

**ENTREPRENEURIAL LAW (MRL203L)**

**Discussion Class Notes**

**Study Unit 1  
Legal Personality**

A company attains legal personality **upon incorporation**.

Legal personality means:

- limited liability of members.
- The assets of the company are its exclusive property.
- Where a company is wronged, the company must itself seek redress.
- Managerial and executive powers are to be exercised by directors.
- Shares in a company entitle holders certain interests in the company.

The new entity can acquire its own rights and duties separate from its members.

The Court can disregard the legal personality to avoid abuse (“lifting” or “piercing the corporate veil”.)

**LIFTING THE CORPORATE VEIL:**

***Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 (4) SA 790 (A) [47]**

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***Hülse-Reutter v Gödde* 2001 (4) SA 1336 (SCA) [48]**

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Section 163(4): if a court finds that the incorporation of a company or any act by or use of a company constitutes an unconscionable abuse of its juristic personality, the court may declare that the company will be deemed not to be a juristic person in respect of the rights, liabilities and obligations relating to the abuse.

Courts will not allow the use of any legal entity to justify wrong, to protect fraud or to defend or hide crime.

Courts will then pierce or lift the corporate veil and hold directors and others personally liable for acts committed in the name of the company.

The veil will only be pierced or lifted in exceptional circumstances where there is no alternative remedy available and piercing the corporate veil will prevent an injustice.

This is a combination of section 65 of the Close Corporations Act and the judgment in *Botha v Van Niekerk*.

*Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*: test to ascertain whether an “unconscionable injustice” was done as applied in *Botha v van Niekerk* was too rigid.

View in *Cape Pacific* is disregarded in s 163 (4).

## 1.5 Legal personality of branches and divisions

If branches and divisions are not registered entities themselves but merely operate separately for practical purposes, they do not for purposes of law have their own separate legal personality.

## Study Unit 2

### Types of Companies

#### Types of companies

The Act provides for profit and non-profit companies.

##### **Profit company:**

Object is financial gain for its shareholders.

May be incorporated by one or more persons.

There is no limit to the number of shareholders that it may have.

**Four entities qualify as profit companies:**

*(1) A public company.*

- Shares may be offered to the public and are freely transferable;
- This company can be listed on the JSE Limited;
- The Memorandum of Incorporation (MOI) is the governing document of this company.

*(2) A state-owned company.*

- Falls under the meaning of “state-owned enterprise” as determined in the Public Finance Management Act, or it is owned by a municipality;
- It is a National Government Business Enterprise;
- It is fully or substantially financed by the National Revenue Fund, tax, levy or other statutory money.
- Examples of state-owned companies: CSIR, SABS and Sasria.

*A personal liability company.*

- Private company, mainly used by professional associations (such as attorneys);
- Directors are jointly and severally liable along with the company for debts and liabilities contracted during their term of office. Section 19(3) uses the word “contracted” and not “incurred”, which was held by the court in *Fundtrust (Pty) Ltd (In Liquidation) v Van Deventer* 1997 (1) SA 710 (A) to limit this liability to contractual debts, and to exclude delictual and statutory liabilities.
- Refer to *Sonnenberg McLoughlin Inc v Spiro* 2004 (1) SA 90 (C) (in part 2.6.3 of your text book) on a section 53(b) company in terms of the Companies Act of 1973. This company is similar to the new personal liability company.

*A private company.*

- Its MOI prohibits offering of shares to the public, cannot freely transfer shares;
- See *Smuts v Booyens; Markplaas (Pty) Ltd and another v Booyens* 2001 (4) SA 15 (A) on this requirement not to transfer shares freely to the public (par 2.6.4 of your text book).

**Non-profit company:**

Company previously registered under section 21 of the Companies Act of 1973.

Objects must relate to social activities, public benefits, cultural activities or group interests.

Must have directors, but they are not allowed to obtain any financial gain from the company other than remuneration for the work they performed.

Does not have to have members.

If they have members, some members may enjoy voting rights while others may not.

## Study Unit 3

### Company Formation

#### 3.2 Incorporation of a company

Section 7(b): Aims of 2008 Act:

- The creation of flexibility in the formation and maintenance of companies.
- Simplicity in the formation and maintenance of companies.
- The encouragement of corporate efficiency.
- The encouragement of transparency.
- The provision of a predictable regulation of companies.

When dealing with the formation of companies, the objectives of flexibility and simplicity are clear. The Act makes it possible to incorporate both simple business structures and very complex business structures.

✦**Note that the heading of section 13 is “Right to incorporate company”. When it comes to incorporation, the flexibility and simplicity of the Act make it easier for people to exercise the right to incorporate companies. When comparing the 1973 Act with the 2008 Act it is clear that the requirements for incorporation are less stringent than they used to be.**

The Memorandum of Incorporation is the founding document of the company. It sets out the relationship between the company and its shareholders; the company and the directors; the company and other parties within the company as well as the company and third parties.

Provisions in the Memorandum of Incorporation may be amended from time to time.

### **3.2.2 *The Incorporation of a company: steps to be taken***

One or more persons may incorporate a profit company. For the formation of a non-profit company, three or more persons are required. Each of these people must complete and sign the Memorandum of Incorporation.

The Act provides a standard form for the Memorandum of Incorporation. However, the use of the standard form is optional. Since the Act allows for flexibility the Memorandum of Incorporation may be in the form provided for in the Act or it may be in a form unique to the company.

As mentioned above, the Notice of Incorporation and a copy of the Memorandum of Incorporation must be filed with the Commission, together with the prescribed fee.

### **3.2.3 *The Incorporation of a company: The role of the Commission***

Once the two documents (the Notice of Incorporation and a copy of the Memorandum of Incorporation) have been filed with the Commission and the prescribed fee paid, the Commission may either accept or reject the Notice of Incorporation.

The Notice of Incorporation **may be** rejected by the Commission under the following circumstances:

- If it has not been completed in full (s 13(4) (a)).
- If it has not been properly completed (s 13(4) (a)).

The Notice of Incorporation **must** be rejected by the Commission under the following circumstances:

- If the initial number of directors is less than the prescribed minimum number (s 13(4) (b)).
- Where as a result of a director's disqualification, the initial number of directors become less than the prescribed minimum number (s13(4)(b)).

↻ **In terms of section 66(2) a private company must have at least one director and a non-profit company must have a minimum of three directors. If the Commission realises that one of the directors does not qualify to be a director, this will reduce the number of directors. If the reduction leads to the number of directors being less than the prescribed number, the Commission has no choice. It must reject the Notice of Incorporation!**

### **3.3 Registration of a company**

Registration of a company is regulated by section 14 of the Act. Once the Notice of Incorporation has been filed, the Commission:

- Assigns a unique number to the corporation.
- Enters prescribed information regarding the company in the Companies Register.
- Issues and delivers a registration certificate to the company, if all the other requirements have been complied with. Note the discussion on page 31 of your prescribed book regarding the registration certificate.

↻ **The date stated on the registration certificate is the date on which the company acquires legal personality. If the promoters have stipulated a specific date on the Notice of Incorporation, the date on the registration certificate will be the later one**

of that date and the date on which the certificate is issued by the Commission.

### **3.3.1 Memorandum of Incorporation**

- *Ben-Tovim v Ben-Tovim and Others 2001 (3) SA 1074 (C)*
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#### **MEMORANDUM OF INCORPORATION AND RULES**

- The Memorandum of Incorporation (MOI) is the governing document of the company.

Memorandum of Incorporation have to be consistent with provisions of the Companies Act (s 15(1) (a)). Where there are inconsistencies, provisions in the Memorandum will be void, but only to the extent of the inconsistency (s 15(1) (b)).

#### **Registration of Companies:**

Notice of Incorporation plus a copy of the Memorandum of Incorporation must be filed with the Commission. In addition the prescribed registration fee must be paid.

The Act is flexible and allows incorporators of a company to include provisions not covered by the Act, in the Memorandum of Incorporation.

Section 15(2)(b) provides that the Memorandum of Incorporation of a company may contain special conditions applicable to the company and requirements in addition to those stipulated in the Act, for the amendment of such conditions. Section 15(2) (c) also allows the Memorandum to prohibit the amendment of any particular provision in the Memorandum. If the Memorandum of Incorporation of a company contains any of the provisions allowed by section 15 (2) (b) and (c), the name of the company must be followed by the expression “(RF)”. This is an abbreviation for the words “ring fencing” and is intended to warn outsiders dealing with the company that there are special

conditions contained in the Memorandum which they should check. The Notice of Incorporation filed by the company must also contain a prominent statement drawing attention to each such provision and where it is located in the Memorandum of Incorporation (s 13(3)).

👉 **Note that where the Act is silent on a particular issue, the incorporators of a company are allowed to include provisions pertaining to that issue in the Memorandum of Incorporation. The objective of flexibility with regards to incorporation is once more highlighted. Do you think this flexibility is a good thing or not?**

### **3.3.2 Rules made by the Board of Directors**

In terms of section 15(3), where both the Act and the Memorandum of Incorporation are silent regarding certain matters that have to do with the governing of the company, the board of directors of a company is generally allowed to:

- Make rules;
- Amend any existing rules;
- Repeal any rules.

Such rules must not be in conflict with the Memorandum of Incorporation of the company or with the Act. In terms of section 15(4)(a), where there is a conflict between a rule made by the board of directors and the Act or the Memorandum of Incorporation, the rule will be void but only to the extent of its inconsistency.

- The board of directors has the power to make rules concerning the governance of the company, provided that they are not addressed in the Act or in the Memorandum of Incorporation.
- A rule made by the board which is inconsistent with the Memorandum of Incorporation or with the Act will be void, but only to the extent of its inconsistency.



- Although the rule becomes effective 20 business days after publication, ratification by an ordinary resolution at the next shareholders' general meeting is important.

### **3.4 The legal status of the Memorandum of Incorporation and the rules developed by the board of directors**

☞ The Memorandum of Incorporation and the Rules are binding between:

- The company and each shareholder (s 15(6) (a)).
- Or among the shareholders of the company (s 15(6) (b)).
- The company and each director or prescribed officer of the company (s 15(6) (c) (i)).
- The company and each member of the audit committee or member of a committee of the board.

### **3.5 Amending the Memorandum of Incorporation**

The Act allows for changes to be made to the Memorandum of Incorporation (unless the amendment of a provision is prohibited by the Memorandum itself in terms of section 15(2) (c) as discussed above in 3.3.1). Such changes may be in the form of:

- A new Memorandum of Incorporation or
- Amendments to the existing provision of the Memorandum of Incorporation.

Proposals for amendment may be made:

- By the board of directors;
- By shareholders who collectively exercise not less than 10% of the voting rights;
- In terms of the procedure set out in the company's Memorandum of Incorporation;

- By means of a court order. An amendment in terms of a court order is given effect via a board resolution but there is no need for a shareholders' resolution.

