

# COMPANIES ACT, 71 OF 2008

## CHAPTERS 1 & 2: MATERIAL MATTERS FOR CONSIDERATION

### 1. INTRODUCTION

The Companies Act of 2008 ("the Act") became effective on 1 May 2011. As a result of this, a number of material changes have been brought about to the manner in which companies are managed in this country. The purpose of this document is to highlight some of the issues found in Chapter 1 and 2 of the Act in order to assist boards of directors and management in taking appropriate action to ensure compliance. Implications of the other chapters of the Act have been dealt with in separate documents that can also be located on the iThemba website.

The items listed below should not be regarded as an exhaustive list as a company may have unique circumstances that require it to also consider other provisions of the Act.

It has become increasingly important for directors to apply their minds, and be seen to apply their minds, to matters of this nature in light of the potential for personal liability. Not only does the Act prescribe the standard of conduct expected from directors and officers (and the potential liability if this standard is not complied with), but it also provides the statutory right to any third party to institute civil action against any person who had caused such third party harm as a result of the contravention of any provision of this Act. This could potentially have severe consequences for any person contravening the Act, but especially so for directors and officers of companies.

The Regulations to the Act form an integral part of the Act and the Act should thus at all time be read in conjunction with the Regulations.

The Act is new to all relevant role players and thus opposing interpretations will be made and opinions provided on more than one of the provisions of this Act. Only over time will we have the benefit of court judgements to bring some clarity and certainty in most of these areas.

## **2. MATERIAL MATTERS FOR CONSIDERATION**

### **2.1 Chapter 1: Interpretation, purpose and application**

- The Act contains numerous **definitions** which are important for a proper interpretation of the provisions of the Act and even terms such as “knowing, knowingly, or knows” have been defined. Reference to specific definitions will be made below where appropriate.
- The concept of “**related and inter-related**” which features throughout the Act is explained and defined in s2.
- The “**solvency and liquidity test**” which has to be applied in a number of instances as indicated below is explained and defined in s4.
- **Electronic communication** with shareholders is provided for in s6 and should be considered by companies in order to limit unnecessary costs in respect of shareholder communication. Listed companies also have to take into account the JSE Listings Requirements in this regard.
- As a matter of interest, it is worth noting the **purpose of the Act** as set out in s7 which, amongst other things, is to promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law.
- The **categories of companies** as set out in s8 could result in public companies (“Limited”) having to convert to private companies ((Pty) Limited) if its constitutional documents do not comply with the requirements for a public company.
- It is important to note the distinction between non-profit companies and **profit companies** (public companies, private companies, state-owned companies and personal liability companies). Caution needs to be exercised when reading the provisions of the Act, not to confuse “profit

company" with "public company" as "profit company" includes the other forms of companies as listed above.

- **Modified application** of the provisions of the Act is provided for in respect of state-owned companies (s9) and non-profit companies (s10).

## 2.2 Chapter 2: Formation, administration and dissolution of companies

- **Criteria for company names** are set out in s11 and needs to be taken into account when a name change is contemplated.
- **One or more** persons may incorporate a **profit** company and **three or more** may incorporate a non-profit company.
- The **Memorandum of Incorporation** ("Mol") will replace the memorandum and articles of association of companies (must be replaced by no later than 30 April 2013).
- The MOI sets out the rights, duties and responsibilities of shareholders, directors and others. If, during the transitional period of two years, there is a conflict between the Act and a pre-existing company's memorandum and articles, the memorandum and articles will prevail, subject to certain exceptions which will be applicable from the effective date:
  - ✓ Duties, conduct and liability of directors (s75, s76, s77);
  - ✓ Rights of shareholders to receive notice or have access to information (s26);
  - ✓ Provisions of the Act regarding shareholders' meetings and board meetings (s61 – s65, s73);
  - ✓ Provisions regarding fundamental transactions (Chapter 5).
- The board of directors may issue **rules** relating to the governance of the company that are not addressed in the Act or the Mol and such rules will become effective 20 days after being published but have to be put to shareholders at the next AGM for approval.
- S15(7) states that **shareholders' agreements** may not be inconsistent with the provisions of the Act or the Mol. A company will have a two year transitional period during which the provisions of a shareholders' agreement to which it is a party will prevail over the Act. The two years terminates on 30 April 2013, unless the shareholders' agreement is

