

CORPORATE GOVERNANCE
AND
ALTERNATIVE DISPUTE RESOLUTION

Presentation to the Pan African Lawyers Union on 27 May 2011



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Attorneys

'Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals... the aim is to align as nearly as possible the interests of individuals, corporations and society'

***Sir Adrian
Cadbury***

***Corporate Governance
Overview, 1999***

World Bank Report

Definitions of Corporate Governance:



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- A set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled
- Primarily concerned with the relationship between the corporation and its stakeholders and the goals for which the corporation is governed.
- Report of SEBI Committee (India): The acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders.

The definition is drawn from the Gandhian principle of trusteeship and the Directive Principles of the Indian Constitution. It is seen as business ethics and a moral duty.

Corruption Statistics in South Africa



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- South Africa is ranked 55th out of 180 countries in the Corruptions Perceptions index released by Transparency International
- South Africa scored 4.7 out of 10 on the Index.
- The highest scorer – New Zealand at 9.4/10 (being the least corrupt country)
- ‘High Profile anti – corruption cases and scandals continue to be regularly reported in countries including South Africa, Ghana and Senegal and risk undermining political stability as well as governments capacity to provide effective basic services’ – Transparency International



ABELE SHEVEL

WHITE-collar crime is estimated to cost the South African economy R156-billion a year, says Steven Powell, director of ENS Forensics. And the incidence of corporate fraud is likely to increase as the economy worsens.

"Where companies were making lucrative profits, a lot of the fraud and corruption was undetected. But now that companies are more diligent with numbers, detection rates have increased," he said.

The profile of the white-collar criminal shows that the typical fraudster is a well-educated, physically healthy first offender, who has worked for the same employer for several years. He is persuasive and a key player in the company — a popular and trusted member of the team.

Over time the fraudster earns loyalty and respect, but these individuals are often psychopaths — compulsive and persuasive liars who genuinely believe they can talk their way out of trouble.

Where there used to be a 70-30 split in favour of men, now it is 60-40.

Powell said although first offenders who do get caught usually leave without being prosecuted, this is illegal if the value of the crime exceeds R100 000.

According to Powell, the recipe for fraud has three main ingredients: financial pressure, opportunity and rationalisation.

"When individuals experience major financial pressure, they'd rather find an illicit way of supplementing their income before losing a home or car," said Powell.

Usually, there is a trigger event or catalyst that induces the employee to commit fraud, such as a medical operation or trauma. But when they realise that no one has picked it up, they cannot resist continuing — with greater amounts.

"Greed is the single greatest reason why people commit fraud. It often finances a lifestyle which is beyond the means of the average individual," said Powell.

Gambling is another big inducer of corporate fraud and, to a lesser extent, drug and alcohol addiction.

"The other factor we find quite often is

FRAUD FEEDS AT THE TOP

White-collar criminals are likely to be affable, educated and trusted

extramarital affairs, mainly men buying expensive gifts, including apartments for their mistresses. They need a separate income stream from their known income."

Powell said the most prevalent type of business crime was procurement fraud committed by people with the power to negotiate contracts and pay suppliers and service providers. "They exploit their position of power to enrich themselves."

Conflict of interest was also a problem. Individuals in senior positions, such as directors, managers and heads of departments, were "completely oblivious to the fact that it's unethical to appoint family or friends", said Powell.

He added that the corporate sector in South Africa did not strictly police declarations of interest.

"We regularly find in government many officials who enjoy senior positions with lucrative salaries, but they set up numerous businesses that are undeclared, and they abuse their positions of authority to enrich themselves or their spouses," Powell said.

Rationalisation happens when the fraudster takes a kickback or steals but justifies it. Powell said employees often feel intimidated when the fraudster is in a position of power and has an autocratic management style, leaving staff to feel they dare not question his or her authority.



