Companies Act 71 of 2008

Topic: Corporate

IN A CALABASH

Introduction

Running a business in South Africa may be done using one of three options:

- **Operating the business under one's own name as a sole proprietorship;**
- **Operating the business under a close corporation, as long as this close corporation was registered and in operation before 1 May 2010; or**
- **Operating the business as a private company, which will be done under and in terms of the Companies Act, 2008.**

A company is a separate legal entity owned by shareholders, which entity exists as distinct and separate from its shareholders and which can perform rights and duties of its own.

A company has to be registered under and regulated by the Companies Act, 2008. This is a relatively new Act, which came into operation on 1 May 2010 and which has replaced the 1973 Companies Act.

Objectives of the Act

The new Companies Act seeks to encourage and promote transparency and to raise the standards of corporate governance in South Africa. The Act also seeks to align South African company law with global standards.

The Companies Act, 2008 seeks to regulate the operations of a number of categories of companies, as outlined below.

Application of the Act and its implication to Tourism

The Companies Act is applicable to shareholders and directors of all companies. Stakeholders within the tourism sector, specifically shareholders and directors of a company, who operate their business through the company need to be mindful of the various provisions of the Companies Act which will apply to their company in order to avoid penalties and personal shareholder or director liability.

Summary of the provisions of the Act

Whilst the Companies Act, 2008 provides that the company is a separate legal entity which can manage its own affairs and business separately from that of the shareholders, its shareholders, directors and other persons may be held jointly and severally liable for the company's debts when such persons fail to comply with the provisions of the Companies Act, 2008 or the company's Memorandum of Incorporation (MOI), an agreement setting out what the company may do and not do.

Legal framework

The Companies Act, 2008 provides for the following types of categories of companies:

- Private companies are profit entities, referred to as (Pty) Limiteds. A private company is defined as a company that is not a state-owned company, and its Memorandum of Incorporation prohibits it from offering any of its securities to the public and restricts the transferability of its securities;
- Personal liability companies are profit entities, referred to as Incs. An Inc is defined as a company whose directors are jointly and severally liable for any debts and liabilities of the company;
- State-owned companies are profit entities, referred to as SOC Limiteds. A SOC is defined as any company which is found under Schedules 2 and 3 to the Public Finance Management Act or any company which is owned by a municipality;
- Public companies are profit entities, referred to as Limiteds. A public company is defined as any company which is not a state-owned company, private company or personal liability company and which does not limit the transferability of its shares; and
- Non-profit entities are referred to as NPCs. An NPC is a non-profit company which usually does not have a shareholder(s).

Owners

A company can be owned by one or more persons, including persons and legal entities. A company or CC can hold shares in a company. The owners are known as shareholders or number of shareholders. Ownership is acquired through a purchase or acquisition of a share in the company.

Shareholders are able to sell and transfer shares to another, provided that the rules attaching to sale and transfer of shares, as per the Companies Act, 2008 or the MOI or shareholders agreement, are complied with.

Company finance and share capital

A company has a capital account, which is divided into share capital. When a company is registered, the directors or person registering the company will determine the share capital of the company, which is known as the 'authorised share capital'. In order to raise finance and to establish a company, the authorised share capital (the shares of the company) are sold to shareholders.

The money received from the shareholders is then used to operate and manage the company, which is known as the 'capital' of the company.

Company office

All companies in South Africa must establish a registered office in South Africa from which its operations will be run and in which its company documents will be held. It must give notice of the address of its registered office to the Companies and Intellectual Property Commission (CIPC).

Operation of a company

Acompany, although it is owned by shareholders, will be managed and operated by a number of directors who are appointed by the shareholders. The directors who comprise the board may also appoint and delegate some of their duties to board committees, such as an audit committee, a social and ethics committee and a risk committee.

Board of Directors

Directors are appointed by the company and by the shareholders. The shareholders must appoint at least 50% of the directors. A company can have as many directors as it likes, but it must have at least one director when it is a Pty Limited and at least three directors when it is a public or non-profit company. Directors owe a fiduciary duty to the company and its shareholders. Directors must have board meetings from time to time and vote on certain matters. Directors can set their own internal board procedures.