amended prior to this date in which event the transitional period terminates on the date of such amendment. Notwithstanding the transitional period, companies with shareholders' agreements will be well advised to **review these agreements** to remove or amend conflicting provisions.

- In terms of s20, shareholder of a company has a **claim for damages** against any person who fraudulently or due to gross negligence causes the company to do anything inconsistent with the Act or with any limitation, restriction or qualification on the purpose, powers or activities of the company that may be included in the company's Mol.
- **Reckless trading** is prohibited by s22 which states that "a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. In addition, the Commission may issue a compliance notice against any company if the Commission is of the opinion that the company is **not able to pay its debts** in the ordinary course of business.
- The nature and retention of **company records** and access thereto is regulated by the provisions of sections 24 and 26.
- The content of **financial statements** and annual financial statements is described in sections 29 and 30. Each company must establish whether it is obliged to have its annual financial statements audited. As a general rule, state-owned and public companies **must be audited** (listed companies must consider the JSE Listings Requirements as far as group companies are concerned). Other companies must be audited if its "public interest score" is in excess of that as prescribed. A "**public interest score**" will be allocated to a company in terms of Regulation 28, read with Regulation 26(2), and will be based on the following factors:
  - ✓ Number of employees
  - ✓ Third party liability
  - ✓ Turnover
  - ✓ Shareholders

Companies that are not obliged to be audited may be audited voluntarily or it must be independently reviewed in the manner as prescribed by the Regulations. A company where every person with a

beneficial interest in the company is also a director does not have to have its annual financial statements audited or independently reviewed.

**Listed companies** should take note of the JSE requirement that the annual financial statements of each company in the listed group should be audited notwithstanding the provisions of the Act.

- Only the name and registration number of companies need to be displayed in all notices and other official publications of the company, including its **letterhead** and other stationary (s32).
- Part D of Chapter 2 deals with **capitalisation** of profit companies. Under the Act, a share will **not** have a nominal or par value and shares will be fixed in number only. Any shares of a pre-existing company that have been issued with a nominal or par value, and are held by a shareholder immediately before 1 May 2011, will continue to have the nominal or par value assigned to them when issued. The Regulations (Reg. 31) regulate the transitional status and conversion of any nominal or par value shares of a pre-existing company. A pre-existing company **may not authorise** any new par value shares after 1 May 2011, **but may issue** further shares after this date from its authorised share capital outstanding as at 1 May 2011 until such time as it has converted its par value shares. A company could thus issue par value shares after 1 May 2011, provided it has sufficient authorised par value share capital. Companies will however have no option but to convert to no par value shares once its unissued authorised shares have all been issued.
- As a general rule, the share capital of a company used to be in the hands of shareholders and directors could not issue or create shares unless with the authority of shareholders. The Act now places shares in the hands of directors (with some exceptions to this general rule – see s41) and **directors can issue or create** shares **unless** it is otherwise provided for in the company's Mol.
- S44 regulates the **provision of financial assistance for subscription** of company securities that will require a special resolution of shareholders, a solvency and liquidity test as well as confirmation that the terms are fair and reasonable to the company.

