

- It is not a legal requirement that everyone wishing to conduct business must form or incorporate a company or close corporation but most business people prefer to operate in a formalised business environment.
- Prior to incorporating a business there are a number of issues that require careful consideration.
- These include the number of persons who will be involved in the business and the extent of their involvement, the capital required to commence the business, the sources of capital, customer and client requirements, tax issues and the strategic objectives of those involved
- Once a company is incorporated
- Registration Certificate issued by CIPC
- Company acquires legal personality
- Can sue and be sued
- Members are not liable for company debts
- Members enjoy limited liability
- In certain cases the courts have disregarded the separate legal personality of a company in order to recognize the substance or practical realities of a situation rather than the form.
- Before the codification of the principle of disregard of a company's separate existence by the Companies Act of 2008, this matter was regulated by the common law and referred to as "**lifting**" or "**piercing**" the corporate veil.
- The courts used it to place limitations on the principle of separate legal personality in order to avoid abuse
- Courts have made it clear that they will not allow the use of any legal entity to justify wrong, to protect fraud or to defend or hide crime
- '**Piercing the corporate veil**' refers to those **exceptional circumstances** where the court **ignores the separate legal existence of the company** and treats the shareholders as if they were the owners of the assets and had conducted the business of the company in their personal capacities OR attributes certain rights or obligations of the shareholders to the company.
- Companies Act like the Close Corporations Act codifies the general principle of piercing the corporate veil.
- Section 20(9) of the Companies Act 71 of 2008 provides that 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 rights, liabilities and obligations relating to the abuse.
- Wording of the section is a combination of section 65 of the Close Corporations Act and the judgment in *Botha v Van Niekerk*.
- It ignores the view expressed in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* that described the test in *Botha v van Niekerk* as too rigid.
- It remains to be seen how the courts will decide what would constitute an unconscionable abuse and to what extent they will use the existing case law dealing with the common-law rule of piercing the corporate veil.
- There are still no hard and fast rules
- No general discretion of the courts
- Each case will still have to be taken into consideration when deciding whether to pierce the corporate veil.
- Companies Act provides for two types of companies ie. profit and non-profit company

### **Profit Companies:**

- Public Company
- Private Company

- Personal Liability Company
- State-owned company

### **Public Company ('Ltd')**

- Shares may be offered to the public and are freely transferable;
- Company can be listed on the JSE Limited;
- Can be formed by 1 person
- Must have at least 3 directors
- Obligated to hold annual general meetings
- Obligated to appoint an auditor
- Obligated to appoint a company secretary
- Obligated to appoint an audit committee

### **A state-owned company ('SOC Ltd')**

- Registered in terms of the Companies Act
- Listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act, or owned by a municipality;
- Examples of state-owned companies: ACSA, Denel and South African Airways.
- The majority of the provisions applicable to public companies apply to state-owned companies except if an exemption has been granted by the Minister
- Obligated to appoint a company secretary
- Obligated to appoint an audit committee

### **A personal liability company ('Inc' / 'Incorporated')**

- Must meet the criteria for a private company,
- Mainly used by professional associations (such as attorneys);
- Memorandum of Incorporation must state that it is a personal liability company
- 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" to limit directors' liability to contractual debts, and to exclude delictual and statutory liabilities.
- A provision that the directors and past directors will be liable jointly and severally, together with the company, for debts and liabilities of the company that were contracted during their periods of office must be included in the Memorandum of Incorporation of a personal liability company.
- The effect of the inclusion of such a clause is that creditors would be able to hold the directors jointly and severally liable for the company's contractual debts and liabilities.
- A director who had paid the debts will have a right of recourse against his or her fellow-directors for their proportionate share.
- Can be formed by 1 person
- Must have at least 1 director
- The doctrine of constructive notice applies in terms of section 19(5) of the Companies Act.

### **Non-profit companies ('NPC')**

- Not formed with the aim of making a profit for its members
- A non-profit company has members and not shareholders like profit companies.
- Objects must relate to social activities, public benefits, cultural activities or group interests.

- Must be formed by at least 3 persons who will be the company's first directors.
- Must have at least 3 directors
- Directors are not allowed to obtain any financial gain from the company other than remuneration for the work they performed.
- If these companies have members, some members may enjoy voting rights while others may not.
- The income and property of non-profit companies are not distributable to its incorporators, members, directors, officers or persons related to any of them.
- Upon liquidation, income and assets must be paid over to another non-profit company, voluntary association or trust with a similar purpose.
  
