic development. As shown throughout the thesis, particularly in chapter 3, it is important to reiterate that the implementation of ESOPs in South Africa (or anywhere else for that matter) will depend on the rules affecting the structuring of the company's share capital. It is noteworthy that the South African corporate legislation contains provisions that enable companies to authorise shares for ESOP purposes and increase such capital for effecting ESOPs. Implementing ESOPs in a newly incorporated company is not necessarily complex since from the onset, the company structure will be aligned to the proposed ESOP at the time of its implementation. To this end, companies in South Africa that intend to introduce ESOPs must include a clause that makes reference to employee share-ownership plans in its founding document. Therefore, the memorandum of incorporation must set out the number of shares to be authorised and issued to employees. These shares will thus fall under the group of shares known as 'employee

[1089] Chapter 6, Para 6.7.
[1090] ESOP Association of Canada Op cit note 1001.

shares.' Once an ESOP is established, the employees, apart from receiving their monthly salaries, will then share in the ownership of their employers' business. This will entitle the employees to enjoy all the benefits of being a shareholder. The role that the company will have to play regarding introducing ESOPs will largely depend on the type of company, i.e. a financially healthy company, financially distressed company or terminally ill company. Each of these companies needs unique responses as they face different challenges.

Dividends and other forms of income derived from an employee share can help the employee and all others connected to this employee to meet their social and economic needs as contained in the Bill of Rights chapter as outlined earlier in this chapter. When one looks at the right to food, not everyone in South Africa has access to and right to food. As stated in chapter four of this thesis, 23 per cent of the people in South Africa suffer from food insecurity.[1091] Poverty is one of the major reasons why people have limited access to adequate and affordable food.[1092] When people are financially emancipated, they will be able to purchase food for themselves instead of relying on the government to provide food, such as the case of food banks. The thesis maintains that food banks create dependency of the less privileged on the government. Although the government, through its social programmes, is mandated to cater for the needs of the society, social assistance is rather short-sighted. This recommendation reiterates that fighting poverty from a social context alone will not reduce poverty. Rather, poverty must be addressed from an economic perspective, where concerted efforts advance to distribute wealth equitably.

7.3.2 Whether the Corporate Law Principles can be Applied to Ensure Companies Have Sufficient Share Capital to Effect ESOPs in South Africa?

The Companies Act of 2008 enacted in South Africa is progressive in the sense that it allows companies to play their part in the economic growth and development of South

[1091] Chapter 4, Para 4.9.1.
[1092] The Guiding Principles on Extreme Poverty and Human Rights. Op cit note 565.

Africa as a whole. The Act contains important principles enabling companies to generate sufficient capital to effect ESOPs in South Africa. Firstly, the Act allows companies to authorise and issue shares to employees under the umbrella of employee-shares.[1093] If the issued shares are not enough to cater to the class of employee shares, the company has the power to increase its authorised capital to implement and/or administer ESOPs properly.[1094] This may be useful if the company does not have sufficient authorised capital for issuing the same for ESOP purposes. Apart from issuing shares for ESOP purposes and increasing share capital for such a purpose, companies can use the corporate principle of financial assistance to assist their employees to acquire shares. This can be done by providing loans or grants to employees to purchase shares or by allowing employees to purchase shares using other means instead of the traditional means of money. By providing them with different options to finance their acquisition of shares, employers remove the unnecessary financial hurdles that employees have to cross to acquire shares. The South African business community can use the aforementioned corporate rules to properly implement and administer ESOPs for the broader goal of economic growth and development.

7.3.3 How Do the Corporate Law Provisions in South Africa Compare to Similar Rules in Other Countries in Effecting ESOPs?

The comparative study amongst the three jurisdictions demonstrates that the Corporate Law provisions of the three jurisdictions are similar in many respects as far as effecting and administering ESOPs are concerned. All three jurisdictions regulate the issuing of shares, including employee shares, allowing companies to increase their share capital to effect shares properly. In addition to this, all three jurisdictions permit companies to provide some form of financial assistance to their employees, thereby making it possible for the latter who could otherwise not acquire shares to do so.

[1093] Chapter 3, Para 3.3.1.
[1094] Ibid. Also see, section 38 of the Companies Act 71 of 2008.

The requirements to be met before a company could render financial assistance though similar to a certain extent, slightly differs in some respects. The general requirement to be met is compliance with the solvency and the liquidity test.

