Employee share schemes under the Companies Act

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Although there are some benefits to establishing ESOPs under the Companies Act, sections 95 and 97 can also make it costly and time-consuming to do so.

The COVID-19 pandemic has made employee share schemes[1] increasingly common in the corporate environment, as companies under financial pressure have sought alternative ways to reward their employees.

Different levels of ESOPs (for example, for lower-level employees, management and senior executives) have their own mechanisms and conditions. Black economic empowerment deals also generally tend to incorporate an ESOP.

We believe it is useful to briefly examine the benefits and the pitfalls of establishing ESOPs under the Companies Act, 71 of 2008 (the Act).

What constitutes an ESOP?

S95(1)(c) of the Act defines an employee share scheme as *"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 business of the company or a 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."*

S95(1)(c) is in stark contrast to a similar provision in s144A of the Companies Act, 1973, which only contemplated a *"sale of shares"*. This article will focus on ESOPs formed *"by means of the issue of shares"*.

Certain commentators[2] favour a wide interpretation of s95(1)(c), in terms of which an ESOP includes the provision of funds by the company establishing the ESOP (Employer Company) to an entity to subscribe for or buy shares in the Employer Company or its holding company. Narrower interpretations[3] have concluded that s95(1)(c) only applies to an offer of securities for subscription by the specific company, and not to an offer for sale. We argue that the legislature purposely moved away from the phrase, "sale of shares" and replaced it with "issue of shares" in the Act, so the stricter interpretation of s95(1)(c) is the more plausible intention of the legislature.

This accords with the approach taken in Schedule 14 of the JSE Listings Requirements, which relates "to all schemes involving the issue of equity securities". Therefore, an ESOP only applies to an offer of securities for subscription and/or an issue of shares by the specific company, and not to an offer for sale.

Benefits and pitfalls of s95(1)(c) and s97

The obvious benefit of establishing an ESOP in terms of s95(1)(c) read with s97 is that an Employer Company is exempted from passing special resolutions for: (i) the issue of shares to a director, officer, or a person related or inter-related to the Employer Company, in terms of s41(1); and (ii) the provision of financial assistance in connection with the subscription for shares and/or to a director or officer, as typically required in terms of s44(3)(a)(i) and s45(3)(a)(i), respectively. The exemption does not, however, apply to the application by the board of the solvency and liquidity test contemplated in s4 of the Act.

If the Employer Company is listed on the JSE, or is a subsidiary of a listed company (and the scheme involves the issue of shares in the listed holding company), an ordinary resolution (supported by a 75% majority of votes cast) is still required.[4]

The exemption is subject to compliance with s97. This entails, firstly, the Employer Company appointing a compliance officer for the ESOP, who is responsible for its administration and is accountable to the board. The compliance officer is required, among other things, to provide a written statement to any employee setting out the full particulars of the nature of the transaction in respect of the ESOP, or material changes to it, and to make regular filings to the Companies and Intellectual Property Commission. Secondly, s97 requires the Employer Company to specify, in its annual financial statements, the number of shares allotted to the ESOP.

Despite the exemption, ESOPs established under s95(1)(c) and s97 are exceptionally onerous, costly and time-consuming.

Conclusion

When establishing an ESOP, companies should seek to adhere to principles of good corporate governance by complying with s95(1)(c) and s97 of the Act. However, the benefit of not needing a special resolution may be negligible in comparison to the cumbersome requirements of s97, especially when obtaining such a resolution is not problematic. It seems that s95(1)(c) and s97 provide little benefit, although they do provide an alternative in instances where the company cannot obtain (without undue effort, or at all) the requisite special resolution. ■

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1 Or employee share ownership plans (**ESOPs**).

2 FHI Cassim et al *Contemporary Company Law* 2ed (2012) and JL Yeats et al *Commentary to the Companies Act of 2008* (2018).

3 P Delport *et al Henochsberg on the Companies Act* 71 of 2008 (2019).

4 In terms of Schedule 14 of the JSE Listings Requirements.