- **Objectives of the Companies Act include**
  - ❖ the promotion of the development of the South African economy
  - ❖ 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
- The Act makes it possible to incorporate both simple and extremely complex business structures
- When incorporating a company, the Notice of Incorporation plus a copy of the Memorandum of Incorporation must be filed with the Commission.
- Old Act – Articles of Association and Memorandum of Association required to be filed
- In addition, the prescribed registration fee must be paid.
- Memorandum of Incorporation (founding document of the company) is defined, as *“the document, as amended from time to time that sets out rights, duties and responsibilities of shareholders, directors and others within and in relation to a company and other matters.”*
- **Memorandum of Incorporation contains** details of Incorporators, number of directors and alternate directors, share capital (maximum issued)
- Companies Act imposes certain specific requirements on the content of a Memorandum of Incorporation, to protect the interests of shareholders in the company.
- A number of default company rules or alterable provisions are provided for.
- Companies may accept or alter the alterable provisions as long as the alteration remains consistent with the Companies Act.
- In case of an inconsistency between the Memorandum of Incorporation and the Companies Act, the Memorandum of Incorporation will be invalid to the extent of its inconsistency.
- Once the Notice of Incorporation and 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 under the following circumstances:
  - ❖ if it has not been completed in full
  - ❖ if it has not been properly completed
- The Commission **must** reject the Notice of Incorporation if:
  - ❖ if the initial number of directors is fewer than the prescribed minimum number
  - ❖ where as a result of a director's disqualification, the initial number of directors becomes fewer than the prescribed minimum number
- A **profit company** must have at least **one director** and a **non-profit company** a minimum of **three directors**.
- If 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 fewer than the prescribed number, the Commission has no choice but to reject the Notice of Incorporation.
- The flexibility of the Act is evident in the role of the Commission when it comes to the incorporation of a company. Where there is a deviation from the design or content of the prescribed form, the deviation will only invalidate the Notice of Incorporation if it affects the substance of the Notice of Incorporation
- Deviation will also invalidate the Notice of Incorporation if such deviation would reasonably mislead a person who is reading the Notice of Incorporation.
- Once the Notice of Incorporation has been filed, the Commission assigns a unique number to the corporation
- It then enters the prescribed information of the company in the Companies Register
- It then issues and delivers a registration certificate to the company, if all the requirements have been complied with.
- The date 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.
- The Companies Act imposes certain specific requirements on the content of a Memorandum of Incorporation, as necessary to protect the interests of shareholders in the company.
- A number of default company rules or alterable provisions are provided for.
- Companies may accept or alter the provisions as long as the alteration remains consistent with the Companies Act.
- The Act is flexible and allows the incorporators of a company to include provisions not covered by the Act, in the Memorandum of Incorporation.
- The Act specifically requires that provisions of the Memorandum of Incorporation have to be consistent with provisions of the Companies Act.
- Where there are inconsistencies, provisions in the Memorandum will be void, but only to the extent of the inconsistency
- 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.
- The Act also allows the Memorandum of Incorporation to prohibit the amendment of any particular provision in the Memorandum of Incorporation.
- If the Memorandum of Incorporation of a company contains those provisions allowed 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
- 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 regard to incorporation is once again highlighted
- RF follows the name of these companies. It is an important principle for representation of companies.
- An RF-company is one of the circumstances where a third party would be deemed to know the restrictions in the Memorandum of Incorporation.
- The other exception to the rule that a company is no longer subject to the doctrine of constructive notice is in case of **personal liability companies**.
- Should the Act and the MOI be silent on certain matters that deal with governing the company then the board of directors is allowed to make rules, amend existing rules and repeal any rules.

- Rules must not conflict with the Act or MOI and if it is then the rule will be void to the extent of its consistency.
- Rules made by the board must be published in the manner stated in the MOI or if there no manner prescribed then the rules must be published as stated in the rules themselves.
- A copy of the rules must be filed with the Commission.
- Twenty business days after publication of the rules or after the date stated in the in the rules, the rules become effective.
- As soon as the rules become effective they are binding on an interim basis until put to the vote in the next shareholder's meeting.
- A rule become permanent it needs to be ratified by an ordinary resolution at the next general meeting.
- If the rule is rejected by a majority of shareholders, the board of directors are not allowed to make a similar rule until a 12 month period has lapsed.
- The board of directors may only make a similar within 12 months if it is approved in advance by ordinary resolution at the shareholder's meeting.
- The MOI and rules are binding – it creates a contractual relationship:
  - ❖ Between the company and each shareholder
  - ❖ Among shareholders of a company
  - ❖ Between the company and each director or prescribed officer of the company.
  - ❖ Between the company and each member of the audit committee or a member of a committee of the board.
- The Act allows for amendment of the MOI unless the MOI prohibits the amendments of a provision.
- Amendments can be in the form of a new MOI or amendments to the existing provision of the MOI.
- If changes are in the form of a new MOI then the new MOI replaces the old one.
- Amendments may be made by the board of directors, shareholder who collectively exercise not less than 10% of the voting rights, in terms of procedure set out in the company's MOI, by means of a court order for an amendment in terms of a court order
- A court order is given effect via a board of resolution and there is no need for a shareholder's special resolution.
- No need to convene a shareholder's meeting to adopt a special resolution.
- Proposal to amend may be submitted to voting shareholders.
- Form CoR15.2 must be filed to effect an amendment.
- Filing fee must be paid and amended MOI must be filed.
- An amendment may result in a profit company not meeting the criteria for that category of profit companies.
- If an amendment causes a personal liability to change to another category of profit company the company must give 10 day prior notice of the filing of the notice of amendment to any professional or industry regulatory authority that has jurisdiction ovr the company.
- They must also given notice to any person who relied on the personal liability of directors and who could suffer prejudice if that liability is terminated.
- When this happens the name of the ending expression must also be amended to reflect the new category that the company falls into.
- Act allows for the changes or alterations to the company's rules and to the MOI.
- These are made with a view to correct spelling, grammar, punctuation and references.
- Board of a company or an individual to whom the board has given authority may make these changes or alterations.

