# Company Contracts Of Shareholders Versus Employment Contracts Of Employees: A Comparison Of The Status Of The Shareholders And The Employees Within The Corporation

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## 1. Abstract

The South African *Companies Act* creates a legal relationship of a *contractual nature* between a corporation and its shareholders. The employment relationship, however, is no longer *solely* based upon the Roman law master and servant principle. It is based nowadays upon various sources, which include the common law, legislation, customs and uses and international conventions. Although company contracts between the company and its shareholders are created by legislation alone, the contract of employment, is nowadays developed by the courts to a significant degree.

Since the employment contract is not completely governed by legislation, as is the case with shareholder contracts, the rights and interests of employees could easily be ignored especially in relation to their participation in matters of corporate governance. There is arguably, however, some legislation, which could further assist employees in safeguarding their rights and interests and provide them with an opportunity of some means of participation in matters of corporate governance. Thus, employees *ought* to have the right, as do creditors, to intervene by using this legislation to assist them in their grievances.

In this paper reference is made to two sections of the Companies Acts, which have, to date, generally not been utilised by employees. These sections include section 252, which encompasses the situation where any particular act or omission of a company is unfairly prejudicial, unjust or inequitable. The court could make an order bringing to an end the matter complained of on the basis of it being just and equitable to do so. Furthermore, in terms of section 344(h) of the South African *Companies Act* a court may order a company to be wound up if it appears to the Court to be just and equitable to do so.

## 2. The contract between a corporation and its shareholders in South African company law

Section 65(2) of the South African *Companies Act* creates a legal relationship of a *contractual nature* between a corporation and its shareholders. It provides,

> (t)he memorandum and articles shall bind the company and the members thereof to the same extent as if they respectively had been signed by each member, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this Act. [1]

Furthermore, leading case decisions have expressed the same views.

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1 South African *Companies Act* 61 (1973), section 65(2).

Trollip JA in *Gohlke and Schneider v Westies Minerale (Edms) Bpk* notes,

> (t)he company and its members are bound only to the same extent as if the articles had been signed by each member, that is, as if they had contracted in terms of the articles. The articles, therefore, merely have the same force as a contract between the company and each and every member as such to observe their provisions. [2]

Furthermore, in *Clark v Workman*, Ross J notes,

> (it) is a contract of the most sacred character, and it is on the faith of it that each shareholder advances his money. [3]

This suggests that a contract is created which entitles the shareholders to receive dividends in the company.

**3. The employment contract**

In respect to employment the South African *common law contract* is based upon the Roman law principle of *locatio conductio operarum.* This is a common law principle in terms whereof a person voluntarily provides his or her services for a certain time for a specific salary.

The courts, however, are

> shifting the contract of employment towards a more substantial and lasting relationship between employer and employee. [4]

Thus, in *Media Workers' Association of S.A. and Others v Perskor* John AM notes,

> (a)t common law a contract can be brought to an end by the employer's acceptance of the striker's repudiation of his contract, evidenced by his refusal, in concert with others, to fulfill his obligations to work. The question in labour law, however, is whether it is fair for the employer so to do. [5]

However, although John AM refers to the common law, by having added principles of fairness and justice to it, the contact has been extended to such a degree, that its common law elements have become *"barely recognisable"*. [6]

Hence, the various *types* of contracts governing the relationships between the company and the shareholder on the one hand, and the employer and employee on the other, are significantly different.

Although the company contract to which the shareholder becomes a party is created by legislation, more specifically section 65(2) of the Act referred to above, the contract of employment, as developed by the courts, has, as its basis, the common law contract. [7] He further notes, however, that

> the quid pro quo, whether it be in the form of a dividend or in the form of wages, is derived from " contract" and the ability of the company (employer) to pay either will depend on the financial

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2 WM Venter, Research Dissertation: "Company Law and the Interests of Company Employees", Cape Town, October 1991, Ch. 1, 22. See also Trollip JA in *Gohlke and Schneider v Westies Minerale (Edms) Bpk*, 1970 (2) SA 685(A) at 692F.

3 Ibid. See also *Clark v Workman* (1920) 1 I.R. 107 at 112.

4 Ibid 25.

5 Ibid. See also John AM in *Media Workers' Association of S.A. and Others v Perskor* (1989) 10 ILJ 1062 (IC) at 1071J et seq.