An amendment may result in a profit company not meeting the criteria for that category of profit companies. When this happens, the name and the ending expression must also be amended in such a way that it reflects the new category that the profit company falls under.

Section 16 relates to the amendment of the Memorandum of Incorporation. Making changes to the Memorandum of Incorporation is allowed and it may be in the form of a new Memorandum of Incorporation or in changes being made to existing provisions of the Memorandum of Incorporation. There is no need to convene a meeting. As it is sometimes difficult for some shareholders to attend meetings, the proposal to amend the Memorandum of Incorporation may be by way of a round robin among shareholders who are entitled to vote.

### **3.6 Alteration of the Memorandum of Incorporation**

The Act allows for changes or alterations to be made to the company's rules and to the Memorandum of Incorporation. These may be made with a view to correcting minor errors such as grammar, punctuation, spelling and references.

**👉 Note that it is the board of a company or an individual who has been given authority to do so by the board, that may make the changes.**

For an alteration to be effected:

- a notice of alteration must be published in accordance with the Memorandum of Incorporation and the rules;
- A notice of alteration must be filed.

### **3.7 Translations of a Memorandum of Incorporation**

A company which has filed a Memorandum of Incorporation has the right to file a translation thereof. The translation may be in any official language or more than one official language of the Republic of South Africa. It must be filed together with a sworn statement by the translator confirming that the translation is a true, accurate and complete translation of the Memorandum of Incorporation (s 17(4)).

In the event of a conflict between a provision in the Memorandum of Incorporation and a provision in the translated version, the provision in the original Memorandum of Incorporation prevails.

### **3.8 Consolidation of a Memorandum of Incorporation**

As stated above, after filing the Memorandum of Incorporation, a company may make amendments or alterations to its Memorandum of Incorporation. Anytime thereafter, the company may file a consolidated revision of its Memorandum of Incorporation. It is possible, also, for the Commission to require the company to do so.

The consolidated revision of the Memorandum of Incorporation has to be filed together with a sworn statement made by a director of the company or by an attorney or notary confirming that it is a true, accurate, updated and complete representation of the Memorandum of Incorporation.

### **3.9 Authenticity of versions of the Memorandum of Incorporation**

In the event of a conflict between the Memorandum of Incorporation and its translated versions, the Memorandum of Incorporation, as altered or amended prevails. The same applies to a conflict between the Memorandum of Incorporation, as altered or amended, and its filed consolidated version. The consolidated version may prevail only if it has been ratified via a special resolution at a general shareholders' meeting of the company.

In the event of a conflict between the latest version of the Memorandum of Incorporation endorsed by the Commission and any other document purporting to be a Memorandum of Incorporation, the latest version as endorsed by the Commission will prevail.

### **3.10 Shareholders' agreement**

The Act allows shareholders to enter into agreements with each other regarding any matter concerning the company. Such agreements must not be inconsistent with the Act and with the Memorandum of Incorporation of the company. Where a provision of the agreement is inconsistent with the Act or with the Memorandum of Incorporation, it is void to the extent of its inconsistency.

### **3.11 Pre-Incorporation contracts**

The common law does not allow a person to act as an agent for a principal who does not exist. This means that under the common law no person can act as an agent for a company which has not as yet been incorporated because the company does not exist before incorporation. This may result in the company losing the chance to enter into beneficial contracts which present themselves prior to incorporation. To avoid this state of affairs, section 21 allows pre-incorporation contracts to be entered into on behalf of the company which has yet to be incorporated.

Section 1 of the Act describes a pre-incorporation contract as “an agreement entered into before the incorporation of a company by a person who purports to act in the name of, or on behalf of, the company, with the intention or understanding that the company will be incorporated, and will thereafter be bound by the agreement”.

A person who enters into such a contract is held jointly and severally liable for liabilities emanating from the pre-incorporation contract if:

- Incorporation does not take place, or
- Once the process of incorporation has been completed, the company does not ratify any part of the agreement. Note, however, that joint and several liabilities will not apply where after

incorporation the contract is substituted by another similar contract.

Section 21 does not exclude the common law, which means that a promoter may also use the common-law alternatives. These are the contract for the benefit of a third party (*stipulatio alteri*), a trust or cession and delegation. The common-law constructions have a major advantage over a section 21 contract because in terms of the common law, the promoter is not automatically liable if the company is not incorporated or does not ratify the contract.

### **3.12 Registration of company names**

When choosing a company name one must avoid names which:

- are offensive to people of a particular race, ethnic group, gender or religion (s 11(2)(c)(iii));
- Amount to passing off. Passing off occurs when a company makes use of a feature which is associated with another business. Common law prohibits passing off.

#### **3.12.1 Criteria for names of companies in terms of the Act**

The name of a company may not:

- be the same as the name of another company, close corporation or co-operative;
- resemble the name of another company, close corporation or co-operative to the extent that it may create confusion or create the impression that the two businesses are associated;
- give the impression that the company is associated with the government, or with a particular person or government office etcetera;
- be the same as the name of a business which has already been registered in terms of the Business Names Act 27 of 1960;

- Be the same as a trademark of a business which has been filed for registration in terms of the Trade Marks Act 194 of 1993.

The name of a company may:

- Be the registration number of the company, provided that it is a 'profit' company. The number has to be followed by the words "(South Africa)".

⚡ **Note that this is only applicable to profit companies. Non-profit companies are not allowed to have registration numbers as their names.**

- Be in any language and it may consist of any letters, numbers or punctuation marks and brackets. It may also contain any of the specified symbols listed in paragraph 2.11.1 of the text book. A combination of the above is allowed. In addition, the name of the company must end with the appropriate expression for that type of company. Remember to add the expression "(RF)" to the list contained in paragraph 2.11.1 of your text book.

### **3.12.2 Change of Name**

Where a name that is to be registered is similar to another registered name, the Act allows the Commission to make use of the registration number of the company as an interim name.

The registration number will appear in:

- the Companies Register and on
- The Registration Certificate.

The registration number must end with the relevant suffix, as stated in section 11(3). The company is provided with another opportunity to file a Notice of Incorporation containing an acceptable name. Upon receipt of the Notice of Incorporation with the amended name the Commission has to enter the new name in the Companies Register. It must also issue an amended Registration Certificate reflecting the amended name.

Where, according to the Commission, there is a possibility that the name is similar to the name of another company or another business undertaking or trade mark or that the name gives an impression that there is a connection between the company that is applying and another entity or state organ, the Commission may compel the applicant to inform parties that may be interested by serving them with a copy of the application and name reservation.

The Act also allows any person who has an interest in the name of a company to apply to the Companies Tribunal for the Tribunal to determine whether or not the name is in accordance with the requirements of the Act.

### **3.12.3 Use of name and registration number**

*Epstein v Bell* 1997 (1) SA 483 (D).

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Section 32 requires that a company provide its full name or registration number to any person on demand. It further prohibits the misstating of the name or registration number and the stating of the name in such a way that it may mislead or deceive a person.

Where the Registration Certificate is issued with an interim name by the Commission, the company is obliged to use its interim name. The interim name is used until the company name has been amended.

### **3.12.4 Reservation of a name for later use**

In terms of section 12 a name may be reserved for use at a later stage, to be used for a newly incorporated company or to be used as a replacement for an existing name of a company.

A reservation is made by filing an application and paying the prescribed fee. Once this is

done, the Commission is obliged to reserve the name.

The commission will not reserve a name if:

- It is already the name of another registered company, close corporation or co-operative.
- It is already a name given to an external company.
- It is a name that has already been reserved in terms of the Act.

There is a six month reservation period. It is calculated from the date of application for reservation. Should the person, who applied for reservation of a name wish to transfer the name to another person, this is possible. It must be done by filing a notice of transfer.

It is possible to reserve a name with a view to making use of it in the future. A name may be reserved for use as

- the name of a new company or
- A new name of an incorporated company.

A name is reserved by filing an application and paying the prescribed fee. The Commission is bound by law to reserve all names that appear in the application for reservation. An applicant may reserve more than one name.

A name is reserved for six months. The six month period is calculated from the date of the application for reservation. You must also note the fact that the Act allows for the transfer of a reserved name to another party.



## Study Unit 4

### Capacity and Representation of a Company

- *Royal British Bank v Turquand* (1856) 6 E & B 327, 119 ER 886 [101]
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- *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480 [103]
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#### 4.2 Capacity of a company and the *ultra vires* doctrine

- Sections 19(1) and 20 of the Companies Act
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**The capacity of a company is the sphere of actions that a company may legally perform.** In terms of our common law, a contract is *ultra vires* the company when the conclusion of the transaction is beyond its legal capacity.

The *ultra vires* doctrine is based on the understanding that a company exists in law only for the purpose for which it was incorporated. According to the *ultra vires* doctrine, when an act on behalf of the company falls outside its main and ancillary objects, the company does not exist in law and consequently such an act is not binding on the company. Such an act is described as an *ultra vires* act.

In *Attorney-General v Mersey Railway Co* (1907) 1 Ch 81 (HL), the court explained that

whether a particular contract falls within the capacity and powers of the company is a question of fact. If the main purpose of the company was to carry on the business of a hotel, it is clear that acts necessary to achieve this purpose, for example, the purchasing of furniture and the hiring of staff, are *intra vires*.

Under section 36 of the Companies Act of 1973, if members of a company find out about a proposed *ultra vires* contract before it is concluded, they may interdict the company from entering into the contract. However, if an *ultra vires* contract has already been concluded, the contract will be binding on the company. An action can then be brought against directors who have exceeded their powers by concluding a contract on behalf of the company which falls outside the capacity of the company, on the basis that the directors have breached their fiduciary duty not to exceed the scope of their authority.

Section 19(1) (b) of the Companies Act of 2008 now considerably widens the capacity of a company. It provides that a company has all the legal capacity and the powers of a natural person except to the extent that a juristic person is incapable of exercising any such power, or the company's Memorandum of Incorporation provides otherwise. The capacity of a company is therefore no longer limited by its main or ancillary objects or business. Although the company's Memorandum of Incorporation may limit, restrict or qualify the purposes, powers or activities of the company (in other words impose restrictions on the legal capacity of the company) in terms of section 19(1)(b)(ii), any such restrictions would not render any contract invalid that conflicts with these restrictions (section 20(1)(a)). Thus, the contract remains valid and binding upon the company and the other party to the contract. Section 20(6) of the Act provides that each shareholder 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 a limitation, restriction or qualification on the powers of the company as stated in its Memorandum of Incorporation, unless ratified by special resolution in terms of section 20(2). This is in addition to the remedy provided in section 165 (see study unit 9).