- A notice of alteration must be filed and published in accordance with the MOI and rules.
- A company that has filed a MOI has the right to file a translation of the MOI in any official language of the RSA.
- The translation must be filed with a sworn statement of the translator confirming that the translation is true, accurate and complete.
- If there is a conflict between the MOI and the translated version of the MOI then the MOI prevails.
- A company is entitled to make alterations or amendments to its MOI.
- The company may file a consolidated revision of its MOI – CIPC may also require the company to do so.
- The consolidated version of the MOI must be filed with a sworn statement by the director of a company, attorney or notary confirming that it is a true, accurate, updated and complete representation of the MOI.
- In the event of a conflict between a translated version of a MOI and the MOI, as altered or amended, the altered or amended version will prevail.
- In the event of a conflict between the altered or amended version of the MOI and its filed consolidated version, the consolidated version will prevail only if it has been ratified via a special resolution at a general shareholder's meeting of the company.
- In the event a conflict between the latest version of MOI endorsed by the commission or any other document purporting to be a MOI the latest version as endorsed by the commission will prevail.
- The act allows shareholder's of a company to enter into agreements with one another concerning the company.
- Such agreements must not be inconsistent with the Act and the company's MOI.
- If a provision is inconsistent with the Act or the MOI it is void to the extent of its inconsistency.
- Common law does not allow a person to act as an agent for a company that does not exist before incorporation.
- This may result in the company losing a chance to enter into beneficial contracts which present themselves prior to incorporation of a company.
- Section 21 allows pre-incorporation contracts to be entered into on behalf of a company which has yet to be incorporated.
- A pre-incorporation contract is a written 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 proposed company, with the intention or understanding that the proposed company will be incorporated and will thereafter be bound by the agreement.
- The contract must have been concluded in writing.
- The person that 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 incorporation process has been completed, the company does not ratify any part of the agreement.
- If a company, after incorporation does not ratify a contract but enters into a similar contract the joint and several liability will not apply.
- If a promoter uses common law alternatives eg. Contract for the benefit of a third party (*stipulatio alteri*), a trust or cession and delegation, this alternative has major advantage over a Section 21 contract because the promoter is not automatically liable if the company is not incorporated or does not ratify the contract.
- If there is a failure to ratify or reject a pre-incorporation contract after a three month period, the agreement will be deemed to have been ratified.
- If the agreement is partly rejected then the person who contracted will be liable for the rejected part.
- If the agreement is totally rejected then the person who concluded the contract is held liable entirely.
- If the contract is ratified by the company then the company is liable.

- If the person concluded the contract is liable, he or she only has a claim for counter performance in terms of the agreement.
- When choosing a company name one must avoid names that are offensive to people of a particular race, ethnic group, gender or religion.
- Mislead the public into believing that an associate exists.
- Names that amount to passing off.
- Passing off occurs when owners of names or other forms of intellectual property such as trademarks are used by other persons passing themselves off or coat-tailing on the owner's reputation or good standing.
- Common law prohibits passing off
- Form Cor9.1 must be completed and a filing fee must be paid to reserve a name.
- The name of a company may not:
  - ❖ Be the same company, external company, cc or the name of a business, a trademark or a mark, expression or word protected.
  - ❖ Be confusingly similar to a name, trademark, mark, word or expression
  - ❖ Give a false impression that the company is associated with government or with a particular person or government office.
  - ❖ May not contain a word, expression or symbol that may constitute propaganda for war, violence or hatred based on race, ethnicity, gender or religion or incitement to cause harm.
- Cannot use a shorted or translated name.
- A company is a foreign language name must be accompanied by a certified translation and certificate of translation.
- In terms of the Consumer Protection members of the public are required to register their business, trading name, sole proprietorship or partnership with the Commission.
- A name similar to another company, trademark or a name that gives the impression that it is associated with another company or state organ the Commission may compel the applicant to inform interested parties by serving them with a copy of the application for a name reservation.
- If the company's name is to be associated with another existing business the Commission will require proof from the applicant that the associated company was made aware before registration of the similar name is allowed.
- A person who has an interest in a name may apply to the Companies Tribunal for it to determine whether or not the name is accordance with the requirements of the Act.
- A registration number of a company can be used as the name of the company and it must be followed by the words "(South Africa)". Only profit companies can use this option.
- A name of a company can be in any language, consist of letters, numbers or punctuation marks and brackets.
- Name of the company must be followed by the appropriate expression for that type of company eg. Public company (Pty).
- Where the name to be registered is similar to another registered name, the Act allows the commission to make use of the company registration number as an interim name followed by the suffix of the type of that company.
- The company is then afforded another chance to file a Notice of Incorporation.
- A name may be reserved for future use as the name of a new company or the new of of an already incorporated company.
- An application must be filed and the prescribed fee must be paid.
- Commission will not reserve the name if it is the name of other company, given to an external company or already reserved.
- There is a six-month reservation period from the dae of application for reservation.
- Can reserve more than one name.
- Can transfer a reserved name to another party.
- Capacity of a company is the sphere of actions a company may legally perform.