In South Africa, a company must comply with two main requirements. Firstly, it must ensure that it will be able to pay its debts as they become due (liquidity test) and that it has sufficient assets to finance its liabilities. The second requirement demands compliance with the administrative requirements in terms of section 97. The first requirement has to do with the company's financial health in general and the second requirement has to do with specific rules on effecting ESOPs. The Brazilian and Canadian Corporate Law provisions on financial assistance requirements are more general regarding the financial position and the financial result of the company. Thus, the Brazilian and Canadian laws do not explicitly require companies to comply with explicit administrative provisions of ESOPs before employees are assisted to acquire shares in the company.

The Brazilian legislation is very detailed on this subject as it outlines what types of financial statements can be used to determine the company's financial health. The said legislation clearly references the balance sheet and what must be contained in a balance sheet. Hence, the asset account must include current, long-term, and permanent assets. Permanent assets are furthermore divided into investments, fixed assets and deferred assets. The liabilities and Shareholders' Equity account is divided into current liabilities, long-term liabilities, deferred revenues and shareholders' equity.[1095] This elaborative provision of the Brazilian corporate legislation relating to the financial statements and the information to be included therein gives directors and any person that has to deal with the financial statement proper legislative guidance when dealing with such. It can avoid unnecessary problems associated with interpreting and analysing financial statements.

Similarly to the South African and Brazilian company law legislation, the Canada Business Corporations Act of 1985, contains provisions requiring companies to comply with the

[1095] Article 178 paragraph (1) of the Corporations Act (Law 6.404/1976).

solvency and liquidity tests before extending financial aid to employees to acquire shares in the company.

The idea behind the solvency and liquidity requirement helps to ensure that a company remains profitable after granting such financial assistance. The purpose of this is to guard against impoverishing the company and allowing it to meet its objectives of making a profit.

7.3.4 How is South Africa's Economic Environment Compared with Other Countries in Effecting ESOPs?

South Africa has undergone Corporate Law reforms to enable it to effect ESOPs. However, the Corporate Law reform is not sufficient to effect ESOPs, if all stakeholders do not play their role. This is especially the case in a country faced with high levels of poverty. Furthermore, legislative reforms such as the BBEEE does not effectively address the issues of poverty and inequality. To effectively implement ESOPs in South Africa, there is a dire need to rely on entrepreneurial principles of free trade inclusivity and fair competition to enable companies to increase share capital. This will allow companies to be able to have sufficient share capital for effecting ESOPs. Thus, the South African government has seemingly tried to create an economic environment that promotes economic growth and development. This move is proven by enacting laws and policies both at domestic and regional levels, such as Afcfa, the Competition Act and the establishment of IDZ.

Both Brazil and Canada have equally enacted laws and policies that aim to facilitate economic development generally and for effecting ESOPs in particular. To a certain extent, these laws are comparable with those of South Africa, although much still needs to be done for South Africa's economy to grow for the proper implementation of ESOPs.

7.4 Recommendations

Implementing ESOPs in South Africa requires a real and meaningful commitment from all stakeholders. Fighting poverty can be a daunting task, but all stakeholders' synergistic approach and concerted efforts can achieve the much-desired outcome. Various factors come into play when implementing ESOPs, and, therefore, each stakeholder must play its part in ensuring the effective implementation of ESOPS. The closing recommendations call on all stakeholders to play their part in making the economic environment fertile enough for the effective and efficient implementation of ESOPs.

7.4.1 ESOP Model for South Africa

The primary recommendation of this thesis is for all stakeholders to play a role and intentionally seek ways to implement ESOPs. The thesis recommends that, regardless of the financial position that they find themselves, companies must endeavour to implement ESOPs. This can be done by partnering with the government and using the Corporate Law principles to implement ESOPs effectively. The thesis proposes the below model as an effective model for implementing ESOPs in South Africa to alleviate poverty. The table provides a model through grouping companies into categories, identifying the key stakeholders and the role they can play in implementing ESOPs in South Africa.