However, if the company or directors have not as yet performed the planned action (for example concluded the contract) that is inconsistent with a limitation or qualification of the company's powers contained in the Memorandum of Incorporation, one or more shareholders, directors or prescribed officers of the company may obtain a court order

restraining (i.e. preventing) the company or directors from doing so. A third party who did not have actual knowledge of this limitation or qualification and acted in good faith, will in such a case have a claim for any damages suffered as a result. In terms of section 20(4), shareholders, directors, prescribed officers and a trade union representing employees of the company may also institute proceedings to prevent the company from doing anything inconsistent with the Act. Note that it is only in the last-mentioned case that a trade union may prevent the company from acting.

### **4.3 Representation**

**Representation relates to a person acting under the company's authority.** If a company gives an agent authority to act on its behalf, the agent possesses actual authority and will bind the company in acts which fall within the scope of the mandate given to him. Authority can be given expressly (in writing or orally) or by implication. Whether authority has been conferred is a question of fact.

A company may also be bound to a contract on the basis of estoppel where the person purporting to conclude the contract on its behalf lacked actual authority, express or implied, but the other party to the contract had been misled by the company into believing that he did have authority. This is referred to as ostensible or apparent authority. (See the discussion in 4.3.3 below.)

#### **4.3.1 The Doctrine of Constructive Notice**

The doctrine of constructive notice provides that third parties dealing with a company are deemed to be fully acquainted with the contents of the public documents of the company. Section 19(4) of the Act partly abolishes this doctrine. Thus, third parties contracting with the company will no longer be deemed to have had notice of the contents of the public documents of a company merely because they have been filed with the Commission or are accessible for inspection at the office of the company. But section 19(5) of the Act provides for two exceptions: firstly, a person is deemed to have knowledge of any provision of a company's Memorandum of Incorporation in terms of section 15(2)(b) (relating to special conditions applicable to the company and additional requirements regarding their amendment). This is subject to the condition that the Notice

of Incorporation contains a prominent statement drawing attention to such a provision as required by section 13(3). The second exception applies to a personal liability company. A person is also regarded as having received notice and knowledge of the effect of section 19(3) on a personal liability company. Section 19(3), in turn, provides that the directors and past directors of a personal liability company are jointly and severally liable, together with the company, for any debts and liabilities of the company contracted during their respective periods of office.

Section 19(4) of the Act provides that third parties contracting with the company are not deemed to have had notice of the contents of the public documents of a company merely because they have been filed with the Commission or are accessible for inspection at the office of the company. Therefore, Mr Matthews is not expected to know that the general meeting's consent was required for the validity of a contract of that size. It seems from the set of facts that the exceptions in section 19(5) are not applicable.

#### **4.3.2 The Turquand Rule**

The *Turquand* rule was derived from *Royal British Bank v Turquand* (1856) 6 El. & Bl. 327; 119 ER 886). According to the common-law *Turquand* rule, an outsider contracting with the company in good faith is entitled to assume that all internal requirements and procedures have been complied with. The company will be bound by the contract even if the internal requirements and procedures have not been complied with. The exceptions are: if the outsider was aware of the fact that the requirements and procedures have not been complied with; or if the circumstances under which the contract was concluded were suspicious. It was formulated to keep an outsider's duty to inquire into the affairs of the company within reasonable bounds.

For the *Turquand* rule to come into operation, the person who acted must have possessed actual authority, which was subject to an internal formality. In *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* 1978 (2) SA 11 (T) the court found that third parties may not automatically assume that a branch manager or an ordinary director has authority to act on behalf of the company. The company may still escape liability on the grounds that the person had no authority.

Section 20(7) of the Companies Act of 2008 now codifies the *Turquand* rule in a modified form by providing that a person dealing with a company in good faith is entitled to assume that the company has complied with all of the procedural requirements in terms of the Act, the company's Memorandum of Incorporation and any rules of the company unless the person knew or reasonably ought to have known of any failure by the company to comply with its formal and procedural requirements.

### **4.3.3 The Doctrine of Estoppel**

Estoppel applies only when the agent did not have actual authority to bind the company. Take particular note of the fact that the misrepresentation (i.e. that the agent had the necessary authority when, in fact he or she did not) must have been made by the company as principal. Based on such misrepresentation, the company will be estopped from denying liability if the third party can prove that:

- a) The company misrepresented, intentionally or negligently, that the agent concerned had the necessary authority to represent the company;
- b) The misrepresentation was made by the company;
- c) The third party was induced to deal with agent because of the misrepresentation;
- d) The third party was prejudiced by the misrepresentation.

## **Study Unit 5**

### **Corporate Finance: Shares, Debentures and Distributions**

- ***Lipschitz v UDC Bank Ltd* 1979 (1) SA 789 (A) [138]**

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## 5.2 The definition of a share

The Companies Act 71 of 2008 defines a 'share' as "one of the units into which the proprietary interest in a profit company is divided."

A shareholder is essentially one of the contributors of the fund that sets up a company. This fund is the share capital of the company.

A 'share' is the unit of the contribution made to the share capital. It is property in itself and can be traded.

### **The Value of Shares:**

**Companies Act of 1973** distinguished between par value and no- par value shares.

Par value shares were shares issued with a nominal value attached, for instance, a company could issue 100 shares with a nominal value of R1 each.

**Companies Act 2008:** no shares will in future be issued with a nominal value attached. Only the number of shares must be authorised in the Memorandum of Incorporation, not their value.

### **Authorised share capital:**

The Memorandum of Incorporation of a company must set out the classes of shares and the number of each class that a company is authorised to issue.

A company may only issue shares that are authorised by the Memorandum of Incorporation.

However, a company's board may increase or decrease the authorised share capital. They may further reclassify any shares authorised but not issued.

### **Issued Share capital:**

The board decides when to issue shares and how many shares must be issued. In other words, not all the authorised shares need to be issued. These are shares that have been issued and for which a counter-performance has been received.

### 5.3 Classes of shares

Shares are divided in classes according to the specific rights that a share confers on its holder. The rights that differ among the various classes can usually be divided into the following:

- The right to vote.
- The right to information.
- The right to share in the profits that have been declared as a dividend.
- The right to share in the assets that are left on the winding-up of a company after the company's creditors have been paid.

The classes of shares most commonly found are preference shares, ordinary shares, and deferred shares.

#### **CLASSIFICATION OF SHARES**

- Preference shares
- Ordinary shares
- Deferred shares

#### **PREFERENCE SHARES:**

- Preferential right to dividends.
- Preferent right upon winding up
- Expressed as percentage.
- Shareholder entitled to claim when dividends are declared.

#### **(a) PARTICIPATING PREFERENCE SHARES**

- right to both fixed % preference & share a residual distributable profit.

#### **(b) CONVERTIBLE PREFERENCE SHARES**

- Right to be converted to ordinary shares.

#### **(c) REDEEMABLE PREFERNCE SHARES**

- Company authorised by articles
- Issue preference shares redeemable either at option of the company/ given date.
- The articles prescribe terms and manner

- May be redeemed out of two possible sources:

(1) Out of proceeds of a fresh issue

(2) Out of divisible profits

**(d) CUMULATIVE PREFERENCE SHARES-**

- unpaid dividends accumulate.

**ORDINARY SHARES;**

- Considered after dividend for preference shares has been made.
- No limit on the amount of dividend
- Regarded as residuary heir

**DEFERRED SHARES:**

- Considered after dividend has been paid to ordinary shareholders
- Issued by way of remunerating promoters for services rendered.

## **5.4 Issue of shares**

The Companies Act regards the decision to issue shares as a management decision. Unless specifically limited in the Memorandum of Incorporation, the board of directors will have the authority to take the decision to issue shares without approval of the shareholders. The board of directors also has the authority to increase the authorised shares of the company.

However, in the following circumstances a resolution by the board of directors to issue shares must be approved by a special resolution of the shareholders:

- Where the shares are issued to the directors, future directors or prescribed officers of the company. A 'future director' or 'future prescribed officer' does not include a person who becomes a director or officer more than six months after the shares were issued.
- Where the shares are issued to a person related or inter-related to the company, a director or a prescribed officer of the company. A natural person is related to another natural person if she is married to, or lives together with, that person as if they were married, or is that person's parent, sister, aunt or first cousin. A



natural person is related to a company when she directly or indirectly controls the company by either having the majority of voting rights or by having the right to appoint the majority of directors of the company. A juristic person is related to another juristic person if it directly or indirectly controls the other by either having the majority of voting rights or by having the right to appoint the majority of directors of the company, or if it is a subsidiary of the company, or if it controls the business of the company.

- Where the shares are issued to a nominee of a director or a prescribed officer of the company.
- Where the voting power of the shares to be issued will exceed 30 per cent of the voting power of the shares of that class held immediately before the issue.

#### **5.4.1 *Right of pre-emption***

As a general rule, shareholders of private companies have a right of pre-emption to new shares issued by the company. This means that when the company issues new shares, these shares must be offered to existing shareholders first, pro rata to their current shareholdings.

The reason why this provision was included in the Companies Act is to guard against the dilution of ownership in private companies. Dilution of ownership can be explained as follows: Suppose that Fidelity (Pty) Ltd has two shareholders who each hold 10 shares. At a meeting of shareholders they will have equal voting power. Suppose that Fidelity (Pty) Ltd wants to issue 20 more shares. If a third person acquires all 20 of these shares, that person will have half of the voting rights at a meeting of shareholders. The original shareholders will now only have a 25 per cent voting power in the meeting of shareholders. If they exercised rights of pre-emption, each of them would have been entitled to half of the 20 shares, and consequently they would retain the same voting power in the company.

## 5.5 Debentures

A debenture is an acknowledgment by a company that the company owes the debenture holder a certain sum of money, as evidenced in the document. Debenture holders are creditors of the company by virtue of having extended loans to the company.

The duties of the company towards the debenture holders can be secured or unsecured. A trustee will usually be appointed to hold security on behalf of the debenture holders. If the company defaults on its commitments to the debenture holders, the trustee will be able to enforce the security on their behalf, without the need for every debenture holder to institute action individually.

The board of directors can decide whether to issue debentures without approval of the shareholders, unless otherwise indicated in the Memorandum of Incorporation.

## 5.6 Distributions

In the Companies Act of 1973 the concept of 'distributions' was rather narrowly defined. Payments made to shareholders in their capacity as shareholders were included in the concept, but a repurchase of shares by a company and redemption of shares were expressly excluded. In the Companies Act of 2008 the last-mentioned acts are now also classified as distributions.

Section 46 of the Companies Act regulates distributions. You need to know that the payment of dividends to shareholders is a distribution in terms of the Act. Other acts that fall under the definition are the purchase by a company of its previously issued shares, the incurrence of a debt for the benefit of one or more of the shareholders of the company, or the forgiveness of a debt owed to the company by one or more of the shareholders of the company

A distribution may be made in the following circumstances:

- The board of directors must authorise the distribution.