- A contract is *ultra vires* the company when the conclusion of the transaction is beyond its legal capacity.
- *Ultra vires* doctrine is based on the understanding that a company exists in law only for the purpose for which it was incorporated.
- 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 (*ultra vires* doctrine).
- If members of a company find out about a proposed *ultra vires* contract it may interdict the company from entering into the contract before it is concluded.
- If an *ultra vires* contract has already been concluded the contract will be binding on the company.
- An action can be brought against the directors of the company who exceeded their powers for breaching their fiduciary duty.
- **Section 19(1)(b)** of the Companies Act of 2008 states that a company has all the legal capacity and the powers of an individual except to the extent that a juristic person is incapable of exercising any such power, for instance the capacity to enter into a marriage.
- The company's Memorandum may impose additional restrictions on the company's capacity. The capacity of a company is therefore no longer limited by its main or ancillary objects or business and these need not even be stated in the Memorandum of Incorporation.
- **Section 20** of the Companies Act 71 of 2008 determines that no transaction is invalid solely because it exceeds the company's capacity.
- Shareholders may ratify transaction that breaches a limitation, restriction or qualification by special resolution
- Shareholders, directors or prescribed officers may restrain a company from doing anything inconsistent with limitations, restrictions or qualifications, but:
  - ❖ May not prejudice the rights of third parties who contracted in good faith; and
  - ❖ Without actual knowledge of the limitation, restriction or qualification.
- Shareholders have a claim for damages against anyone who intentionally, fraudulently or due to gross negligence causes the company to act inconsistent with the Act or a limitation, restriction or qualification of capacity unless ratified by the general meeting
- 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 or her.
- 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 or she did have authority. This is referred to as ostensible or apparent authority.
- 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.
- The Act partly abolishes this doctrine.
- 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.
- The Act provides for two exceptions: firstly, a person is deemed to have knowledge of any provision of a company's Memorandum of Incorporation 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.
- 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.
- 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 following exceptions apply: if the outsider was aware of the fact that the requirements and procedures had not been complied with; or if the circumstances under which the contract was concluded were suspicious.
- The rule 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 effect, 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 the company's behalf. The company may still escape liability on the grounds that the person had no authority.
- 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.
- Estoppel applies only when the agent did not have actual authority to bind the company.
- Take particular note of the fact that the misrepresentation (ie. 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

- 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."
- To understand this definition, we should start by asking: What is a shareholder?
- 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.
- In terms of the Companies Act of 1973, shares could be issued with a nominal value attached for instance, a company could issue 100 shares with a nominal value of R1 each.
- These shares were known as par value shares.
- In terms of the new Companies Act, in future, no shares will be issued with a nominal value attached.

- Only the number of shares, not their value, must be authorised in a company's Memorandum of Incorporation.
- A company's Memorandum of Incorporation must set out the classes of shares and the number of each class that a company is authorised to issue.
- This is referred to as the company's "authorised share capital".
- A company may only issue shares 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.
- 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.
- If a company issues 100 shares and the price per share that a shareholder pays is R1, the company will have a share capital of R100. In other words, the company will have raised R100 to use in its business.
- After the initial issue, the share will be worth what the market is willing to pay for it.
- The decision in *Standard Bank of SA Ltd v Ocean Commodities Inc* provides the classical definition of a share in the view of the courts.
- A share usually entitles its holder to vote at a shareholders' meeting, to share in dividends if declared by the board and to share in any assets of the company after it has been wound up.
- Shares are divided into classes according to the specific rights 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 in the winding-up of the company after its creditors have been paid.
- The classes of shares most commonly found are preference, ordinary and deferred shares.
- Preference shares provide their holders with a preference over other shareholders to dividends, and/or return on capital on winding-up.
- One needs to consult the company's Memorandum of Incorporation as well as the terms of issue of the preference shares, to find out in which respect they confer a preference on their holders.
- If the preference shareholders have the right to receive dividends first, this right is usually subject to a dividend being declared.
- If the company has not made any profit, or if the directors decide instead to use profits in the business than to declare them as dividends, the preference shareholders do not have a right to demand a dividend payment.
- In return for the preferential rights to dividends, the right of preference shareholders to vote is usually curtailed in the Memorandum of Incorporation.
- Even if the Memorandum of Incorporation provides that preference shareholders do not have the right to vote, the Companies Act provides that they have an irrevocable right to vote on any proposal to amend the preferences, rights, limitations and other terms associated with their shares.
- There must always be at least one class of shareholders of the company that can vote at a meeting of shareholders and at least one class of shareholders that are entitled to the net assets of the company upon its liquidation.
- A company is not allowed to only issue preference shares that do not grant their holders the right to vote.
- The following types of preference shares can be distinguished:
  - . **Cumulative preference shares.** If a dividend is not declared in a specific year, the shareholder's right to a dividend is carried over to the next year. When a dividend is declared the next year, the preference shareholder will have to be paid two years' dividends before the ordinary shareholders can receive their dividends.

. *Participating preference shares.* After receiving their preference dividends, preference shareholders may be given the right to also receive normal dividends along with the ordinary shareholders or just after the ordinary shareholders.

. *Preferential right to capital on winding-up.* Preference shareholders could be given the preferential right to receive repayment of the capital they contributed to the company on its winding-up. In addition, they can be given the right to share in any surplus assets of the company upon its winding-up after receiving their capital contributions, but this is the exception rather than the rule.

. *Convertible preference shares.* The right to convert the preference shares to shares of another class after a certain date attaches to the preference shares.