Figure 1

Type of company	Stakeholder	Action required/role to be played
Financially healthy companies	Company	✓ Partner with the government and take advantage of policies based on trade, competition and investment to increase capital ownership ✓ Implement ESOPs without requiring employees to

		bear the financial burden. This can be possible where companies can partner with the government to grow their capital
	Employees	✓ Increase productivity to increase the turnover of the company
	Government	✓ Eliminate corporate tax on corporate income which is paid to the ownership trust ✓ Assist to ensure that companies can finance ESOPs by reducing the cost of repaying the loans for the ownership trust
Financially distressed companies	Company	✓ Encourage trade, investment and competition through AFCFTA and other means to help companies increase their capital ownership ✓ Make use of business rescue procedures to help the company to recover financially
	Employees	✓ Implement ESOPs ✓ Co-operate with the company to implement the business rescue proceedings ✓ Co-operate with the company to implement ESOPs
	Government	✓ Provide financial support to fund the ESOPs

Terminally ill companies	Company	✓ Commence liquidation proceedings ✓ Enter into an option contract with employees to purchase the assets of the insolvent company for the purpose of establishing ESOPs
	Employees	✓ Co-operate with the company to implement the liquidation proceedings ✓ Exercise the option contract to purchase the assets of the insolvent company ✓ Establish an ESOP
	Government	✓ Partner with financial institutions such as the African Development Bank to assist employees to purchase assets from the insolvent estate to establish an ESOP

7.4.2 Political Will to Encourage Economic Growth

South Africa is based on a constitutional democracy[1096], where the active participation of the citizens gives the political power to democratically elected leaders to govern the country.[1097] The political will of South Africa can slow down, stop or foster economic

[1096] Section 1 (1) of the Constitution of the Republic of South Africa.
[1097] Section 19 (2) of the Constitution of the Republic of South Africa.

growth and the country's development. Therefore, it is recommended that the South African government and, more particularly, the legislature actively promote economic growth. This is in line with the constitutional mandate to *"improve the quality of life of all citizens and free the potential of each person."*[1098] The country's efforts in fostering economic growth and development can be seen in its readiness to fight corruption. As indicated in chapter four, South Africa has enacted anti-corruption legislation and agencies. However, acts of corruption continue to cripple the economy. The government needs to continue to strengthen its business of fighting corruption through legislative, policy and administrative measures.[1099]

Another equally important indicator of a country's willingness to promote economic growth is seen through the promotion of trade and investment. South Africa's political will must continue to foster national and international investment activities. Therefore, it is recommended that the government continues to safeguard political peace, stability and tranquillity gained on the eve of South Africa's freedom, as this can either attract or deter international investment.

Article 9(2) of the Constitution further calls on the government to design measures, legislative or policies to advance persons previously discriminated against by the apartheid government. The government is recommended to engage in high-level consultative meetings and take policy directives on how to play its role in helping the business community in establishing ESOPs.

7.4.3 Remove Barriers to Trade

Hassan *et al.* assert that international trade has immensely contributed to the economic growth and development of many countries globally.[1100] International trade is concerned

[1098] Preamble of the Constitution of South Africa.

[1099] No government can ensure economic growth and development without fighting and preventing corruption at all costs. According to Mbaku (2013), op cite 503, corruption is a key constraint to wealth creation and economic growth. Hence, any measure taken to promote economic development will not succeed for so long as corruption issuesare not rooted out, especially in a developing country such as South Africa.

[1100] Hassan D N *et al* 'International Trade: A mechanism for emerging market economics' (2014) 4 *International Journal of Development and Emerging Economics* 24.

with the transfer of goods and services from one country to another.[1101] This is usually guided by the laws and policies of the countries concerned. It is, therefore, recommended that the government continues to fulfil its mandate of fostering international trade and removes any possible barriers to trade through its legislative and policy measures. Continuous implementation of the Protection of Investment Act[1102] becomes handy in contributing to investment promotion in South Africa. By removing barriers to trade, South Africa can easily trade with other countries in SADC and internationally, thereby boosting its economy. Growth in the economy will contribute positively to the implementation of ESOPs in South African companies.

7.4.4 Inclusivity and Competition

Inclusivity and competition are the key drivers of economic growth. The South African government should continue to act through legislative and policy frameworks, encourage competition across all its sectors and open up the country's markets to foreign service providers. African countries have been vocal about black economic empowerment and local ownership. Though this is desirable, it cannot be achieved with no substantive economic growth. Therefore, the South African government needs to heavily rely on practices that promise economic growth before channelling the results of good economic growth to black economic empowerment and local ownership.