Company secretary

Public companies and state-owned companies must appoint a company secretary. This function will assist the board in discharging its company duties and will ensure that the company complies with the Companies Act, 2008.

Private companies, Incs and NPCs do not have to appoint a company secretary.

Auditor and audit committees

Public companies and state-owned companies must appoint an independent auditor and audit committee. The audit committee must consist of at least three directors, one of whom must be independent.

Private companies, personal liability companies and non-profit companies do not have to appoint an auditor unless they are obliged to have their annual financial statements audited. The audit of financials and appointment of an auditor can be done, however, on a voluntary basis should the company so elect.

Private companies, personal liability companies and non-profit companies do not have to appoint an audit committee, although they can do this on a voluntary basis.

Memorandum of Incorporation

The constitutional documents and contracts setting out what a company may do and not do are–

- a 'Notice of Incorporation' instead of a Certificate of Incorporation; and
- a combined document to be known the 'Memorandum of Incorporation' ('MOI'), which has replaced both the Memorandum of Association and the Articles of Association of a company, both of which were required by the 1973 Companies Act.

Each provision of the MOI must be consistent with the provisions of the Companies Act, 2008. The MOI will be void to the extent that it contravenes or is inconsistent with the Act.

The Companies Act, 2008 stipulates alterable provisions (provisions that have room for tailoring), unalterable provisions (provisions that cannot be tailored) and default provisions (alterable provisions that will apply by default if not expressly altered in the MOI) in relation to matters to be included in the MOI.

Pre-existing companies are encouraged to file a new MOI in compliance with the Companies Act, 2008 which will then supersede and replace its existing Memorandum and Articles of Association, especially if it wishes to tailor the alterable provisions and does not wish to be bound by the default provisions housed under the Act.

The MOI sets out the rules of the company, what it can and cannot do. The MOI binds the company, the shareholders and the directors. The content of the MOI is only binding as between the shareholders, the company and the directors.

The doctrine of 'constructive notice' has, to a large extent, been abolished in order to bring South African company law in line with that of other jurisdictions. In this regard, a person will no longer be deemed to have knowledge of the contents of any company documentation, such as the MOI, simply because such documentation has been filed with the relevant authority or is available for inspection at the company's registered office.

There is one slight exception to the above rule. The doctrine of 'constructive notice' will still apply to specific provisions, such as ring-fenced provisions housed under a company's 'Memorandum of Incorporation', provided that such company's 'Notice of Incorporation' or a 'Notice of Amendment' filed subsequently has specifically drawn the reader's attention to such specific provision. In other words, if the MOI is restricted and has provisions which cannot be changed, these are known as ring-fence provisions and the company must insert the letters 'RF' after its name. This warning or notification seeks to bring to the attention of any third party the fact that the company has certain restrictions. If these restrictions are overreached, such act will be null and void and invalid and whoever has carried out the 'invalid' act will be liable to any other person who may have suffered damages as a result of the 'invalid' action.

The shareholders of a company have the right to enter into an agreement with one another, an agreement which will govern their relationship as shareholders of a company. Such agreement must be consistent in all respects with the provisions of the company's MOI. This agreement will be known as a shareholders' agreement.

Therefore, shareholders can no longer enter into shareholders' agreements containing provisions which are inconsistent with the provisions of the MOI of such company. If this is found to be the case, such provisions will be null and void and will be of no force and effect. The provisions of the MOI will always trump the provisions of a shareholders' agreement.

Shareholders

Whilst the day-to-day business of the company is managed by the directors and board, shareholders will from time to time be called upon to determine and vote on certain matters concerning the company. Whenever shareholders are required to vote, the shareholders will be called to a shareholders' meeting for the purposes of casting a vote. Each shareholder has one vote for every share it holds in the company, unless expressly stated differently under the MOI and shareholders' agreement.