- It must reasonably appear that the company will be able to satisfy the solvency and liquidity test immediately after the distribution has been made.

☛ **The solvency and liquidity tests are set out in section 4 of the Act:**

*Solvency test:* considering all reasonably foreseeable financial circumstances of the company at that time, the assets of the company, fairly valued, equal or exceed the liabilities of the company as fairly valued.

*Liquidity test:* considering all reasonably foreseeable financial circumstances of the company at that time, it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after the distribution. If the distribution was in the form of giving a loan to a shareholder or forgiving a loan made to a shareholder, the period runs from 12 months after the test was considered.

The distribution must be made within 120 days after the test was applied, otherwise the resolution by the board must be taken again and the test must be applied again.

As long as these requirements are met, dividends can be paid out of the share capital of a company. However, usually dividends are paid from the profits of a company. The board of directors decides how much of the profits they want to pay out to shareholders. They are free to decide that they are going to keep all profits for the expansion of the business of the company. Normally in such circumstances the shareholders are not entitled to dividends.

## **5.7 Capital maintenance**

Originally companies were required to maintain their share capital. In other words, they were not allowed to return to shareholders some of the funds originally given in return for their shares, nor were companies allowed to issue shares at a discount, causing the company to gain less share capital in return for the shares than the nominal value of the shares reflected.

Gradually the maintenance of capital was relaxed through amendments to the

Companies Act of 1973. You do not need to know the details of these provisions. All you need to know now is the following:

- A company is allowed to repurchase its shares. This is considered a distribution, which means that the solvency and liquidity tests must be met. See above for the definition of these tests.
  - After the company has purchased its shares, there must be shares left other than convertible or redeemable shares. Some shares must be held by shareholders other than the company's subsidiaries.
  - If the company repurchased shares and it emerges that it did not meet the solvency or liquidity tests, the agreement between the shareholder and the company in terms of which the company would repurchase his shares, remains enforceable.
- The company must apply for a court order to suspend the repurchase of the shares. The company bears the burden of proof that it did not meet the financial requirements of the Act. The court may make any order it deems fit.
  - The court's order must ensure that the person from whom the shares are bought will be paid at the earliest time that the company will still be able to fulfill its financial obligations as they fall due and payable.
    - Alternatively, if the repurchase was in contravention of the solvency and liquidity tests, the company can apply for a court order to have the repurchase reversed:
      - The person from whom the shares were bought will then be required to return the consideration received.
      - The company will have to issue shares to that person in return.

Directors who approved a repurchase of shares in contravention of the requirements relating to distributions are liable in the same manner as set out on page 57 of the text book.

## 5.8 Financial assistance for the purchase of shares

In terms of the Companies Act of 1973 it was prohibited for a company to provide financial assistance to a person to enable that person to acquire shares or other securities in the company, except for some very specific exceptions.

In terms of section 44 of the Companies Act of 2008 a company may assist a person in acquiring shares and other securities in the company, provided that such assistance is not prohibited by the Memorandum of Incorporation and that certain requirements are met.

The decision to assist a person to acquire shares in the company rests with the board of directors, but only where the assistance is in terms of an employee share scheme or where a special resolution by the shareholders authorised such assistance to a specific person or persons that fall in a specific class or category. In the latter case the person to whom the assistance will be given must fall in that class and the resolution must have been taken within the two years preceding the board's decision to assist.

Section 44 further requires that the board must be satisfied that the solvency and liquidity requirements are met (see above) and that the assistance is given under terms that are fair and reasonable to the company.

The Memorandum of Incorporation may place further restrictions on the provision of financial assistance and the board must ensure that these requirements are also met.

The *Lipschitz* decision dealt with the prohibition of financial assistance in terms of the old Act. However, the decision is still important for the application of section 44, because it gives us guidelines of when the provisions of the section will be applicable to a particular scenario.

In *Lipschitz* it was held that the transaction must be assessed in two phases:

- First, it must be ascertained whether there was financial assistance. In *Gradwell (Pty) Ltd v Rostra Printers Ltd* 1959 (4) SA 419 (A) the 'impoverishment test' was formulated to assist in

determining whether financial assistance was provided. In terms of the impoverishment test, one considers whether a transaction will have the effect of leaving the company poorer. If so, financial assistance was provided. In *Lipschitz* the court held that this is not the only measure of financial assistance, but that exposing the company to risk will also qualify as financial assistance for purposes of the Act. For example, if the person obtained a loan to purchase shares in the company and the company stood surety for that loan, it will count as financial assistance. If the company buys an asset from the person in order to enable that person to purchase shares in the company, it will depend on the facts whether there was financial assistance. Factors that have emerged from case law to assist in this regard are whether the company needs the asset in its normal business and whether the company paid a fair price for it.

- Second, it must be determined whether that assistance was for the purpose of acquiring shares in the company. Suppose Company A is a major creditor of Company B. Company A acquires most of the shares in Company B. After the acquisition, Company A causes Company B to grant security over its movable assets to secure the loans. This will be financial assistance in terms of the first test, but it is not in connection with the purchase of shares. The assistance is to secure a loan.

When a transaction passes these two phases, it will have to comply with section 44 to be valid. If it was not financial assistance, or if the assistance was not in connection with the purchase of shares, section 44 is not relevant to the transaction.

## Study Unit 6

### Shareholders and Company Meetings

- ***Gohlke and Schneider v Westies Minerals (Pty) Ltd* 1970 (2) SA 685 (A) [61]**

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- ***In re Duomatic Ltd* [1969] 1 ALL ER 161 (Ch) [71]**

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- ***Pender v Lushington* (1877) 6 ChD 70 [70]**

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- ***Sammel & Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) [114]**

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## 6.2 Notice of Meetings

Section 62 provides that a notice:

- must be in writing
- must include the date, time and place for the meeting;

- must explain the general purpose of the meeting;
- must contain a statement that a shareholder is entitled to appoint a proxy to attend, participate in and vote at the meeting in the place of a shareholder;
- should indicate the participants will be required to provide proof of identity at the meeting;
- must be accompanied by a copy of any proposed resolution which will be considered at the meeting; and
- a notice of 10 days must be given before the date of the meeting.

## **6.3 Representation by Proxy**

### **6.3.1 *Appointment of a proxy***

The appointment:

- Must be in writing and signed by the shareholder;
- Is valid for one year;
- May be for a specific period of time;
- May be for two or more persons concurrently exercising voting rights for different shares;
- A proxy may delegate authority to act on behalf of the shareholder to another person;
- A copy of the proxy appointment form must be delivered to the company before the shareholders meeting;
- A shareholder is not compelled to make an irrevocable proxy appointment;
- A shareholder may alter proxy by cancelling it in writing, appointing another proxy and deliver a copy of the revocation to the proxy and the company.



## 6.4 Demand to convene a shareholders' meeting

- **Section 61 of the Companies Act**

A shareholders' meeting may be called by the board or any person authorised by the Memorandum of Incorporation . A meeting must be convened if required by the Act or the Memorandum of Incorporation, or demanded by shareholders holding at least 10% of the voting rights that may be exercised at that meeting.

## 6.5 Shareholders acting other than at a meeting

- ***Gohlke and Schneider v Westies Minerals (Pty) Ltd 1970 (2) SA 685 (A)***
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The Companies Act of 1973 provides that a particular annual general meeting need not be held if all the members who are entitled to attend such a meeting consent in writing. In such a case, any resolution that would have been dealt with at this meeting will also be deemed to be valid if it is in writing and signed by all the members entitled to vote at that meeting. Otherwise, resolutions have to be taken at properly constituted members' meetings.

### **Unanimous Assent:**

In terms of this rule, certain decisions may be valid without a meeting being held, if all the members are fully aware of the facts and all of them assented thereto, although it need not be in writing. In *Gohlke and Schneider v Westies Minerals (Pty) Ltd 1970 (2) SA 685 (A)* the court held that members may validly appoint a director to the board without any formal meeting being held because there was evidence of their unanimous consent. The court in *In re Duomatic Ltd [1969] 1 ALL ER 161 (Ch)* held that the

unanimous approval of directors' remuneration by the two directors holding all the voting shares in a company could be regarded as a resolution of a general meeting approving the payment.

Although the general principle still remains that shareholders exercise their rights through resolutions at meetings, a resolution may be submitted to shareholders and, if adopted in writing by the required majority, will have the same effect as if it had been adopted at a meeting without actually holding a general meeting of shareholders (s 60). This means that the unanimous assent of all shareholders will no longer be necessary. However, any business of a company that must, in terms of the Act or the company's Memorandum of Incorporation, be conducted at an annual general meeting may not be conducted by using this procedure.

## 6.6 Annual General Meeting

In terms of the Companies Act of 1973, every company was compelled to convene an annual general meeting at the times prescribed by the Act unless all the members who were entitled to attend the meeting agreed in writing that the meeting need not be held. In terms of the Companies Act of 2008, only **public companies** have a statutory obligation to convene annual general meetings.

Section 61(8) stipulates that at least the following matters must be transacted at the Annual General Meeting:

- Election of directors to the extent required by the Act or the company's Memorandum of Incorporation;
- Appointment of an auditor for the following financial year;
- Appointment of an audit committee;
- Presentation of the directors' report;
- Presentation of audited financial statements for the immediately preceding financial year;
- Presentation of an audit committee report;
- Any matter raised by shareholders.

## 6.7 Convening a meeting in special circumstances

section 61(11): company cannot convene a meeting because it has no directors or all its directors are incapacitated.

section 61(12): company, fails to convene its annual general meeting or a meeting required by its Memorandum of Incorporation or shareholders.

## 6.8 Quorum

Section 64 : A meeting may not begin until sufficient persons holding at least 25% of all the voting rights are present. Furthermore, if a company has more than two shareholders, at least three shareholders must be present.

## 6.9 Conduct of meetings

The requirements for both a special and an ordinary resolution clearly state that the required percentage of votes **exercised** on the resolution must be in favour of the resolution to have it validly adopted. Only the votes of shareholders who actually exercise their votes are thus taken into consideration.

## 6.11 Exercise of voting rights

Three possible situations are discussed under this heading. Briefly summarised, they are the following:

- (1) A profit company (other than a state-owned enterprise) with only one shareholder:
  - The shareholder may exercise all the voting rights.
  - Rules of setting a record date etcetera do not apply.

(2) A profit company (other than a state-owned enterprise) with only one director:

- The director may exercise any power or perform any function of the board at any time except when the Memorandum of Incorporation provides otherwise.

(3) A company (other than a state-owned enterprise) where every shareholder is also a director:

- Shareholders may decide on any matter to be referred by the board at any time, without notice or compliance with any internal formalities except when the Memorandum provides otherwise; subject to certain specified conditions.