- Ordinary shareholders usually receive dividends after the preference shareholders have received theirs.
- Ordinary shareholders also usually have the right to receive any of the company's surplus assets after it has been wound up.
- Ordinary shareholders normally have the right to vote at meetings of shareholders.
- This right may be curtailed in terms of the Companies Act, so that one class of ordinary shareholders will not have the right to vote.
- There must always be at least one class of shareholders with the right to vote and if there is only one class of shareholders, they must all have the right to vote.
- Occasionally, shares are issued to the founders of a company that entitle them to dividends, only if the dividend amount exceeds a certain threshold and after the ordinary shareholders have been paid
- Deferred shareholders are last in line to receive dividends.
- The Companies Act regards the issuing of 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 the shareholders' approval.
- 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 interrelated 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 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
- Pre-emption refers to new shares issued by the company.
- This means that when the company issues new shares, these 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 decides 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 had exercised rights of pre-emption, each of them would have been entitled to half of the 20 shares, and they would consequently retain the same voting power in the company.
- A debenture is an acknowledgment by a company that it 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 the debenture holders' behalf. 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.
- The concept of distributions was rather narrowly defined in the Companies Act of 1973.
- 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 company's shareholders.
- 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.
  - 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 a company's share capital
- Dividends are usually paid from the profits of a company.
- The board of directors decides how much of the profits they wish 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.
- In such circumstances, the shareholders are normally not entitled to dividends.

- Companies were originally required to maintain their share capital - 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.
- The maintenance of capital was gradually relaxed through amendments to the Companies Act of 1973.
- A company is allowed to repurchase its shares.
- This is considered a distribution, which means that the solvency and liquidity tests must be met.
- 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 the shareholder's 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 purchased will be paid at the earliest time that the company will still be able to fulfil 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.
- In terms of the Companies Act of 1973, a company was prohibited from providing financial assistance to a person to enable him or her to acquire shares or other securities in the company, except for a number of very specific exceptions.
- In terms 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 who 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 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.
- In *Lipschitz*, it was held that the transaction had to be assessed in two phases:
  - . **First**, it had to 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 would 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 would count as financial assistance. If the company buys an asset from the person 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 it 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 in order 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.
- The Companies Act of 2008, unlike the Companies Act of 1973, where a shareholder was also referred to as a member of the company, uses only the term "shareholder" in respect of a profit company.
- The term "member" of a company is reserved for non-profit companies that do not have shareholders.
- Hence there is now a definite difference in meaning between a member and a shareholder.
- A "shareholder" is defined as a person who is entitled to exercise any voting rights in relation to a company, irrespective of the form, title or nature of the securities to which those voting rights are attached.
- A company may provide for a shareholders' meeting to be conducted by electronic communication.
- Where a company allows for participation in a meeting by electronic communication, a notice convening the meeting must inform the shareholders or their proxies of the availability of the option to participate electronically. The shareholders bear the costs of participation.
- Section 62 provides that a notice must be in writing; must include the date, time and place of 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; must indicate the participants will be required to provide proof of identity at the meeting; must be accompanied by a copy of any proposed resolution that will be considered at the meeting; and notice of 10 days must be given before the date of the meeting.
- The proxy appointment should meet the following requirements:
  - . It must be in writing and signed by the shareholder.
  - . It must be valid for one year.
  - . It may be for a specific period of time.

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- . A proxy may delegate to another person authority to act on behalf of the shareholder.
- . 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 delivering a copy of the revocation to the proxy and the company.
- A shareholder may appoint more than one proxy.

- Shareholders could be invited by the company on the proxy appointment form to appoint a proxy from a list provided by the company.
- However, a shareholder is not obliged to choose one or more persons from the list.
- The appointment form should contain sufficient space for the shareholder to indicate whether the proxy will vote in favour of or against the resolution.
- 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.
- 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.
- However, in English and South African case law, the common law rule of unanimous assent was accepted.
- 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 they all 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* 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.
- The situation has now been changed by the Companies Act of 2008.
- 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.
- 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 means of this procedure.
- The shareholders of Zithulele (Pty) Ltd may elect a director without having a formal meeting, by written polling of all shareholders entitled to vote on his or her election.
- The company must deliver a statement within ten business days after adopting the resolution, describing the results of the vote, consent process or election to every shareholder entitled to vote on the resolution.
- 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:
  - . the election of directors to the extent required by the Act or the company's Memorandum of Incorporation
  - . the appointment of an auditor for the following financial year
  - . the appointment of an audit committee
  - . the presentation of the directors' report