Standards of directors' conduct

All the directors of a company owe a fiduciary duty to the company. This means that all directors, whether they are executive or non-executive directors, must exercise their powers and function–

- in good faith and for a proper purpose;
- in the best interest of the company; and
- with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions and having the general knowledge, skill and experience of that director.

A director's judgment is regarded as reasonable if the director takes reasonably diligent steps to become informed about the subject matter, does not have a personal financial interest and the director had a rational basis to believe that the decision is in the best interest of the company. The duties imposed in terms of the Companies Act, 2008 are in addition to, and not in substitution for, any duties of a director of the company under common law.

The Companies Act, 2008 does, however, allow a director, when complying with any duty, to rely on one or more employee of the company, legal counsel, accountants or other professional persons, or a committee of the board of which the director is not a member.

Director's liability

Directors of a company may be held jointly and severally liable for any loss, damage or costs sustained by the company as a result of a breach of the director's fiduciary duty or the duty to act with care, skill and diligence. In addition, a director may also be held liable where he or she–

- acts in the name of the company without the necessary authority;
- is part of an act or omission while knowing that the intention was to defraud shareholders, employees or creditors;
- signs financial statements that are false or misleading in a material respect; and/or
- issues a prospectus that contains an untrue statement.

The strict standards of directors' conduct and liability are somewhat tempered by the fact that companies are allowed to advance funds to cover the expense of litigation against directors, to indemnify directors in certain circumstances or to purchase insurance to protect either the director or the company. Directors may never be indemnified from willful misconduct or willful breach of trust.

The Act provides for a procedure in which an aggrieved stakeholder may apply to the court for an order to declare a director either delinquent, and therefore prohibited from

being a director, or under probation, and thus restricted to serve as a director within the conditions of the probation.

Company formation, naming and dissolution

To register a company, any person may complete the relevant CoR documentation and lodge this, together with its MOI, with the Commission. If all paper work is in order, the CIPC will register the company and issue the directors with a certificate of incorporation.

This, together with the MOI and, if applicable, the shareholders' agreement, is the governing documentation of the company. Any person who would like to register a company may reserve a specific company name. Any company name will be acceptable, provided such name–

- is not misleading or does not falsely imply an association that does not in fact exist; and
- does not infringe an existing registered company name, CC name or trade mark.

Annual return

Every company must submit to the CIPC, on the anniversary date of its registration, a company annual return in the prescribed manner and form and with payment of a prescribed fee.

The financial statements or verified financial statements of the company and the calculation of its public interest score will accompany the annual return. Where annual financial statements are not submitted, the company will have to file an annual accountability and transparency report.

Insolvency and winding-up

Any director or shareholder may resolve to close and wind-up any company that is not insolvent under the Companies Act, 2008. Once wound-up, the company will be deleted from the CIPC companies register and such company will no longer exist.

The winding-up of an insolvent company, one which is unable to pay its debt and continue operating, will be done under and in terms of the old Companies Act, 1973.

Financial statements and requirement for an audit

All companies, whether they are private, public, profit or non-profit, have to–

- have an appointed registered office;
- maintain and keep their records at that office, or at another location, notice of which has been given to the Commission;
- compile, in accordance with applicable and generally acceptable accounting practices, financial statements and records;
- retain all records and documents for at least seven years, or longer where another law requires;
- make specified records available to shareholders, in a manner that is harmonised with the Promotion of Access to Information Act 2 of 2000;
- have a fixed financial year, which may be modified only within restrictions;

- maintain accurate financial records, which must be kept in accordance with any prescribed standards, but which may vary for different categories of companies. Falsification of those records is an offence;
- set out under its financial records the director fees and other remuneration earned by their directors;
- produce any financial statements, or summary of such a statement, in a manner and form that satisfies prescribed financial reporting standards, which standards may vary for different categories of companies but must be consistent with International Financial Reporting Standards of the International Accounting Standards Board;
- stipulate on any financial statements or summary of any financial statements whether the statements have been audited, independently reviewed or are not audited, the date of the statements, the period to which they apply and the name and professional designation, if any, of the person responsible for preparing the statements;
- produce annual financial statements each year, unless it has been dormant since the last time it had to produce such a statement or it is a private or personal liability company and either all of its securities are held by one person or every security holder of the company is also a director of the company.