Barriers to competition kill economic growth. The thesis recommends that any act or practice that may potentially affect fair competition and deny the key players of the domestic and international markets the opportunity to compete for services and products fairly must be banned at all costs. The Government's commitment to implementing the provisions of the Competition Act,[1103] the SADC Declaration on Regional Cooperation in Competition, Consumer Policies and the principles of the African Continental Free Trade Area can positively promote economic growth. Compulsory compliance with these laws

[1101] Ibid at 26.
[1102] Protection of Investment Act 22 of 2015.
[1103] Competition Act 89 of 1998.

and policies is therefore highly recommended. Economic growth means abundance of resources in the country. Thus, again growth in the economy will ensure that ESOPs are implemented in South African companies with ease.

7.4.5 Promoting the Adoption of ESOPs in South Africa by Corporations

On the corporate landscape, the thesis calls for the active participation of companies in the use of ESOPs in the quest to reduce poverty in South Africa. ESOPs can help companies achieve their objectives of longevity and investment;[1104] thus, it is beneficial not only for employees but also for companies. Although the government is the key role player in driving the economy of South Africa, business owners should assist by showing their willingness to adopt and implement ESOPs within their companies. A radical approach to policy changes forcing businesses to adopt ESOPs cannot be effective to address poverty. In other words, companies' unwillingness will nonetheless not offer much assistance in fighting poverty. Therefore, the thesis recommends that companies prepare themselves by any means possible to adopt and implement ESOPs. Governmental aid in providing financial assistance to companies can help meet this recommendation. However, this recommendation must be preceded by other recommendations based on economic growth and development because even if the companies are willing to implement ESOPs, this will be impractical or difficult in an economy that is not growing.

7.4.6 Establishing an ESOP Hub

South Africa needs to establish an ESOP association. The government can finance the establishment of this association. The government has a constitutional mandate to drive the country's economic development and redress the inequalities of the past regime. Therefore, having its national development goals in mind, the government should allocate funds through its national budget and establish the ESOP association. Setting up such

[1104] Institute for the Study of Employee Ownership and Profit Sharing. 2019 Op cit note 48.

an association may be costly, but the long-term benefits can justify its establishment. The ESOP hub can serve as an information centre where all documents relating to the ESOPs in South Africa can be stored and retrieved when needed. The hub can help promote the ESOP culture in South Africa and keep all stakeholders abreast with international trends, laws and policies regarding ESOPs. Furthermore, an ESOP Association can also provide education and training to employees, employers and policymakers on all aspects relating to the following areas:

(a) Principles of company law and its function in fostering development in South Africa;

As pointed out, company law is fundamental to economic growth and development. Consequently, all stakeholders must be familiar with the use of company law to drive economic development.

(b) Principles of labour law and its function in fostering development in South Africa

Labour law governs the employment relationship between the employer and the employee, and it outlines the rights and obligations of both the employer and the employee. Hence, it is not sufficient for employees to understand their roles from the company law perspective. Employees must comprehend their roles as derived from labour law. Furthermore, the developments in labour law help employees understand their roles in fostering the success of their employers' business and the country's economic growth.

(c) Rights and duties of shareholders, particularly employee-shareholders;

As pointed out in chapter 2, employees-shareholders have corporate rights and duties. A proper understanding of these rights and duties is necessary for the proper execution of duties.

(d) The rights and duties of companies in respect of ESOPs;

A company's role in fostering growth and development can never be overemphasised. Companies are primarily responsible for creating and implementing ESOPs. On this basis, the companies need to understand their role in creating and maintaining ESOPs. Establishing ESOPs involves financial and administrative hurdles, and thus, a good understanding of the legislative and administrative process around it can assist companies to introduce ESOPs efficiently.

(e) The principles of economic growth such as inclusivity, competition, and free trade.

Entrepreneurial principles of inclusivity, competition, and free trade are necessary for an economy such as South Africa to drive development. Government departments and companies need continuous training and information sharing on the changes in global trends on competition laws and free trade policies.

All companies with ESOPs can register with the ESOP Association, and both companies and individual employee-shareholders can enjoy the benefits derived from being a member. Benefits include receiving information related to the creation and operation of ESOP, free training and reductions in conference fees.

7.4.7 Educate Employees About their Rights and Responsibilities

Many people in South Africa and across the world continue to suffer at the hands of the powerful because of not knowing their rights. It is thus important to educate employees about their rights, particularly the rights associated with being an employee-shareholder. A person cannot have access to something if he or she is unaware of its existence and knowing about the existence of something is also meaningless if you do not know how to access that very thing. Thus, being an employee-shareholder will not profit employees much if they do not know or fully understand the rights and privileges associated with being an employee-shareholder. Therefore, companies must actively and continuously run programmes aimed to educate employee-shareholders about the rights attached to

being an employee-shareholder and how such rights and benefits can be accessed or exercised.