- The provision of **loans and financial assistance to directors and related or inter-related companies** is governed by s45. In terms of this section, loans by a company to its directors, prescribed officers, related companies, inter-related companies or any member of any related or inter-related companies or any person related to any of those entities must be approved by way of special resolution. The special resolution can be a specific resolution or a general resolution adopted during the previous two years. It is suggested that this resolution be adopted at the AGM as soon as possible after the Act is implemented in order to regularise the granting of inter-company loans or guarantees.
- **Distributions**, including dividends (see definition of "distribution" in s1), must be authorised by the board as provided for in s46, but only after a solvency and liquidity test has been considered by the board. The resolution approving the distribution must be carefully worded to ensure that it includes an acknowledgement that the solvency and liquidity test has been applied.
- **Share buy backs** may, in terms of s48, be authorised by the board unless shares are to be acquired from directors or officers, in which event a special resolution of shareholders will be required. There are also additional requirements if the shares to be acquired constitute more than 5% of the issued shares of that particular class.
- Part E of Chapter 2 regulates the **registration and transfer of securities** and again provides for both certificated and uncertificated securities.
- An important section of the Act is contained in Part F of Chapter 2 that regulates the **governance of companies**. The critical provisions of the Part F can be summarised as follows:
  - s57: Certain companies may be exempted of some of the provisions of Part F, when there is only one shareholder or one director or when all shareholders are also directors of the company.
  - s58: Shareholder right to be represented by proxy. Content of proxy forms has to be reviewed in terms of the provisions of this section.

- s60: Round robin resolutions of shareholders – ordinary and special resolutions may be passed by way of round robin resolutions, unless the Act specifically requires the resolution to be approved at a meeting. Within 10 days after adopting a resolution in terms of this section, a statement must be delivered to each shareholder, the content of which is prescribed. It should be noted that an AGM can no longer be dealt with by way of round robin resolution.
- s61: Shareholders' meetings – all provisions relating to shareholders' meetings. Provision is also made for electronic participation by shareholders (also see s63(2)). Only public companies are required by law to hold annual general meetings.
- s62 – s64 address issues related to shareholders' meetings, including the notice and conduct of the meeting, meeting quorum and adjournment.
- s65 deals with shareholder resolutions, including the percentages required to pass ordinary and special resolutions and the flexibility to vary these percentages in a company's Mol.
- s66: Board, directors and prescribed officers:
  - It is important to note that directors' authority can only be limited either by the Act or by the provisions of the Mol. This is of specific relevance in instances where shareholders have reserved matters for shareholder approval in terms of a shareholders' agreement.
  - A private company must have at least one director and a public company and non-profit company, at least three directors.
  - The Mol of a profit company must provide for the election of at least 50% of directors and 50% of alternate directors by shareholders.
  - Provision is made for *ex officio* directors.

- The appointment of a director is only effective when the written consent to serve as a director has been delivered to the company.
- Remuneration may only be paid to directors for their services as directors if approved by shareholders by way of a special resolution.
- Prescribed officers are defined in the Regulations
- s68: Election of directors of profit companies - Directors are to be elected by shareholders, but a board of directors may fill a vacancy on a temporary basis if so provided for in the company's Mol.
- s69: Grounds for ineligibility and disqualification of persons to be directors or prescribed officers. The period of the disqualification is also discussed.
- s70: There are several occurrences that causes a vacancy on a board of a company and the criteria (who and when) to fill the vacancy on a board.
- s71: Removal of directors –
  - the criteria to remove a director of a company will depend on the Mol or any other agreement between a company/shareholders and a director. A director may be removed by an ordinary resolution adopted at a shareholders meeting or resolution approved by the directors, subject to specific requirements, including a notice being given to the director and a reasonable opportunity granted to the director to make a presentation in his own defence;
  - An aggrieved director may apply to court to review the decision of the board at his own cost, unless the court reverses the decision of the board.
  - The removed director may have a right to apply for damages or other compensation consequential to the removal.
- s72: Board committees –