## 6.12 Shareholder resolutions

Two types of resolutions that may be taken in a shareholders' meeting:

### Ordinary resolution

- Requires more than 50% of the voting rights exercised;
- The Memorandum may provide for a higher percentage;
- The Companies Act provides that there should be a margin of at least ten percentage points between the requirements for the adoption of a special resolution and an ordinary resolution.

### Special resolution

- Requires at least 75% of the voting rights exercised;
- The Memorandum may provide for a lower percentage;
- There must be a margin of at least ten percentage points between the requirements for a special resolution and an ordinary resolution.

### 6.13 Decisions that require a special resolution

A special resolution is compulsory for certain resolutions stipulated in the Act but may also be required by the Memorandum of Incorporation.

### 6.14 Postponement and Adjournment of meetings

A meeting may be adjourned for a week if within an hour of the scheduled starting time the quorum is not formed.

A notice of adjournment will only be given if the location of the adjourned meeting is different. A meeting may be adjourned for a fixed time and place or until further notice. Where a meeting is adjourned, it may not be adjourned for more than 120 business days.

## Study Unit 7

### Directors and Board Committees

#### 7.2 Meaning of the word “director” and the different types of directors.

**A director is** a member of the board of a company and includes any person occupying the position of a director or alternate director. A person becomes a director only:

- when that person has given his or her written consent to serve as director,
- after having been appointed or elected or holding office in accordance with the provisions of section 66 of the Companies Act.

The **King Code** differentiates between the following three types of directors:

- Executive directors;
- Non-executive directors;

- Independent directors.

*Howard v Herrigel* 1991 (2) SA 660 (A): It is unhelpful or even misleading to classify company directors as 'executive' or 'non-executive' **for purposes of determining their duties** to the company or when any specific or affirmative action is required of them. Once a person accepts an appointment as director, he or she is obliged to display the utmost good faith towards the company irrespective of whether such a person is an 'executive' or 'non-executive' director.

The **Companies Act** recognises the following types of directors:

- An *ex officio* director;
- A Memorandum of Incorporation- appointed director;
- An alternate director;
- An elected director;
- A temporary director who is appointed in order to fill a vacancy.

### 7.3 Directors and managers

***Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168** An employee or manager of a company has duties similar to that of the fiduciary duties of a director towards a company.

There are many differences between being a 'director' and a 'manager'. A **manager** is an **employee** of a company whereas a **director does not have to be an employee**. Managers and directors also differ in their roles with regards to *inter alia*, leadership, decision making and their respective duties and responsibilities. The boards of directors, for example, are responsible for the leadership and direction of a company while the managers' tasks are to carry out the strategy on behalf of the directors. Directors are also responsible for organisational decision making while managers are concerned with the implementation of such decisions and policies.

## 7.4 Number of directors and consent

The different types of companies should each have a specified minimum number of directors in terms of the Companies Act.

Type of company	Number of directors
Private company	
Personal liability company	
Public company	
Non-profit company	

A person becomes a director of a company when that person:

- has been appointed or elected as a director in terms of the Companies Act or Memorandum of Incorporation,
- or holds an office, title, designation or similar status entitling that person to be an *ex officio* director of the company.

A person will only become a director once he or she has delivered a written consent accepting such a position.

*S v Vandenberg and Others* 1979 (1) SA 208 (D)

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Where a company does not have the prescribed minimum directors this does not negate or limit the authority of the Board. This will also not invalidate any act performed by the Board or the company.

## 7.5 Directors: the Act and a company's Memorandum of Incorporation

Read

## 7.6 Ineligible and disqualified persons

### Ineligible:

- means that such a person is **absolutely prohibited** from becoming a director without any exceptions.

### Disqualified:

- Person may still be appointed as a director of a company with the permission of the court.
- The other disqualifications are **not absolute because** the court has discretion on application to allow such disqualified persons to be appointed as directors.

## 7.7 Director disqualifications: exemptions

Section 69(11) : court has a discretion to exempt certain disqualified persons

Section 69(12): shareholders of certain private companies may avoid disqualification.

### 7.7.1 Exemptions by a court

A court may exempt certain disqualified persons from the disqualification.

*Ex Parte Schreuder* 1964 (3) SA 84 (O) and *Ex Parte Tayob* 1990 (3) SA 715 (T).

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In *Ex Parte Barron* 1977 (3) SA 1099 (C) the Court held that it could be more lenient in a case where a private company is affected than where a public company is affected. This is due to the fact that a director of a public company deals with funds in which a vast number of people are involved.

## **7.8 Application to declare a person delinquent or under probation**

The power given to a court to declare a director either delinquent or under probation is introduced into South African company law for the first time by the Companies Act of 2008. Depending on the grounds on which a person has been declared to be a delinquent, he will subsequently be either unconditionally disqualified from being a director for the rest of his life, or disqualified for a period of at least seven years and subject to any conditions that the court considers appropriate.

An order of probation, on the other hand, may not exceed a period of five years and may be made subject to any conditions the court considers appropriate, such as a designated remedial program. Refer to the table on pages 91-94 of your text book for a summary of who may apply to court, the grounds for application, the order sought and the effect of the order. You should also take note that three additional grounds to apply for an order of delinquency are available to the Commission or Takeover Regulations Panel (see page 94 of your text book in this regard).

- A company can apply to a court of law for an order to have a director declared as delinquent;
- Where a director grossly abused his position as director and acted in a manner that amounted to a breach of trust a declaration of delinquency may be made;
- This declaration may be subject to any conditions the court consider appropriate and will be for at least seven years from the date of the order.

### **7.8.1. Application to court to suspend or set aside a delinquency order**

This application may be made only in those cases where the declaration was not made

unconditional and for the lifetime of the person declared delinquent.

The applicant first has to apply for a suspension of the order and then, after a further two years, may apply for it to be set aside.

## 7.9 First directors of a company

Different types of companies must have a minimum number of directors required for that specific type of company. At the incorporation of a new company, every incorporator is deemed to be a director of such company until sufficient directors have been appointed to meet the required minimum number of directors. If after its incorporation, the number of directors of that company is lower than the minimum number of directors required for that company the board of the company will have to call a meeting within 40 business days after the date of incorporation for the purpose of electing sufficient directors to fill all vacancies.

## 7.10 Vacancies on the Board

A vacancy will arise on the board of a company if, for example, a director resigns, dies or is unable to perform his or her duties as director.

In the *Rosebank Television & Appliance Co (Pty) Ltd v Orbit Sales Corporation (Pty) Ltd* case the court confirmed that a director's resignation becomes effective once it has been communicated to a company irrespective of whether it was only later accepted.

## 7.11 Filling of vacancies

- **Section 70 of the Companies Act**

If a vacancy arises in the board, other than as a result of an *ex officio* director ceasing to hold that office, it must be filled by a new appointment or by a new election as prescribed by the Act.

## 7.12 Removal of directors

A director can be removed by shareholders and in some circumstances by the board of directors.

A director who has been removed from office may apply to a court to review the determination of the board. This application must be brought within 20 business days from the date of a decision taken by the board. The court has discretion whether to confirm the determination of the board.

## 7.13 Board committees

The board of directors may, except to the extent that a Memorandum of Incorporation provides otherwise, appoint committees and may delegate any of the authority of the board to such committee. You should, however, note that a director will still remain liable for the proper performance of his or her duties despite the delegation of a duty to a committee.

The Minister of Trade and Industry may in terms of the Companies Act 71 of 2008 prescribe that a company or a certain category of company must have a social and ethics committee. In terms of section 94(2), every public or state-owned company must appoint an audit committee of at least three members.

In terms of the *King Code* a public listed company should at least have both an audit and remuneration committee. The establishment of a nomination committee is also recommended. The respective committees make certain recommendations and assist the board of directors with regard to the specific area of expertise.

## 7.14 Board meetings

Board meetings may be called by directors so authorised. The necessary notice must be given to all directors before any meeting is held. A majority of the directors of the board must be present at a meeting before a vote may be called. Every director has one vote

per meeting, while the chairman has a deciding vote in the event of a tie. Minutes of all decisions as well as any resolution taken by the board at a meeting must be kept.

## 7.15 Duties of directors

There are four sources from which the duties of directors arise, namely their contracts with the company (if any), the company's constitution (Memorandum of Incorporation), the Companies Act and the common law. The rights and duties created by contract are determined by reference to the specific contract. Those created by the company's constitution were discussed in study unit 3 while the duties imposed by the Companies Act 71 of 2008, as well as by the common law will be discussed in this study unit.

Apart from a few specific duties and limitations placed on directors by the Companies Act of 1973, such as the duty to disclose to the board any interest in contracts of the company, most of the duties of directors were determined by the common law. At common law directors are subject to fiduciary duties to exercise their powers *bona fide* (in good faith) and for the benefit of the company, and to the duty to exercise their powers with care and skill.

The Companies Act 71 of 2008 now introduces a partially codified regime of directors' duties, which includes duties similar to the common-law fiduciary duties and the duty to perform their functions with reasonable care and skill. However, the common law is not excluded by the statutory provisions, and will continue to apply except insofar as it is specifically amended by the Act or is in conflict with a provision of the Act. Note that for purposes of these codified duties, "director" includes an alternate director and a member of a committee of the board who is not a director.

For the first time, the Act now also places an explicit duty on the board of directors to manage the company (s 66(1)).

**Briefly summarised, the newly codified duties of directors in the Companies Act of 2008 are the following:**

- (1) To disclose to the board any personal financial interest in matters of the company (s 75).
- (2) Not to use the position of director or information obtained as director to gain an advantage for himself or another person, or to knowingly cause harm to the company or a subsidiary (s 76(2) (a)).
- (3) To disclose to the board of directors any material information that comes to a director's attention (s 76(2)(b))
- (4) To act in good faith and for a proper purpose (s 76 (3) (a)).
- (5) To act in the best interests of the company (s 76 (3) (b)).
- (6) To act with a reasonable degree of care, skill and diligence (s 76 (3) (c)).

### **7.15.1 Standards of directors' conduct**

### **7.15.2 Directors must not abuse their position or information (s 76(2)) and must act in a certain way when there is a personal financial interest (s 75)**

Firstly, section 75 of the Companies Act of 2008 prescribes how a director should act when his or her personal financial interests conflict with those of the company. Two different situations are regulated in this provision. If a director is the only director but not the only shareholder of the company, he must disclose any personal interest in an agreement or other matter of the company to the shareholders and obtain their prior approval by an ordinary resolution before he enters into this agreement or deals with the matter. In all other cases, disclosure must be made to the board of directors of any personal financial interest of the director in a matter to be considered at a board meeting and may not be present or take part in the discussion. A director may also make an advance general disclosure of his personal financial interests to the shareholders or board, as the case may be.

Secondly, in terms of section 76 (2) (a) of the Companies Act of 2008, a director may not abuse his position as director, or information obtained while acting as a director, to gain an advantage for himself or for another person other than the company or a wholly-owned subsidiary of the company, or to knowingly cause harm to the company or a subsidiary of the company.