Apart from the rights associated with being a shareholder, employees have certain corporate duties, such as the duty to attend shareholders' meetings and the duty to vote and make decisions. Therefore, it is recommended that all employees need to be provided with continuous training on their duties to ensure that they can contribute meaningfully to the affairs of the company. The proper execution of employee-shareholder duties can be in their interests. If the company wins, its shareholders equally win. One way to guarantee continuous training and education is by establishing an ESOP association, such as in Canada's case.

7.4.8 Amendment of the Companies Act 71 of 2008

Terminally ill companies do not have any other option but to face liquidation and dissolution. Hence, to finance and discharge creditors' claims, such companies are required to sell their assets. The thesis recommends for the Companies Act 71 of 2008 to include a provision that will require the insolvent company that faces liquidation, and which is required to sell its assets to first offer such property to employees. This will help implement the ESOP model referred to in 7.4.6. There is nothing in the predecessor legislation or the current legislation that mandates an insolvent company from first offering its property which is the subject of sale on liquidation to its employees. As such, without a mandatory condition for the liquidated company to first offer the property to its ex-employees, employees will always be left in the cold when their ex-employer closes its business doors.

For terminally ill companies facing liquidation to first offer their assets to employees, it is recommended that the following provision be included in the Companies Act:

> (1) Despite anything to the contrary in the company's Memorandum of Incorporation or the rules or any agreement between the ex-company and the ex-employee, no ex-company may, upon liquidation, sell any of its

assets to a third party without first making an offer to sell such assets to its ex-employees.

(2)The offer made to the ex-employees must remain open for a period of at least two months from the date on which the offer was made, within which any of the employees can accept it.

(3) The ex-employees, upon receiving the offer referred to in subsection (2),, can accept or reject the offer so made. If any ex-employees accept the offer, a binding agreement is concluded between the liquidated company and the ex-employee who has accepted the offer.

(4) If the ex-employees reject the offer referred to in subsection (2), the offer automatically terminates.

(5) If the two-month period referred to in subsection (2) expires, the offer automatically lapses.

(6) If the offer referred to in subsection (2) terminates as contemplated in subsection (4) or (5), the ex-company is free to enter into a transaction with any third party.

(7) The offer referred to in subsection (2) must contain all material information necessary to sufficiently place the ex-employee in the position to decide whether to purchase the assets of the liquidated company.

(8) The material information referred to in subsection (7) must be of such a nature to identify the asset(s) being sold and the value or the purchase price of the asset(s) so sold.

(9) Any transaction for the sale of assets of a liquidated company entered into between the liquidated company and a third party is void in the event where such transaction was entered into without the liquidated company first making an offer of sales of its assets to a third party.

(10) Any breach of contract committed either by the liquidated company or the ex-employee will be resolved through compliance with this Act read together with the ordinary rules of the contract. This Act shall take precedence over any ordinary rules of contract, in any event where such rules conflicts with any of the provisions of this Act.

7.4.9 Amendment of the Employment Equity Act 55 of 1998

To provide a concise definition of employment equity, it is recommended that section 1 of the Employment Equity Act be amended with the insertion of the following definition:

> Whenever used in the Act, employment equity shall refer to:
>
> (a) a rule, policy, programme developed or designed to reserve employment for people previously disadvantaged under the apartheid regime; and/or
>
> (b) the action of providing additional employment opportunities or preferential treatment as far as employment opportunities are concerned to people who have been previously disadvantaged because of any of the enumerated grounds in terms of the Constitution of South Africa.

7.5 Final Conclusion

The thesis concludes that although there may be many strategies employed to reduce the inequality gap between the rich and poor, ESOPs are an important economic strategy that can be used to close some of the national wealth gaps.[1105] All stakeholders must meaningfully and purposely contribute towards the adoption and use of ESOPs in South Africa to transform South Africa into a prosperous country.

The companies afford employees an opportunity to earn a living while contributing to the country's economic growth and development. However, there is little that the business community can do in an economy that is not growing. The government should provide support through policies and programmes to cultivate the ground for economic growth. This can be done by fostering investment and productive infrastructure. Once the environment is economically friendly, economic instruments such as ESOPs can find a

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proper place for assisting with poverty reduction. The implementation of ESOPs can positively impact the lives of individuals, the community and the overall development of South Africa.

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