- . the presentation of audited financial statements for the immediately preceding financial year
- . the presentation of an audit committee report
- . any matter raised by shareholders
- Section 61(11), has to do with the situation in which the company is unable to convene a meeting because it has no directors or all its directors are incapacitated.
- The second situation is regulated by section 61(12), which applies to the situation in which a company, for reasons other than those covered by section 61(11), fails to convene its annual general meeting or a meeting required by its Memorandum of Incorporation or shareholders.
- **Note that a quorum is required for the meeting to begin, as well as for the consideration of each specific matter.**
- Section 64 provides that a meeting may not begin until sufficient persons holding at least 25% of all the voting rights are present.
- If a company has more than two shareholders at least three shareholders must be present.
- Since three shareholders are present and hold 30% of the voting rights, a quorum is present and the meeting may commence.
- Note the difference in the number of votes that may be exercised, depending on whether voting takes place by a show of hands or a poll.
- A person who abstains or fails to exercise his or her voting rights on a resolution will be deemed to have voted against the resolution.
- This statement is not based on any provision of the Act, and must also not be taken to mean that an abstention vote will be taken into consideration when determining whether a resolution has been adopted.
- 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.
- Since the shareholders of Zithulele Ltd are voting by way of a poll, a shareholder or his or her proxy will exercise all the voting rights attached to the shares.
- The required percentage of votes that may be exercised on a resolution is present (at least 25%).
- Only the votes exercised on a resolution are taken into consideration.
- Since only 30% of the voting rights will be exercised, more than half of them, that is, more than 15% of the total voting rights, will have to be exercised in favour of the resolution to have it validly adopted.
- Three possible situations are discussed under this heading.
- Briefly summarised, they are as follows:
  - (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.
- Where every shareholder is also a director of a company, they 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 of Incorporation provides otherwise.



- All the directors must be present at the board meeting when the matter is referred to them in their capacity as shareholders.
- A quorum must be present at the meeting and the resolution passed must be accepted for it to be either an ordinary or special resolution.
- All the shareholders of Zithulele (Pty) Ltd 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 of Incorporation provides otherwise.
- The Companies Act of 2008 like the Companies Act of 1973, also provides for two types of resolutions that may be taken in a shareholders' meeting, namely an ordinary resolution, requiring more than 50% of the votes exercised, and a special resolution, requiring at least 75% of the voting rights exercised.
- The primary difference is that the Companies Act of 2008 allows a company to stipulate a higher percentage for approval of all or some ordinary resolutions in its Memorandum of Incorporation (except one for the removal of a director), or a lower percentage for a special resolution, on condition that there must always be a difference of at least 10% between the percentages required for an ordinary and a special resolution.
- **Ordinary resolution**
  - . It requires more than 50% of the voting rights exercised.
  - . The Memorandum of Incorporation 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**
  - . It requires at least 75% of the voting rights exercised.
  - . The Memorandum of Incorporation 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.
- A special resolution is compulsory for certain resolutions stipulated in the Act but may also be required by the Memorandum of Incorporation
- A meeting may be adjourned for a week if within an hour of the scheduled starting time if the quorum is not formed.
- May extend the one-hour limit, where the quorum is not formed at the scheduled starting time on the grounds that exceptional circumstances exist.
- A notice of adjournment will only be given if the location of the adjourned meeting is different.
- Shareholders may agree on different periods in the Memorandum of Incorporation and alter the one-hour rule and the one-week adjournment.
- 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.
- **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 he or she has given his or her written consent to serve as a director
  - . after having been appointed or elected or holding office in accordance with the provisions of section 66 of the Companies Act
- Different **types of directors** have been recognised by both the *King Code* and the Companies Act.
- The textbook refers to the *King II Report* of 2002 but there is also now a third *King Report on Corporate Governance (King III)* which became effective in September 2009 but does not differ substantially from its predecessor.
- King Codes are not law.
- They do not have the force of law and are therefore not enforceable, except for provisions that have been included in an Act or have been made compulsory in

another way, say, by being included in the listing requirements of the JSE Ltd for companies wishing to list on the stock exchange.

- They are guidelines to indicate the principles that a company should adhere to for purposes of good governance.
- The **King Code** differentiates between the following three types of directors:
  - . executive directors
  - . non-executive directors
  - . independent directors
- The court in *Howard v Herrigel* held that it is unhelpful or even misleading to classify company directors as "executive" or "nonexecutive" **for the 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 a 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 "nonexecutive" 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
- 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 regard to, *inter alia*, leadership, decision making and their respective duties and responsibilities.
- The boards of directors, are responsible for the leadership and direction of a company, while the managers have to implement the strategy on the directors' behalf.
- Directors are also responsible for organisational decision making, while managers are concerned with the implementation of such decisions and policies.
- The different types of companies should each have a specified minimum number of directors in terms of the Companies Act.
- A person becomes a director of a company when he or she 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 him or her 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.
- Certain provisions of the Act, including some in respect of directors, may be changed by the provisions of a company's Memorandum of Incorporation, while others may not.
- In terms of its Memorandum of Incorporation, a public company may specify a higher number than the minimum number of directors required in terms of the Act.
- Locke Ltd may therefore require that a minimum of six directors be appointed.
- Section 66(4) of the Act provides that the Memorandum of Incorporation of a profit company must provide that the shareholders will be entitled to elect at least 50% of any alternate directors.
- The provision stating that the shareholders will only be allowed to elect at least 30% of the alternate directors is therefore invalid.
- A company's Memorandum of Incorporation may provide for the payment of remuneration to its directors and the term of office.
- Clauses 3 and 4 of the Memorandum of Incorporation will thus be valid.
- Certain people are **ineligible** to be appointed as a director of a company, while certain people are **disqualified**.