The third duty that is discussed under this heading is the duty of a director to disclose any information that comes to his attention, subject to the exceptions mentioned in the text book.

- *Robinson v Randfontein Estate Gold Mining Co Ltd* 1921AD 168 [case 75]
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- *Regal Hastings Ltd v Gulliver* 1All ER 378(HL) [case 76]
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- *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* 1981 (2) SA 173(T) [case 80]
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- *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 (2) SA 54 (T)
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- *CyberScene Ltd and Other v i-Kiosk Internet and Information (Pty) Ltd* (page 104 and 107 of you text book)
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- *Gherssi and Others v Tiber Development (Pty) Ltd and Others* (page 105 of your text book) and answer the following question:

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A director may be in breach of the duties owed by him or her to the company despite termination of his or her office. In *Sibex* the directors resigned from their office to form a close corporation which competed directly with the special business of the company. The court found that the knowledge they had gained whilst employed by the company could not be used to the advantage of a rival before or after they had left the employ of the company.

### 7.15.3 Acting with a certain degree of care, skill and diligence

*Fisheries Development Corporation of SA v Jorgenson* [case 87]

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*Philotex (Pty) Ltd v Snyman and Others; Braitex (Pty) Ltd and Others v Snyman and Others* 1998(2) SA 138(SCA) Although the test is an objective one, it contains subjective elements in that the general knowledge, skill and experience of the particular director in question are taken into account. A director who is a chartered accountant will therefore need to be more skilful when it comes to the company's financial affairs than a director who is an electrician by trade.

The Companies Act introduced what is called the **business judgment rule (s 76(4))**. This provision states that a director will be regarded as having acted in the best interests of the company and with the required degree of care, skill and diligence if the director:

- took reasonable steps to become informed about the matter;
- had no material personal financial interest in the subject matter of the decision or knew of anybody else having a financial interest in the matter, or disclosed his interests; and

- made or supported a decision in the belief that it was in the best interests of the company;

A director is also entitled to rely on information provided by certain persons specified in the Act.

#### ***7.15.4 Liability of directors and prescribed officers***

Directors may be held liable for certain losses or damage sustained by the company due to their actions. These actions may include acting without the necessary authority, fraudulently or in contravention with the provisions of the Companies Act or the company's Memorandum of Incorporation or duties.

A director will be jointly and severally liable with any other person who is or may be held liable for the same act. The court may however relieve a director from liability, other than for willful misconduct or willful breach of trust, provided it appears to the court that the director acted honestly and reasonably.

#### ***7.15.5 Indemnification and director's insurance***

A company may not indemnify a director in respect of liability arising out of certain circumstances such as a breach of his or her fiduciary duties.

A company is however entitled to take out indemnity insurance to protect a director against any liability or expenses for which the company is **permitted to indemnify** a director. The company may also take out insurance to insure itself against expenses that the company is permitted to advance to a director to defend litigation.

It is impossible to exempt directors from personal liability for negligence, default, breach of duty or breach of trust. The Memorandum of Incorporation may not conflict with any statutory rule.



## Study unit 8

### Auditors and the company secretary

- *Thoroughbred Breeders' Association v Price Waterhouse* 2001 (4) SA 551 SCA [149]
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- *International Shipping Co (Pty) Ltd v Bentley* 1990 (1) SA 680 (A) [153]
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#### Duties of Auditors:

In terms of section 44 of the Auditing Profession Act 26 of 2005, it is the duty of an auditor to examine a company's financial statements and accounting records and to express an opinion as to the truth and fairness, in all material respects, of the statements and the accountant's adherence to financial reporting standards. Section 1 of the Auditing Profession Act 26 of 2005 states that an "audit" means the examination of, "in accordance with prescribed or applicable accounting standards, (a) financial statements with the objective of expressing an opinion as to their fairness or compliance with an identified financial reporting framework and any applicable statutory requirements; or (b) financial and other information, prepared in accordance with suitable criteria, with the objective of expressing an opinion on the financial and other information". By attesting that the financial statements fairly present the financial condition and past performance of a company, an auditor plays a vital function in reinforcing the reliability of financial information.

### 8.3 Appointment of an auditor

- A public company or state-owned company is required to appoint an auditor every year at the annual general meeting.
- Other companies such as private companies, personal liability companies and

non-profit companies are not required under the Companies Act to appoint an auditor, but may do so voluntarily.

- Section 85 of the Companies Act: Every company that appoints an auditor must file a notice of the appointment with the Registrar within ten business days after the appointment. The notice must reflect the name of the auditor and the date of appointment.
- Section 85(4) requires that the incorporators of a company file a notice of the appointment of the company's first auditor as part of the company's Notice of Incorporation.

Section 90(2) of the Companies Act: persons disqualified from being appointed as the auditor :

- a director or prescribed officer of the company;
- an employee or consultant of the company who was or has been engaged for more than one year in the maintenance of any of the company's financial records or the preparation of any of its financial statements;
- a director, officer or employee of a person appointed as company secretary;
- a person who, alone or with a partner or employees, habitually or regularly performs the duties of accountant or bookkeeper, or performs related secretarial work, for the company;
- a person who, at any time during the five financial years immediately preceding the date of appointment, was a person contemplated above or is a person related to a person contemplated above.

## 8.4 Resignation and vacancies

- Resignation effective upon receipt of notice
- **Must within 40 days appoint new auditor**
- Must propose a new auditor within 14 days after vacancy arose

## 8.5 Rotation of auditors

### **Section 92 of the Companies Act: Rotation of auditors.**

The same individual may not serve as the auditor or designated auditor of a company for more than five consecutive financial years.

This rotation requirement applies to individual auditors only and not to firms and also does not

apply to private companies.

## 8.6 Rights and restricted functions of auditors

Section 44(6) of the Auditing Profession Act provides that a registered auditor may not conduct the audit of any financial statements of an entity, whether as an individually registered auditor or as a member of a firm, if the registered auditor has or had a conflict of interest in respect of that entity, as prescribed by the **Independent Regulatory Board for Auditors** (IRBA). The IRBA is required to define in the code of professional conduct (see s21(2)(a) of the Auditing Profession Act) which non-audit services an auditor is prohibited from rendering to the company it is auditing.

### **Section 93 of the Companies Act:**

- Company auditor has a right to access the accounting records and all books and documents of the company.
- An auditor may require from the directors or officers such information and explanations as are necessary for the performance of his or her duties.
- The auditor may apply to court for an order to enforce the above rights and the court may make any order that is just and reasonable to prevent frustration of the auditor's duties by the company, directors, prescribed officers or employees.
- The court may further make a costs order against any director or prescribed officer whom the court has found to have willfully and knowingly frustrated, or attempted to frustrate, the performance of the auditor's functions.

Hamid is therefore entitled to have access to the documents requested from Barney, and may apply to court if necessary for an order that the documents be furnished to him. The court may make a costs order against Barney in his personal capacity.

## 8.7 The Auditing Profession Act 26 of 2005 – read only

## 8.8 Audit committees

### Section 94 Companies Act 2008:

At each annual general meeting, a public company, a state-owned enterprise and any other company which has voluntarily decided to have an audit committee, must appoint an audit committee for every financial year.

The audit committee must have at least three members and consist only of non-executive directors of the company who have not been involved in the day to day management of the company in the preceding three financial years.

## 8.9 The company secretary

### ***8.9.1 Mandatory appointment of company secretary***

The company secretary is the principal administrative officer of his or her company.

Every public company or state-owned enterprise must appoint a company secretary.

A private company, personal liability company or a non-profit company may voluntarily appoint a company secretary.

The first company secretary of a public company or state-owned enterprise may be appointed by:

- the incorporators of the company; or
- within 40 business days after the incorporation of the company, by either the directors of the company or an ordinary resolution of the company's shareholders (s 86(3)).

Within 60 business days after a vacancy arises in the office of company secretary, the board must fill the vacancy by appointing a person whom the directors consider to have the requisite knowledge and experience (s 86(4)).

Every company secretary must be a permanent resident of the Republic, and must remain so while serving in that capacity (s 86).

### **8.9.2 Disqualification as company secretary –**

- A person who is disqualified to serve as a director of a company

Other disqualified person is a person that-

- has been prohibited to be a director or has been declared to be delinquent by a court order;
- is an unrehabilitated insolvent;
- is prohibited in terms of any public regulation to be a director of the company;
- has been removed from an office of trust, on the grounds of misconduct involving dishonesty; or
- has been convicted, in the Republic or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury, or an offence (i) involving fraud, misrepresentation or dishonesty; (ii) in connection with the promotion, formation or management of a company; or (iii) under the Companies Act or some other Acts listed in the section and also listed in your text book on page 146.

Section 87: a juristic person or partnership may be appointed to hold the office of company secretary if every employee of that juristic person, or partner and employee of that partnership, as the case may be, satisfies the requirements contemplated in section 84(5); and at least one employee of that juristic person, or one partner or employee of that partnership, as the case may be, satisfies the requirements contemplated in section 86.

### **8.9.3 Duties of company secretary**

- providing the directors of the company collectively and individually with guidance as to their duties, responsibilities and powers;
- making the directors aware of any law relevant to or affecting the company;
- reporting to the company's board any failure on the part of the company or a director to comply with this Act;
- ensuring that minutes of all shareholders meetings, board meetings and the meetings of any committees of the directors, or of the company's audit committee, are properly recorded in accordance with this Act;

- certifying in the company's annual financial statements whether the company has filed required returns and notices in terms of this Act, and whether all such returns and notices appear to be true, correct and up to date;
- ensuring that a copy of the company's annual financial statements is sent, in accordance with this Act, to every person who is entitled to it; and
- carrying out the functions of a person designated in terms of section 33(3) (i.e., person responsible for filing the company's annual return).

#### **8.9.4 Resignation or removal of company secretary**

Section 89(1): A company secretary may resign from office by giving the company one month written notice, or, with the approval of the board, less than one month written notice. If the company secretary is removed from office by the company's board, the secretary may require the company to include a statement in its annual financial statements relating to that financial year setting out the secretary's contention as to the circumstances that resulted in the removal.

### **8.10 Registration of company secretaries and auditors**

#### **Sections 85 of the Companies Act**

In addition to the record of company secretaries and auditors that a company must keep, every company that appoints a company secretary or auditor is required to file a notice of the appointment, or the termination of service of such an appointment, with the Registrar within ten business days after the appointment or termination, as the case may be

Section 85(4) : The incorporators of a company may file a notice of the appointment of the company's first company secretary as part of the company's Notice of Incorporation.

## **Study Unit 9**

### **Remedies, Enforcement Agencies and Alternative Dispute Resolution (ADR)**

***Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries Ltd 1979 (3) SA 713 (W)***  
**[166]**

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## **9.2 Remedies against directors who have abused their position**

Against directors who have abused their position.