Public companies and companies who score more than 350 points when they calculate their public interest score must have their annual financial statements audited. Those who do not have to have their annual financial statements audited, however, still have to have them independently reviewed and verified.

In addition, where a company's annual financial statements are audited, these financial statements as audited must be approved by the directors of the company and include a directors' report. The directors' report should house a detailed disclosure of information concerning the compensation and other amounts of money paid to directors.

Use of the company name

All company documents must contain the full name and registration number of the company. The company is also required to submit a filing sheet with any faxed or emailed document, setting out the name of the company as sender, the details of the recipient, the number of pages of the document submitted or transmitted and a contact person whom the recipient may contact should he or she not receive all the documents submitted.

Company governance

The Companies Act, 2008 addresses all matters relating to company governance which is designed to promote transparency and accountability.

In particular, the Act–

- introduces flexibility in the manner and form of shareholder meetings, the exercise of proxy rights and the standards for adoption of ordinary and special resolutions, already addressed above;
- retains existing qualifications and disqualifications for directors, with some enhanced flexibility for very small companies where the sole shareholder may be the only director;
- explicitly recognises and provides for the use of alternate directors, directors who may be appointed by persons designated in a company's MOI and for *ex officio*

directors, while requiring that a minimum of at least half of all directors of a company must be elected by the shareholders of the company; and
- provides a detailed procedure which allows a person to apply to the courts for the removal of directors from office based on incompetence or delinquency.

Takeovers and fundamental transactions

The Companies Act, 2008 covers fundamental transactions such as a merger, acquisition or scheme of arrangement. All these transactions require shareholder approval and approval from the CIPC Panel, which panel has replaced the Securities Regulation Panel (SRP). In addition, certain of these transactions will require court approval if there was a significant minority (at least 15%) of shareholders opposed to the transaction.

Business rescue

The existing regime of judicial administration of failing companies has been replaced with a modern business rescue regime, which is largely self-administered by the company under independent supervision of a business rescue practitioner.

The Companies Act, 2008 recognises the interests of shareholders, creditors and employees and provides for their respective participation in the development and approval of a business rescue plan.

Recognised creditors of the company are shareholders, creditors and employees who have been given a voting interest to the extent of any unpaid remuneration before the commencement of the rescue process.

The business rescue practitioner has to consult with the shareholders, creditors and employees in the development of the business rescue plan, to allow them the raise queries and suggest amendments to the plan and to give them, as a group, the right to buy out any dissenting creditor or shareholder who has voted against approving a rescue plan.

Remedies

The High Court remains the principal forum for remedies in terms of the Companies Act, 2008. Any aggrieved person, including a trade union, employee or shareholder, has the right to commence an action on behalf of the company when it is of the opinion that the company is being mismanaged.

A whistle-blowing regime has also been established, compelling all companies to set up a confidential help line where persons may report, under protection, irregular behaviours concerning the company. This system and function has been harmonised with the protections already afforded employees under the Protected Disclosures Act.

As well as retaining certain existing remedies, the Companies Act, 2008 provides that–
- shareholders may apply for a declaratory order and seek an appropriate remedy where their rights have been infringed;
- any person has the right to apply to have a director declared delinquent or placed under probation;
- any dissenting shareholder, one who has voted against a transaction, has the right to have his or her shares appraised and to be compensated for the fair value of those shares by the company;

- any person who feels aggrieved and who has suffered damages as a result of another person not complying with the Companies Act, 2008 may pursue legal action against such person in the high court;
- the Companies Act 2008, provides for a derivative action which replaces any common-law derivative action; and
- a director may be sued for damages where he or she has breached his or her fiduciary duties.

Enforcement

A large number of criminal offences housed under the old 1973 Companies Act have been removed. That being said, there are still a few offences for which persons, including directors and accounting officers, may be criminally charged. These include any noted falsification of records or documents, publishing of untrue or misleading information, refusal to respond to a summons or give evidence, perjury and similar matters relating to the administration of justice in terms of the Companies Act, 2008.