Paul Simpson, managing director of SSG Forensic Consultants, South Africa's largest criminal and fraud investigation group, said banks were issuing triple — if not quadruple — the number of instructions they did a year ago, because of

increased misrepresentations in contracts. The number of cases from liquidators had also increased. "We're getting instructions of R100-million and R200-million in terms of misrepresentation and irregularities, up to R1.2-billion and R1.3-

NOTHING BUT THE TRUTH: In this file picture taken in January, disgraced financier Bernard Madoff leaves a US district court in Manhattan after a bail hearing. Madoff has entrenched himself in corporate fraud history by pleading guilty to one of the largest swindles to hit Wall Street, involving \$65-million. Picture: AP

billion in big companies," Simpson said. He expected to see a greater degree of corporate fraud uncovered in coming months. "There's also a lot of money laundering through legitimate businesses."

Bernard Hotz, director of litigation at legal firm Werksmans, said lower-level employees were pushed into white-collar crime by desperation and poverty, especially when a person could not provide for his or her family. Addiction to gambling or drugs, or falling foul of micro-lenders was also a catalyst for crime.

"There is a difference between someone who aspires to materialism and puts together intricate complex corporate scams and someone who is living beyond their means," Hotz said. "I wouldn't classify them as born criminals. They have been pushed into this scenario."

"The masterminds who orchestrate a very complex type of corporate crime are intellectually arrogant and believe that they are not ever going to be caught," Hotz said.

"Invariably, you find those type of people are very outgoing, affable and the kind of person you would like and with whom you'd want to have a drink and smoke a cigar."

Linda MacPhail, associate director of forensic services at PricewaterhouseCoopers, said despite fears of negative publicity arising from the involvement of law enforcement, companies that did refer fraudsters for prosecution, whether internal or external, suffered no significant collateral damage.

In fact, in many cases, they experienced a decrease in the collateral damage to their public relations, business relations and morale.

The Need for Corporate Governance



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- Strengthening the Scope for Institutional Investment
- Socio – economic Development
- The Escalation in the Use of Technology

The King Code – History and development



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❖ King I

- Established by the Institute of Directors of Southern Africa in 1994
- Mervyn King heads the Committee
- The approach taken was to 'look beyond the corporation itself and take into account the larger community'
- Recognised internationally on its approach to corporate governance

King II



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- Developed at the Institute of Directors Conference in 2002
- Comprises of 6 Sections namely:
 - Boards and Directors
 - Risk Management
 - Internal Audit
 - Integrated Sustainability Reporting
 - Accounting and Auditing
 - Compliance and Enforcement
- Takes the Inclusive Approach adopted in King I considerably further owing to the 'growing weight of expectation on organisations to act as good corporate citizens

Need for King III



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- The introduction of the new Companies Act
- Changes in international governance trends
- Remaining at the forefront of governance globally
- Putting financial results of companies in perspective

King III and South Africa



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- ❖ Applies to all entities
- ❖ Follows an “apply or explain” approach.
- ❖ Effective leadership as a key aspect
- ❖ Sustainability as a moral and economic source
- ❖ Integration of social, economic and environmental issues
- ❖ Inclusive stakeholder approach
- ❖ Integrated reporting

New Requirements as per King III



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- The need for an annual integrated report
- A statement by the audit committee to the board and shareholders on internal financial controls to be included in the integrated report
- The consideration of the strategic role of IT and its importance from a governance perspective
- The need for a risk-based internal audit: a written assessment of the company's system of internal control
- The governance of risk through formal risk management processes

King III



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Chapter 1 – Ethical leadership and corporate citizenship

Chapter 2 – Boards and Directors

Chapter 3 – Audit Committees

Chapter 4 – Governance of Risk

Chapter 5 – Governance of Information Technology

Chapter 6 – Compliance with laws, rules, codes and standards

Chapter 7 - Internal Audit

Chapter 8 – Governing stakeholder relationships

Chapter 9 – Integrated reporting and disclosure



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CHAIRMAN OF THE SARC

Boardroom battle eclipses news

Infighting and mismanagement rule at the
national broadcaster, writes **Chris Barron**

Chapter 8 – Governing stakeholder relationships



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- ❖ Appreciation of stakeholders' perceptions
- ❖ Proactive approach to stakeholders' relationships
- ❖ Balance between stakeholder Grouping and the Interest of the Company
- ❖ Equitability for shareholders
- ❖ Transparent and Effective Communication with Stakeholders
- ❖ Dispute Resolution