- Application to declare a director delinquent or under probation and
- The derivative action in terms of section 165.

### **9.2.1 *Application to declare a director delinquent or under probation***

- A court may declare a director to be a delinquent director or place a director under probation;
- Such an order has serious consequences for a director;
- A court is obliged to make an order declaring a person to be a delinquent director if one of the statutory grounds is established;
- A court may place a director under probation on the grounds in section 162(4).

### **9.2.2 *Derivative action in terms of section 165***

*TWK Agriculture Ltd v NCT Forestry Co-operative Ltd and Others 2006 (6) SA 20 (N)*  
 regarding the nature of the derivative action:

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- The common-law derivative action was unsatisfactory for a number of reasons, hence section 266 of the 1973 Act introduced a statutory derivative action as an alternative to the common-law remedy;
- In *Thurgood v Dirk Kruger Traders (Pty) Ltd 1990 (2) SA 44 (E)* [par 11.3 of your text book] the applicant brought a successful application in terms of section 266 of the 1973 Act for the appointment of a *curator ad litem*;

- Section 165 of the 2008 Act retains the statutory derivative action in terms of section 266 of the 1973 Act, but with important changes;
- Section 165 abolishes the common-law right of a person other than the company to bring legal proceedings on behalf of the company;
- Specific steps must be taken to institute an action in terms of section 165;
- Instead of a *curator ad litem* appointed by the court, the new procedure provides for the appointment of an independent and impartial person or committee by the company to investigate the demand and report back to the board.

### 9.3 Remedies available to shareholders to protect their own rights

Statutory remedies for shareholders:

S 163: Relief from oppressive or prejudicial conduct

S 164: Dissenting shareholders' appraisal

S 161: Application to protect the rights of the holders of securities.

#### 9.3.1 *Relief from oppressive or prejudicial conduct in terms of section 163*

- Section 252 of the 1973 Act provided a statutory remedy to minority shareholders who were the victims of oppressive conduct by the majority;
- This remedy was in addition to the personal action which minority shareholders could bring against the company under the common law;
- Section 163 of the 2008 Act essentially retains the remedy provided for in section 252 of the 1973 Act, but with a number of important refinements;
- In *Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries Ltd* 1979 (3) SA 713 (W) [case 166] preference shareholders were unsuccessful in their action under section 252 where they were deprived of certain rights but granted additional privileges, because an order in terms of section 252 would have resulted in the shareholders receiving a price for their shares that was far in excess of their actual market value;
- *Robson v Wax Works (Pty) Ltd* 2001 (3) SA 1117 (C) is an example of a situation where section 252 would have brought appropriate relief.



### **9.3.2 *Dissenting shareholders' appraisal rights in terms of section 164***

#### **Section 164 of the Companies Act**

- Although section 163 of the 2008 Act retains the remedy provided for in section 252 of the 1973 Act, and although relief under section 252 could include the purchase by the company of a dissenting shareholder's shares, the current Act provides for an independent remedy for dissenting shareholders, called dissenting shareholders' appraisal rights;
- An appraisal right is the right of a shareholder to require his company to buy his shares at their fair value if his company takes any of the listed triggering actions;
- A specific procedure must be followed by the shareholder once his company has taken a triggering action.

### **9.3.3 *Application to protect the rights of securities holders in terms of section 161***

#### **Section 161 of the Companies Act**

- The holder of issued securities may apply to court for a declaratory order regarding his rights;
- Alternatively, the holder of the securities can apply for an appropriate order to protect his rights or to rectify any harm done to him by the company as a result of an act or omission in contravention of the Act, the Memorandum of Incorporation, rules or applicable debt instrument, or harm done by any of the company's directors, but only to the extent that they may be held liable under section 77.

## **9.4 Liability for abuse of separate juristic personality of company**

### **Section 163 Relief from Oppressive and Prejudicial Conduct**

**Appraisal rights in section 164.**

## 9.5 Enforcement agencies and ADR

Unlike the 1973 Act which extensively provided for criminal sanctions, the 2008 Act generally uses a system of administrative enforcement.

The body normally responsible for the enforcement of the Act is the Companies and Intellectual Property Commission (the Commission), except as regards matters within the jurisdiction of the Takeover Regulation Panel. The Commission takes the place of the Registrar of Companies under the 1973 Act. Among other things, the Commission must monitor proper compliance with the Act, investigate complaints concerning contraventions of the Act, promote the use of ADR by companies for resolving internal disputes, keep a Companies Register, advise the Minister on changes to the law, etcetera.

The Commission plays a central role in the enforcement of the Act. Any person may file a complaint with the Commission and the Commission may also initiate complaints on its own motion or at the request of another regulatory authority. The commission may respond to complaints in different ways.

The Act also establishes a new entity, namely the Companies Tribunal. Its two main functions are to serve as a forum for voluntary ADR in any matter arising under the Act and to carry out reviews of administrative decisions made by the Commission.

As an alternative to applying to court or filing a complaint with the Commission, an applicant or complainant may refer a matter to the Companies Tribunal or to an accredited entity for resolution by mediation, conciliation or arbitration. There are certain differences between these three methods of ADR. Use of ADR is voluntary and all parties must agree to the use of the process.

## Study Unit 11

## Close Corporations

- ***Haygro Catering CC v Van der Merwe and Others* 1996(4) SA 1063 (C) [176]**
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- ***Gatenby v Gatenby* 1996 (3) SA 118 (E) [169]**
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- ***De Franca v Exhaust Pro CC (De Franca Intervening)* 1997 (3) SA 878 (SE) [170]**
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### 11.3 The Number and Nature of Members

- Even though certain natural persons may not have the legal capacity to participate in the management of a close corporation, even minors, insolvent persons and other persons with legal disabilities may with assistance become members of a close corporation.
- No juristic person (i.e. another close corporation or a company) may however be a member.
- Trustees in their capacities as trustees of trusts mortis causa or inter vivos, or as administrator of persons under legal disability, may become members of a close corporation unless a juristic person would be a beneficiary of such a trust or the beneficiaries would result in the close corporation's membership exceeding the restricted number.

Should a person that is disqualified from membership become a member, such person bears the risk of being held personally liable for all the debts of the close corporation.

## 11.4 Formation of a close corporation and members' interests

Before a close corporation can be registered a name has to be reserved. After name reservation, the founding statement must be lodged at the registration offices (CIPRO) in triplicate, accompanied by a letter of the accounting officer accepting his or her appointment as such and payment of the prescribed fee.

### Founding members are required to sign:

- Each founding member is required to sign the founding statement or provide written authorisation (a power of attorney) for it to be signed on their behalf.
- A guardian or parent is required to sign on behalf of a minor.
- Where a trustee or curator signs on behalf of a member, such a person must indicate the capacity in which they sign the document.

### Transitional provisions

After the coming into force of the Companies Act of 2008, it will no longer be possible to register new close corporations in terms of the Close Corporations Act or to convert existing companies into close corporations.

- Close corporations are registered by 1 to 10 natural persons
- Upon registration, a close corporation acquires separate legal personality.
- The existence of a close corporation will not be terminated by changes in membership, insolvency or personal circumstances of its members.
- A close corporation also holds its asset separate from its members and therefore it is not severely affected should the estate of a member be sequestrated.

## 11.5. Acquisition and Disposal of Member's Interest

The following are characteristics of member's interest:

- Member's interest is expressed as a percentage (out of a total of 100%) in the founding statement.
- Member's interest may not be jointly held
- The aggregate member's interests must at all times be 100%
- A member's interest in a close corporation is similar to a share in a company
- Member's interest is an incorporeal, moveable thing
- Member's interest is a personal right to share in the profits of the close corporation after its creditors has been paid.

**Member's interest can be acquired by:**

- Becoming a member upon registration of the founding statement
- Acquiring member's interest from existing members
- Making a contribution to the close corporation.

**Disposal of member's interest:**

Controlled by the members to a large extent.

**Requirements for disposal of member's interest:**

- Must be made in accordance with association agreement; or
- Consent from all members.

**Death of a member:**

A member may bequeath his or her member's interest to his or her heir/ legatee in a Will. Transfer of the member's interest to the heir/ legatee may however only occur with the consent of the other members.

Should the members not permit such transfer, the executor of the estate may:

- Sell the member's interest to the close corporation
- Sell the member's interest to other members
- Sell the member's interest to a third party subject to the other members' pre-emptive right to purchase the member's interest.

The money value will thereafter be paid over to the heir/ legatee.

### **Insolvency of member:**

Section 34(1) mandatory procedure for disposal of an insolvent member's interest.

If a member becomes insolvent, the trustee may realise the member's interest and:

- Sell the member's interest to the close corporation
- Sell the member's interest to the other members
- Sell the member's interest to a third party subject to the other members' pre-emptive right to purchase the member's interest.

The money value will thereafter be paid over to the creditors.

### **Attachment and sale in execution:**

Section 34A of the Close Corporations Act :

The member's interest may then be sold to the close corporation, other members or an outsider subject to the right of pre-emption in favour of the close corporation and other members.

## **11.6 Duties members owe to the close corporation**

Members owe two duties to the close corporation, namely:

- A fiduciary duty (duty of good faith) -s 42 of the Close Corporations Act 69 of 1984 and
- A duty of care and skill.

### **11.6.1 *Fiduciary Duty***

Similar to the fiduciary duty a director owes to a company.

Section 42 of the Close Corporations Act states that a member should:

- act honestly and in good faith;

- avoid a conflict of interest between his or her own interests and those of the close corporation;
- exercise powers in the interest of the corporation;
- disclose any interest in a transaction to the other members of a close corporation as soon as possible;
- not gain any financial gain by virtue of being members of the close corporation.

### **Contracts concluded between member and close corporation:**

Fiduciary duty

Members must disclose material interests and all material facts to other members.

### **Effect of non-compliance:**

Non-disclosure will render contract voidable at the option of the close corporation.

Application can, however, be made to the Court to declare the contract as binding upon the parties despite failure to disclose.

If the fiduciary duties are breached a member may be held personally liable for any loss suffered by the corporation or debts incurred as a result of such a transaction (s 42(3)). The member would in such an event have to repay any profit made by him or her.

### **Personal liability for debts:**

A member may incur personal liability for the debts of the close corporation should a contract be concluded in conflict with his or her fiduciary duty to the close corporation.

Personal liability can however be avoided by disclosing all material facts regarding the member's interest in a transaction to the other members of the close corporation and acquiring prior written approval from all the other members.

### **11.6.2 *Duty of Care and Skill***

A member will be liable only if the close corporation suffers a loss as a result of the breach of this duty (s 43(1)).

**Test** : objective test

measured against the conduct which could reasonably have been expected from a person with the same skill and knowledge as the member (to establish negligence).