- Unless the MoI provides otherwise, the board of a company may appoint committees of directors and delegate to such committee any of the authority of the board.
  - Such committees may include persons who are not directors, but with certain qualification requirements, the committee may consult with or receive advice from any person and has the full authority of the board in respect of a matter referred to it.
  - The Minister may prescribe that certain category of companies must have a **social and ethics committee** if in the public interest. A company may apply for exemption to appoint such a committee.
- s73 deals with the criteria for a director to call board meetings, how to conduct a board meeting by electronic communication, the voting rights of directors, how to keep minutes of board meetings and directs that resolutions adopted by the board must be dated and sequentially numbered.
  - s74 makes provision for a decision that could not be voted on at a board meeting to be adopted by written consent of a majority of the directors in person or by electronic communication if each director has received notice of a proposed matter to be decided.
  - s75 provides for instances when a director must disclose a personal financial interest in respect of a decision by the board or transaction, and the validity of decisions if a personal financial interest was not disclosed–
    - This section is applicable to a director, including an alternate director, prescribed officer and member of a committee of the board of a company and a related person as set out in section 1, including a second company of which the director or related person is also a director, or a close corporation of which the director or a related person is a member.

- It is important to note that not only is the conflicted director required to disclose the interest, as well as any relevant information, but must also recuse himself from the meeting where the matter is being discussed.
- s76 sets the following **standards for directors' and officers' conduct** whilst in the appointed position:
  - not to use the position or information to harm the company;
  - to disclose any material information to the board, unless it is in the public domain or the individual is prevented from disclosure based on a contractual or ethical obligation;
  - to act at all times:
    - in good faith and for a proper purpose;
    - in the best interest of the company; and
    - with due care, skill and diligence.
  - a director will have satisfied the above obligations duties if:
    - he has taken reasonably diligent steps to become informed about the subject matter/s; and
    - does not have a personal financial interest in the subject matter of the decision and no reasonable basis to know of a related person's interest; or
    - he has disclosed the interest in terms of s75; and
    - he had a rational basis for believing, and did believe, that the decision/s was in the best interest of the company.
  - In discharging the above duties, directors are entitled to rely on:
    - one or more employees, professional persons retained by the company, board and board or other committees; and
    - information, opinions, reports or statements provided by the abovementioned.
- s77: **Liability of directors and prescribed officers -**

- s77 provides for directors and officers to be **personally liable** for **all damages** suffered by the company in the event of such a person:
  - Failing to comply with the provisions of s75 (disclosure of personal financial interests) and s76 (standard of conduct);
  - Allowing the company to proceed with certain activities, such as a declaration of a dividend, without complying to the relevant requirements of the Act;
  - Being a party to reckless;
  - Acting outside the individual's level of authority;
  - Being a party to publishing false, misleading, incomplete or non-compliant financial information.
- In addition certain contraventions such as being party to the falsification of any accounting records of a company could potentially result in a criminal offence, punishable by a fine and/or imprisonment of a maximum of 10 years (see s214 and s216). Other contraventions of the Act could be punishable by a fine and/or imprisonment of up to 12 months.
- s78: Indemnification and directors' insurance
  - Directors and the other persons specified may not be relieved of a duty contemplated in s75 or s76 or of liability as provided for in s77. In addition, the legal consequences arising from an act or omission may not be negated, limited or restricted if the said act or omission constitutes wilful misconduct or wilful breach of trust.
  - There are however certain instances where indemnification of directors and officers is allowed and in these instances the company is also allowed to purchase directors' and officers' liability insurance cover.

- **Part G** of Chapter 2 contains the criteria for **winding-up of solvent companies** by either voluntary winding-up or winding-up and liquidation by court order as well as the dissolution, deregistration and removal from the register of companies. A company is dissolved as of the date of removal from the register unless the reason for the removal is that the company's registration has been transferred to a foreign jurisdiction (sections 79 to 83).

## **NEED ASSISTANCE WITH THE IMPLICATIONS OF THIS ACT?**

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**NOTE:** For other advisory notes on the various chapters and provisions of the Companies Act of 2008, see the iThemba website at [www.ithemba.za.com](http://www.ithemba.za.com).

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