6 Ibid.

7 Ibid 26.

> well-being of the company. … The employee is, in accordance with his contract with his company, compelled to tender his services in exchange for his wages. … This relationship, inter alia, includes concepts of fidelity and obedience. The position of the shareholder is different. The courts have affirmatively held that shareholders owe no duty of care to the company or to other shareholders and have traditionally defended the free exercise of the individual's right to vote. Thus the respective duties of shareholder and employee remain far removed from one another. [8]

Because both the shareholder and the employee derive rights from and incur obligations against the company by contract, both parties *should* be afforded the protection required to safeguard their rights and interests. Thus, the rights and interests of the employee should not, in any way, be treated by legislation as inferior to those rights and interests of the shareholders. Xuereb notes that no particular right or interest, whether that is of the employee or shareholder, is entitled to predominate always. [9]

Furthermore, Gower notes,

> (n)ow, however, the time is past when our blood can be made to run cold at the thought of crossing the wires of company law and 'master and servant' law. [10]

Hence, industrial democracy is demanding that the traditional master and servant relationship of the Victorian era is terminated. Thus,

> ... it remains true that if the South African lawyer ignores the demands and aspirations of the workforce in the era of the new South Africa, he will find himself overtaken by events. [11]

**4. Various sections of the South African Companies Act to provide relief to employees**

Various sections of the South African *Companies Act* 61 of 1973 may further assist employees in asserting their rights in the participation of corporate governance matters. [12] These include sections 252 and 344(h).

It is necessary to consider the possible extension of relief envisaged in section 252 to employees of the corporation.

For example, section 252 provides that

> (1) Any member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable to him or to some part of the members of the company, may, subject to the provisions of subsection (2), make an application to the Court for an order under this section.
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> (2) …
> (3) If on any such application it appears to the Court that the particular act or omission is unfairly prejudicial, unjust or inequitable, or that the company's affairs are being conducted as aforesaid and if the Court considers it just and equitable, the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the future conduct of the company's affairs or for the purchase of the shares of any members of the company by other

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8 Ibid 27.

9 Ibid 28. See also PG Xuereb, "The juridification of industrial relations through company law reform" (1988) 51 *MLR* 156 at 159.

10 LCB Gower (1979), *Gower's Principles of Modern Company Law*, 4th edn, Stevens and Sons, London, Great Britain, ch 5, 66. See also Venter, above n 2, 29.

11 Venter, above n 2, 29.

12 Ibid.

> members thereof or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.

In this way, section 252 permits the court to assist a member or members of the corporation who complain about the way the affairs of the company are being conducted where the same is unfairly prejudicial, unjust or inequitable.

In *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Colliers Ltd*, Preiss J notes,

> ... the applicant must establish a lack of probity or fair dealing, or a visible departure from the standards of fair dealing or a violation of the conditions of fair play on which every shareholder is entitled to rely. [13]

It is argued that the *standards of fair dealing* referred to above, should apply to *employees* as well. Thus,

> ... that if sub-section 1 were to be amended to provide for the inclusion of similar rights to employees, this could have a profound effect on the employment relationship between companies and their employees because in accordance with sub-section 3, the court may make such order "as it thinks fit" in the circumstances. … (An amendment) will make a considerable contribution towards lessening the tensions between a company and its employees particularly if one anticipates a demand for some form of workers' democracy in the new South Africa. [14]

This indicates that the time is opportune for labour to erode *the foundations of company law* so that employees of the corporation do *in fact* have their interests protected in such a way that it does become *meaningful to them*.

An aggrieved employee should be able to rely on the provisions of sub-section 3 in terms whereof the court could make an order bringing to an end *the matter complained of* on the basis of it being *just and equitable* to do so. Thus,

> …it is suggested that where the company is conducting its affairs as described in sub-section 1, an employee could obtain rights in addition to those to which he may be entitled under existing law. The employee could also protect his rights in cases of unfairness, which may be more extensive under the section than any rights he may enjoy in unfairness situations in labour law. Where the matter complained of is of a nature that will seriously impair the well being of a company's employees or their relationship with the company, the situation could be prevented by the intervention of an employee or employees in terms of the section. [15]

There are sound reasons to extend the provisions of section 252 to *include* the interests and rights of employees as well. This is primarily due to the fact that neither the employee nor the corporation could abuse the provisions of section 252 because the right to grant relief at all times vests in the court.

Furthermore, section 344(h) of the South African *Companies Act* pertains to one of the circumstances where a court may order a company to be wound up. It provides that

> A company may be wound up by the court if:
> ...
> (h) it appears to the Court that it is just and equitable that the company should be wound up. [16]

In a discussion of section 111(g) of the now repealed *Companies Act* of 1926, which is very similar to the present 344(h), Trollip J in *Moosa N.O. v Maujee Bhawan (Pty) Ltd and Another* notes,

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13 Ibid 31. See also *Donaldson Investments Pty Ltd and Others v Anglo-Transvaal Colliers Ltd* (1979) 3 SA 713 (W) at 722E.

14 Ibid 31-32.

15 Ibid 32.

16 Ibid 34. See also the South African *Companies Act* section 344(h).

> ... just and equitable ... postulates not facts but only a broad conclusion of law, justice and equity, as a grounds for winding-up. ... In its terms and effect, therefore, sec. 111(g) confers upon the Court a very wide discretionary power, the only limitation arguably being that it had to be exercised judicially with due regards to the justice and equity of the competing interests of all concerned. [17]

Furthermore, Meskin *et al* note,

> ... an applicant must come to court with clean hands and a creditor may apply provided that if the creditor is not also a member, or entitled to be registered as a member, he must have a legitimate interest. [18]

With regard to *the competing interests of all concerned*, two important issues arise, which are:

> (a) Where conduct by the directors or the members is *fraudulent or otherwise wrongful, oppressive or unfair*, then the competing interests of all the stakeholders (including the employees) in the corporation ought to be considered. With regard to employees themselves, this is significant because of the fact that their existence depends on the company's affairs being managed properly; and
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> (b) Where a company is not properly managing its affairs, and as a consequence of which is forced into liquidation, employees *ought* to have the right, as do creditors, to intervene.