Consequence: Another member may institute action against the close corporation or its members in his or her personal capacity.

*Geany v Portion 117 Kalkheuwel Properties CC and Others and Moosa NO v Mavjee Bhawan (Pty) Ltd and Another*

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### **11.6.3 Remedies in Case of Breach**

#### **Section 50 of the Close Corporations Act 69 of 1984: Statutory derivative action**

Action instituted by member against a fellow-members

on behalf of the close corporation for liability to the company on the specified grounds including a breach of a fiduciary duty or the duty of care and skill.

Person instituting action will be liable for costs if action is unsuccessful

## **11.7 Cessation of membership by order of court**

There are two remedies for members against other members:

- Section 36: Order of court terminating membership
- Section 49: Assistance from court regarding unfairly prejudicial conduct.

### **Section 36**

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*Gatenby v Gatenby and De Franca v Exhaust Pro CC*

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### **Section 49**

Section 49 is a remedy available to a member where there was a single act or omission in the conduct or affairs of the business by the corporation or other member/s which was unfairly prejudicial to such member. The court will only intervene if it is just and equitable to do so. The court may then direct that the aggrieved act or omission be stopped, order the corporation to amend the founding statement or association agreement, or in certain cases upon application make an order to wind-up the corporation.

## **11.8 Acquisition of member's interest by the corporation**

### **Acquisition of a members' interest:**

It is possible for a close corporation to acquire a member's interest from one of its members.

### **Requirements for acquisition of member's interest by a close corporation:**

- Must have at least one other member;
- Aggregate member's interests must remain 100%;
- Written consent from all members prior to payment;
- The corporation must be **solvent** and **liquid**.

**Financial Assistance:**

Section 40 of the Close Corporations Act 69 of 1984 requires:

- Prior written consent from every member;
- Solvency and liquidity of the close corporation.

**11.9 Association agreements****Association agreements:**

- Founding statement is the only compulsory constitutive document.
- Association agreements are optional.
- Association agreements must be in writing and signed by or on behalf of each member.
- Association agreements are not viewed as a public document and only members may inspect it, but must be held at the registered offices of the business.

**Alterable provisions:**

- The rights of the members to carry on business and manage the close corporation
- What the requirements are for making a decision and voting
- The procedure and proportions for payments to members.

**Unalterable provisions:**

- Rights of members to call meetings
- Disqualification from participating in management
- How insolvent members' interest must be disposed of.

Any stipulation in contravention of the Close Corporations Act in the association agreement will be void.

## 11.10 Power of members to contract on behalf of the close corporation

*J& K Timbers (Pty) Ltd v GL& S Furniture Enterprises CC 2005 (3) SA 223 (N):*

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Section 54 of the Close Corporations Act states that every member has the authority to conclude contracts on behalf of the close corporation in relation to a person who is not a member (an outsider or third party).

- The doctrine of constructive notice does not apply to close corporations.
- *Ultra vires* doctrine does not apply - it does not matter whether or not the transaction falls within the scope of the main business of the corporation.

### **Exception: (CC not bound)**

Outsider or third party knew or reasonably should have known that the member who concluded the contract on behalf of the close corporation lacked authority.

## 11.11 Payments by corporation to members

Capacity as member – s 51 must be adhered to

Creditor – s 51 not applicable

## 11.12 Prohibition on loans to and security on behalf of members

Section 52 of the Close Corporations Act:
<ul style="list-style-type: none"> <li>- The provision of loans and security to members is prohibited,</li> <li>- unless all the other members consent in writing may such loan or security be</li> </ul>

extended
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Loans/ security otherwise extended are invalid  
members who permitted the transaction will incur liability.

### 11.13 Accounting officer, records and financial statements

- Close corporations are not exempted from financial reporting.
- An annual financial statement must be approved by or on behalf of members holding at least 51% of the member's interest in the close corporation.
- A report must be drawn up by the appointed accounting officer.

DUTIES OF ACCOUNTING OFFICERS:

#### ***Maccelari and Others v Help U Build Project Management CC***

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- A close corporation need not appoint an auditor. However, an accounting officer must be appointed.
- Accounting records must be kept and approved by members annually.
- The accounting records need not be submitted to the Registrar.
- The accounting officer must account in conformity with generally accepted accounting practice. He or she also plays a very important reporting function.
- If an accounting officer becomes aware of irregularities in the accounting policies or practices within the corporation, this must be disclosed to the members.
- The Registrar must also be informed should the accounting officer be removed, the corporation is not carrying on business or if its liabilities exceed the assets at the end of the financial year.

### 11.14 Circumstances when members and others can be liable for a corporation's debts

*Haygro Catering BK v Van der Merwe en Andere* 1996 (4) SA 1063 (C):

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*Airport Cold Storage (Pty) Ltd v Ebrahim and others* 2008(2) SA 303

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#### **Piercing the Corporate Veil:**

A close corporation is a separate legal person.

The court at times may 'pierce the corporate veil' to hold the guilty parties liable.

#### **Personal Liability:**

- S 23.....
- S 26.....
- S 42.....
- S 43.....
- S 52.....
- S 55.....
- S 65.....

#### **Joint Liability:**

- S 63.....

#### **S 64 - Reckless and Fraudulent Trading:**

A person who knowingly conducts or is party to conducting the business of the close corporation in a reckless or fraudulent manner will be held liable for all debts of the corporation.

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## Questions:

1. The Companies Act 2008 changes the classification of companies. Discuss the new position regarding to the classifications of Companies.

**Discuss Profit and Non-Profit Companies under the 2008 Act. Profit companies are divided into:**

- **Private**
- **Public**
- **State-owned**
- **Personal Liability.**

**Each has its distinctive features – you should be able to explain this**

**Non- profit: Know the distinctive features of these types of companies.**

2. A concludes a written agreement with B for the purchase of a delivery vehicle. A informs B that he is acting as an agent for a company to be incorporated in due time. The contract is after incorporation of the company not ratified.
  - Explain, with regard to the common law position, whether a valid contract was concluded.
  - Explain the position in terms of the Companies Act 2008

### Common Law

- **Agency impossible in case of non-existent principle**
- **Contract would be void.**

### ➤ **SECTION 21 COMPANIES ACT 2008**

- **Requirements: Written**

### **APPLY TO FACTS!**

- **3 months after incorporation board must ratify or reject**
- **if unratified/ rejected after 3 months deemed to be ratified**

- if company does not ratify promoter liable jointly and severally
- Promoter has a claim against company for any benefit in terms of the agreement

3. Compare the fiduciary duties of directors in companies in terms of the Companies Act 2008 with the fiduciary duties of members of a close corporation.

### **CLOSE CORPORATIONS:**

A member's fiduciary duties towards the close corporation are similar to the fiduciary duty a director owes to a company. However, it is not only the common-law principles regarding good faith that apply but also provisions of the Close Corporations Act.

The Close Corporations Act (s 42) provides that a member should:

- act honestly and in good faith;
- avoid a conflict of interest between his or her own interests and those of the close corporation;
- exercise powers in the interest of the corporation;
- disclose any interest in a transaction to the other members of a close corporation as soon as possible;
- not gain any financial gain by virtue of being members of the close corporation.

### **COMPANIES:**

#### **DIRECTORS DUTIES**

##### ➤ **Sources of Duties:**

- (1) Common Law
- (2) Contract
- (3) MOI
- (4) Companies Act 2008

##### (1) COMMON LAW:

-Fiduciary Duties

## -Reasonable Care and Skill

Companies Act 2008 partially codifies duties

➤ Duties in Companies Act 2008:

-s 75: disclose financial interest

Directors must avoid a conflict of interest:

*Regal Hastings Ltd v Gulliver:*

*Robinson v Randfontein Estate Mining*

*CyberScene Ltd and Others v i-Kiosk Internet and Information*

-s 76(2)(a): not abuse information

-s 76(2)(b): disclosure of material information

-s 76 (3)(a): Act in good faith and for a proper purpose

-s 76(3)(b): Act in best interest of Company

4. Briefly discuss and operation of the doctrine of constructive notice in terms of the Companies Act 2008.

**The doctrine of constructive notice has been abolished. Third parties will therefore no longer be deemed to have knowledge of the content of companies' public documents. Much like in close corporations a company will only be able to escape liability where the third party was not acting in good faith (i.e. he or she knew or reasonably ought to have known that the person contracting on behalf of the company in fact did not have the required authority).**

5. Samuel wishes to start a business early in 2013. He does not know whether he should register a private company or a close corporation. Advise Samuel.

**Transitional Provisions – after incorporation of the Companies Act 2008 it will no longer be possible to register new Close Corporations.**

6. Distinguish between shares and debentures and the distinctive rights of their holders.

### SHARES

- Complex of rights and duties INCLUDING VOTING RIGHTS
- Shareholders participate in the profits of the company
- Shareholders entitled to dividends when declared

### DEBENTURES



- **Debenture holder is a creditor**
- **Receives interest at predetermined rate, payable at fixed times**
- **Does not confer voting rights**

7. The main object of XYZ (Pty) Ltd is buying and selling of second hand cars. In terms of the articles of association any director of the company is authorized to conclude contracts on behalf of the company. Contracts exceeding R75 000 must be approved by the company in general meeting first. Explain whether the company is bound to the contract if a director buys a car for R145 000 on behalf of XYZ (Pty) Ltd, from X, a member of the company.

### **Application of the Turquand Rule – see section 20(7) of the Companies Act 2008**

**If a person other than a director, shareholder or prescribed officer deals with company in good faith, such person may presume the company is making any decision in exercise of its power complied formal and procedural requirements in terms of the Companies Act and its Rules and its MOI**

**UNLESS... \*Person knew**

**\*Reasonably ought to have known company failed to do so**

#### *IMPORTANT NOTES REGARDING EXAMINATION:*

- (1) The examination consists of two different question papers – one for persons registered for this year and the other for persons that registered last year and are writing a supplementary/ aegrotat. Please make sure that you do the correct section!!!*
- (2) The examination is divided into 2 sections. 70% of the paper is longer questions dealing with Close Corporations (20) Companies (General) (25) Companies (Shares) (25). 30% is 10 multiple choice questions for 3 marks each. Remember that Partnerships and Trusts are not included at all in the examination. Do not waste time studying this!*
- (3) In answering questions ensure that you distinguish first whether the question deals with a company or a close corporation! Do not confuse the two as you shall be penalized!*
- (4) If applicable you should always refer to relevant case law by including part of the name (one of the parties to the case at least) and the short summary as you have done in these notes in your answer.*
- (5) Please make sure that you answer the questions! Apply the law to facts provided and conclude!!!*
- (6) This is an aid only in your preparation for the examination. Please allow enough time to read through sections that are not discussed herein.*
- (7) The cryptic guidelines in answering the questions above should not be viewed as a memorandum.*