- **Note:** If a person is ineligible to be appointed as a director, he or she is absolutely prohibited from becoming a director, without any exceptions.
- If a person is **disqualified** from being appointed as a director this means that, with the exception of a person who has been prohibited from being a director by a court of law, a person may still be appointed as a director of a company with the permission of the court.
- The other disqualifications are thus **not absolute because** the court has discretion on application to allow such disqualified persons to be appointed as directors.
- A court may exempt certain disqualified persons from the disqualification.
- Where the applicant was removed from an office of trust for misconduct relating to dishonesty, he or she will have to prove that he or she has been rehabilitated from his or her wrongful ways and can be trusted with the responsibilities of a director.
- In order for the court to determine whether the applicant is honest and trustworthy, certain factors will be considered such as the nature of the offence and the circumstances under which it was committed.
- The court correctly held in the Ex Parte Barron case that it could be more lenient in a case where a private company is affected than where a public company is affected.
- This is because a director of a public company deals with funds in which a vast number of people are involved.
- Such a director should obviously be under more scrutiny than a director of a private company.
- The power given to a court to declare a director either delinquent or under probation was 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 or she will subsequently be either unconditionally disqualified from being a director for the rest of his or her life, or disqualified for a period of at least seven years and subject to any conditions the court considers appropriate.
- An order of probation, however, 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 programme.
- A company (Centro Pharmaceuticals (Pty) Ltd) can apply to a court of law for an order to have a director declared delinquent.
  - . Garry 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 considers appropriate and will be for at least seven years from the date of the order.
- Note that 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.
- Also note that 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
- Steven will be able to apply for the suspension of the order of delinquency because three years have elapsed since the order of delinquency was made and the order was not based on one of the two grounds which would have resulted in an unconditional declaration subsisting for his lifetime.
- He will, however, have to satisfy the court that he has rehabilitated himself and has met all the conditions of his court order.
- 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 the vacancies.
- A vacancy will arise on the board of a company if, say, a director resigns, dies or is unable to perform his or her duties as director.
- A resignation becomes effective once it has been communicated to a company, irrespective of whether it was only subsequently accepted.

- 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.
- A director can be removed by the 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 board's determination. 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.
- 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 a committee.
- A director will still remain liable for the proper performance of his or her duties despite the delegation of a duty to a committee.
- In terms of the Companies Act 71 of 2008, the Minister of Trade and Industry may prescribe that a company or a certain category of company must have a social and ethics committee.
- Every public or state-owned company must appoint an audit committee of at least three members
- The *King Code* also proposed that board committees should be established to assist the directors by giving detailed attention to important areas. Examples of such committees include an audit committee and a remuneration committee.
- 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 in the specific area of expertise.
- Board meetings may be called by the directors authorised to do so.
- 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 chairperson has a deciding vote in the event of a tie.
- At a meeting, minutes must be kept of all decisions and any resolution taken by the board.
- 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.
- 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.
- 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 the 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
- **Briefly summarised, the newly codified duties of directors in the Companies Act of 2008 are as follows:**
  - (1) To disclose to the board any personal financial interest in matters of the company
  - (2) Not to use the position of director or information obtained as director to gain an advantage for himself or herself or another person, or to knowingly cause harm to the company or a subsidiary
  - (3) To disclose to the board of directors any material information that comes to a director's attention
  - (4) To act in good faith and for a proper purpose
  - (5) To act in the best interests of the company
  - (6) To act with a reasonable degree of care, skill and
- The provisions in the Companies Act of 2008 are subject to and not in substitution of any of the duties of directors under the common law.
- When interpreting the provisions of the Companies Act, the courts may still have regard to the common law, including past case law.
- The prescribed case law is therefore still of great value and should be taken into account when studying the Act.
- It should also be kept in mind that the provisions in the Companies Act relating to directors' duties, are a partial codification (adopting the general principles while allowing some room for the development of the common law) of the company law.
- 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 or she 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 or she 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 he or she may not be present or participate in the discussion.
- A director may also make an advance general disclosure of his or her personal financial interests to the shareholders or board, as the case may be.
- In terms of section 76 (2) (a) of the Companies Act of 2008, a director may not abuse his or her position as director, or information obtained while acting as a director, to gain an advantage for himself or herself 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 duty of a director is to disclose any information that comes to his or her attention, subject to the exceptions.
- In the case of *Regal Hastings Ltd v* the court held that directors should avoid placing themselves in a position where their duty to the company conflicts with their own interests.
- This was also the stance of the court in the case of *Robinson v Randfontein Estate Gold Mining Co Ltd* where the court held the following: "Where one man stands to another in a position of confidence involving a duty to protect the interest of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his personal interest conflict with his duty".
- There are limits to the duties that a director owes to his or her company.
- The court held in *Gheri and Others v Timber Developments (Pty) Ltd and Others* that the facts of each case are important in determining whether or not a person has acted in breach of the fiduciary duty owed to his or her company.
- A director should not abuse his or her position as director or misuse any information obtained as director.
- He or she must prevent a conflict arising between his or her own interests and those of the company.