The Principles are similar to King II with the inclusion a new Requirement: the board should adopt communication guidelines that support a responsible communication program



- The board should ensure that disputes are resolved as effectively, efficiently and expeditiously as possible
 - The board should adopt formal dispute resolution processes for internal and external disputes
 - The board should select the appropriate individuals to represent the company in ADR

ADR is a new requirement in King III and did not form part of King II

Introduction to Arbitration



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- What is arbitration?
 - Dispute resolution procedure in terms of which the parties determine, by agreement, a forum in which the dispute is to be heard – outside of the court process – as well as the procedure to be followed in that forum
 - Conciliation – where a third party attempts to guide the parties to common ground
 - Mediation – where a third party acts as the go between, and the parties can withdraw at any time



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NOW WE'RE GOING
TO GET REASONABLE
AREN'T WE?!





Advantages

- Voluntary in initiation, compulsory in continuation
- Finality brought about earlier
- Potential saving in cost and time
- Choice in the adjudicator (arbitrator)
- Facilitation of specialisation
- Determination of the issues and the arbitrators' powers
- Procedure designed to suit parties' needs
- Arbitration is generally held in private
- Time and place is flexible
- Less adversarial – allows relationships to be maintained
- Disputants may represent themselves



Disadvantages

- Only effective if both parties agree to the process
- No right of appeal, except by agreement, however decision can be reviewed
- If appeal is to another arbitrator or to a panel of arbitrators, a further appeal to the courts is not possible
- A review is an inspection by the High Courts of the procedure followed in the arbitration
- An order can be set aside on review on grounds of:
 - Misconduct by the arbitrator
 - A gross irregularity in the proceedings
 - Improper attainment of an award
- Where parties have unequal bargaining positions, process may only serve the interests of the more powerful



Co-operative governance

- Section 41(1)(h)(vi) of the Constitution requires all organs and spheres of state to “co-operate with one another in mutual trust and good faith by avoiding **legal disputes** with one another”
- Section 42 of the Constitution mandates the enactment of an Act of Parliament to provide for mechanisms and procedures to facilitate the settlement of intergovernmental disputes
- Section 40(1)(b) of the **Intergovernmental Relations Framework Act 13 of 2005 (“IRFA”)** requires all organs of state to make every reasonable effort to settle intergovernmental disputes without resorting to **judicial** proceedings
- Section 40(2) of the IRFA requires any formal agreement, between organs of state, that regulates their respective statutory powers, to include appropriate dispute resolution procedures or mechanisms
- Section 42(1)(b) of the IRFA requires organs of state to consider alternative dispute resolution mechanisms
- Section 45 of the IRFA prohibits organs of state from instituting judicial proceedings against another organ of state, unless efforts to settle the dispute in terms of the IRFA have failed

Guidelines for effective conflict management in terms of IRFA



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- Duty to avoid litigation
- Always consider resources and cost-efficiency in dealing with conflict
- Dispute resolution processes must have time limits
- Duty of good faith in dispute settlement process (inherent in arbitration)
- Prohibition of court process before all efforts have been made to settle the dispute in terms of the IRFA

Lufuno Mphaphuli & Associates (Pty) Ltd v Andrews and Another (CC)

- Section 34 of the Constitution does not apply directly to private arbitrations:
 - “Everyone has the right to have any dispute that can be resolved by the application of law decided in a fair public hearing before a court or, where appropriate, another independent and impartial tribunal or forum.”
- All arbitrations must be conducted fairly in terms of the arbitration agreement
- An arbitration agreement may be contrary to public policy and the Constitution
 - Eg Lack of a fairness clause in the arbitration agreement



Conclusion

- Generally, consider the following factors when deciding whether or not to arbitrate:
 - Are issues private and confidential?
 - Does the dispute involve only the parties in dispute or does it have wider ramifications?
 - Is the dispute urgent? If not, would it be more convenient for the issues to be resolved more quickly
 - Does the dispute involve a settled question of law?
 - Does the dispute require a highly specialised adjudicator?
 - Is the dispute clear-cut or will it be better to retain an appeal?



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Thanks

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