In *Sweet v Finbain*, it was noted that

> ... there are individuals with rights, expectations and obligations, inter se, which are not necessarily submerged in the company structure. One such individual must surely be an employee for if a creditor is able to rely on section 344(h) to protect his debt, there is no reason in law or in logic why an employee should not indulge in the same privilege so as to protect his vital interests. It seems that employees have been timid or reluctant in applying the provisions of this subsection towards protecting their interests but this is no doubt due to a lack of knowledge of the internal workings of the company. ... [19]

Finally, Simitis notes,

> ... The law must replace the unilateral decision of the employer by an increasingly objective decision-making process. ...The legislature must increasingly intervene … with the aim of steering economic and social developments in a direction, which … control social conflict. … (J)uridification is an inescapable consequence of industrialisation … to achieve … a democratic society. A study of the process and effects of juridification cannot simply concentrate on 'labour law' in the narrow sense, but must see labour law as part of a wider 'social law' convening the whole employment relationship. [20]

It would appear, therefore, that there are sound reasons for the introduction of legislation, which would allow employees in companies the opportunity to have a more equal treatment in law with shareholders. Thus, this principle would enable directors to satisfy the interests of employees, but would be subordinated to those interests of its shareholders where this is *reasonably* required or necessary in long-term shareholder and employee interests, but not otherwise. [21]

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17 Ibid 35. See also the decision of *Moosa N.O. v Maujee Bhawan (Pty) Ltd and Another* (1967) 3 SA 131 (T) at 135G-H.

18 Ibid. See also Philip M Meskin et al (eds) (1985), *Henochsberg on the Compamies Act*, 4th edn, Butterworths, 587.

19 Ibid 37. See also *Sweet v Finbain* (1984) 3 SA 441 (W) at 445B-C.

20 Ibid 65. See also Spiros Simitis, "Verrechtlichung der Arbeitsbeziehugen" in (1987-8) *Comparative Labour Law Journal* Vol. 9, 93 (condensed translated version).

21 Ibid 67.

**5. Conclusion**

Section 65(2) of the South African *Companies Act* creates a legal relationship of a *contractual nature* between a corporation and its shareholders. However, the courts have shifted the contract of employment towards a more substantial and lasting relationship between employer and employee. The employment relationship is no longer solely based upon the Roman law *locatio conductio operarum* (master and servant) principle. It is composed of and based nowadays upon the common law, legislation, customs and uses and international conventions. This is due to the fact that the employee/employer relationship is no longer based solely upon the traditional master and servant relationship. The employment relationship is further shaped and developed by *inter alia* economics, sociology and political science. [22]

There are good reasons for extending the provisions of section 252 to include, in addition, a consideration of the rights and interests of the employees as stakeholders of the corporation. This is primarily because neither the employees nor the corporation would be able to abuse the provisions of section 252, as the right to grant relief would remain fixed in the hands of the courts.

Furthermore, regarding section 344(h), if a creditor is able to rely on this section to protect his or her debt, there is no reason in law or in logic why an employee should not be able to do the same in order to protect his or her rights and interests. Consequently, where the conduct of a director or member is fraudulent or otherwise wrongful, oppressive or unfair or where a company is not properly managing its affairs, then the competing interests of all the stakeholders (including the employees) in the corporation ought to be considered.

Further to this, Xuereb notes,

> (i)t is submitted that the answer lies in the law's demanding that directors act in continuing interests of the hypothetical shareholder and hypothetical employee, balancing short-term interests against long-term interests so that short-term demands of either group will be met … provided these are compatible with long-term interests (… a continuing reputation for taking employee interests into account). [23]

By extending the practical application of these two provisions of the Companies Acts to employees, a movement in the right direction towards an improved model of corporate governance for South Africa can be achieved. This recognition would further empower employees, improve their rights of participation in the decision-making processes of the corporation and promote their sense of well-being. As a result, organisations would generate greater job satisfaction, improve its customer service and enhance its profitability. Consequently, South Africa still has a long way to go in attaining an acceptable balance in labour between the rights of employees and those of the employers. At this time, employers still have very much the upper hand in South African labour law. Changes are always viewed with great skepticism, but are nevertheless vital to progress. It is an economic necessity and a moral imperative and will contribute to a wealthier and happier South Africa.

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[22] Ibid 64.

[23] Ibid 68. See also PG Xuereb, "The juridification of industrial relations through company law reform" (1988) 51 *MLR* 156, 159.