Any such offences must be referred by the CIPC or complainant to the National Public Prosecutor for trial in a magistrate's court. Any person found guilty of an offence will be fined, or jailed for up to 10 years in prison.

In place of the criminal sanction, the Companies Act, 2008 now relies on a system of administrative enforcement. The CIPC or Panel may receive complaints from any stakeholder, may initiate a complaint itself or may act on a matter as directed by the Minister.

Following an investigation into a complaint, the CIPC or Panel may–

- end the matter;
- urge the parties to attempt voluntary alternative resolution of their dispute;
- advise the complainant of any right he or she may have to seek a remedy in court;
- commence proceedings in a court on behalf of a complainant, if the complainant so requests;
- refer the matter to another regulator, if there is a possibility that the matter falls with its jurisdiction; or
- issue a compliance notice, but only in respect of a matter for which the complainant does not otherwise have a remedy in a court.

A compliance order may be issued against a company or against an individual if the individual was implicated in the contravention of the Act.

A person who has been issued a compliance notice may challenge it before the Companies Ombudsman and in court, but, failing that, is obliged to satisfy the conditions of the notice. If that person fails to do so, the Commission may either apply to a court for an administrative fine or refer such failure to the National Prosecuting Authority as an offence.

When a company has failed to comply, it will be fined up to 10% of its annual turnover at the time of the offence. Furthermore, in addition to the fine, when such company continues to contravene the Companies Act, 2008 the CIPC or Panel may apply to a court for an order dissolving the company.

WHAT HAPPENS IF YOU DO NOT COMPLY?

There are a handful of areas under the Companies Act, 2008, which, if not complied with, may lead to possible criminal charges and sanctions. These areas largely concern the drafting and publication of incorrect or misleading documents such as a prospectus or financials.

Where a criminal charge is not pursued, the CIPC can issue a compliance notice on the company concerning any area of non-compliance. If the notice or order is not followed and the behaviour is not rectified, the Commissioner can impose a fine on the company which may be a penalty of up to 10% of the company's turnover.

In addition to the above sanctions, any person, including a director who does not comply with the Companies Act, 2008, can be held personally liable and sued for damages.

Non-compliance may also lead to reputational fall-out, loss of support from financial backers, shareholders selling their shares and the ultimate closure of company.

RECOMMENDED ACTIONS OR CONTROLS WHICH SHOULD BE IMPLEMENTED BY THE TARGET AUDIENCE TO ENSURE COMPLIANCE WITH THE ACT

The following controls should be in place to demonstrate compliance with the Act:

- MOI and shareholder agreements in place by 30 March 2013;
- MOI drafted and in line with the Companies Act, 2008;
- Social and Ethics Committee in place by 31 April 2012;
- Annual financial statements finalised and either audited or verified by company at financial year end;
- Appointment of directors and chairman at end of rotation;
- AGM at financial year end;
- Submission of annual return at end of financial year;
- Directors in place and director register up to date;
- Committees in place including Social and Ethics Committee;
- Shareholders correctly reflected in statutory books;
- Shareholders' meetings held when required;
- Shareholders' agreement in place where required;
- Resolutions in place;
- Minutes in place and duly signed;
- Financial records in accordance with accounting standards in place;
- Company secretary appointed;
- Auditor appointed, where required to audit books of account;

- Documents with CIPC in place;
- No attempt to contract out of the Companies Act, 2008 using anti-avoidance tactics;
- Directors made aware of their fiduciary duties;
- Disclosure of directors' personal financial interest;
- Application of solvency and liquidity test when required;
- CIPC documents up-to-date, including filing of annual return;
- Calculation of public interest score; and
- Board charter to be in place.

FURTHER INFORMATION

Regulators

Department of Trade and Industry
Companies and Intellectual Property Commission
Companies Tribunal
Securities Regulation Panel

Websites

www.thedti.gov.za
www.cipc.co.za

Prescribed Forms

Relevant forms may be downloaded off the following website:
http://www.cipc.co.za/AllForms.aspx