- This means that a director may not for personal gain make use of any information he or she has acquired in his or her capacity as a director.
- 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.
- The textbook focuses on the duty to act with care, skill and diligence, but the duties to act in good faith and for a proper purpose, and in the best interests of the company, are equally important.
- Whereas the duty to act in the best interests of the company speaks for itself, the duty to act for a proper purpose perhaps merits further explanation.
- This is one of the fiduciary duties recognised in terms of our common law as well, and requires that directors should use their powers for the real or true purpose for which these powers were given.
- One example of a breach of this duty that has often occurred in practice, is where boards issued shares to dilute the voting rights of other shareholders or obtain more votes for themselves to ensure their continued control over the company, instead of using this power for its real purpose, namely to obtain more capital for the company.
- Regarding the duty to act with care and skill, the court held that 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, say, an electrician by trade.
- The Companies Act introduced what is called the business judgment rule
- 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 he or she
  - . 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
- 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 of the provisions of the Companies Act or the company's Memorandum of Incorporation
- The first item in this list refers to the liability of a director for breaching the newly codified common-law duties.
- The remaining influence of the common law is clear when looking at this liability because the Act states that for a breach of the first five duties in the list a director will be held liable in accordance with the common-law principles relating to breach of a fiduciary duty, while for a breach of the duty of care, skill and diligence, liability will be on the basis of the common-law principles of delict.
- 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 wilful misconduct or wilful breach of trust, provided it appears to the court that the director acted honestly and reasonably.

- You will note that quite a lot is expected of a director.
- However, directors who act honestly and reasonably will not be held liable for losses or damage suffered by the company.
- 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.
- Indemnity insurance may also not be taken out for such circumstances.
- 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.
- The Companies Act makes it 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.
- Thus the board of directors should be advised that the provisions purporting to exempt directors from liability in all instances except where gross negligence was present, are void.
- Compulsory disclosure of financial information concerning the company plays a vital role in protecting the interests of shareholders, investors and creditors.
- In order to undertake certain projects, companies usually depend on capital investments made by members of the public.
- Members of the public may purchase shares or debentures in the company or advance loans.
- Investors and financiers are usually unwilling to invest or lend money unless there is proper financial reporting and disclosure of how the company's funds are applied.
- The availability of reliable financial information on the company's affairs is conducive to a healthy economic climate.
- The whole aim of a company's financial statements is to inform the existing shareholders, as well as prospective investors in the company, of its financial standing.
- The financial statements reflect the company's general financial state.
- They disclose whether its assets exceed its liabilities, whether it has sufficient liquid funds and the extent of its working capital (liquid assets as well as credit facilities).
- The annual financial statements which must be placed before the annual general meeting consist of the following:
  - . a balance sheet
  - . an income statement
  - . a statement of cash flow information
  - . a directors' report
  - . an auditor's report
- The law regulating the disclosure of financial information and the auditing profession is incorporated in the Companies Act 71 of 2008 and the Auditing Profession Act 26 of 2005.
- The Companies Act 71 of 2008 contains a number of sections which regulate a company's financial disclosures and maintenance of accounting records.
- The Companies Act imposes certain minimum financial disclosure requirements on all companies and more stringent disclosure requirements on public companies and certain private companies.
- The Companies Act stipulates a number of records that the company must maintain, including copies of all accounting records for the current and previous seven financial years.
- In terms of section 28, a company is required to keep accurate and complete accounting records, in one of the official languages, as necessary to enable the company to satisfy its obligations under the Companies Act and any other law with respect to the preparation of financial statements
- The accounting records must be kept in the prescribed manner and form and must be kept at or be accessible from the company's registered office.

- The type of accounting records which a company must maintain depends on factors such as the type of company, its purpose and the nature and extent of its activities.
- Section 29 of the Companies Act states that a company's financial statements must satisfy the financial reporting standards, present fairly the state of affairs and business of the company and explain the transactions and financial position of the company's business.
- The financial statements must also show the company's assets, liabilities and equity, as well as its income and expenses and any other prescribed information.
- Section 30 of the Companies Act requires all public or state-owned enterprises to prepare annual financial statements within six months after the end of its financial year.
- The annual financial statements must include an auditor's report
- In terms of section 44 of the Auditing Profession Act 26 of 2005, it is an auditor's duty to examine a company's financial statements and accounting records and to express an opinion on 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 a company's financial condition and past performance, an auditor fulfils a vital role in reinforcing the reliability of financial information.
- The *Thoroughbred Breeders* case would probably be decided differently today.
- The Supreme Court of Appeal held that, although the negligence of the Breeders' Association had also contributed to their loss, their claim against the auditors was based on contract, and the Apportionment of Damages Act only applied to claims based on delict.
- However, in terms of section 58(2) of the Auditing Profession Act, which was enacted after the *Thoroughbred Breeders' Association* case, contributory negligence now applies to claims based on either delict or contract.
- This section provides that in respect of damages suffered by any person as a result of an act or omission of a registered auditor, the reference in the Apportionment of Damages Act 1956 to "damage" must also be construed as a reference to damage caused by a breach, by the registered auditor, of a term of a contract concluded with the registered 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 nonprofit companies are not required under the Companies Act to appoint an auditor, but may do so voluntarily.
- The Companies Act requires that 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.
- The auditor may be an individual person or a firm and is appointed by a company by way of a contract.
- In companies with an audit committee, the audit committee is required in terms of section 94(7) of the Companies Act, to nominate for appointment a registered



auditor who is independent of the company and determine the auditor's fees and terms of engagement.

- Only a registered auditor may be appointed as auditor of a company.
- In terms of section 37 of the Auditing Profession Act, only persons who have complied with the prescribed education, training and competency requirements; have made arrangements regarding his or her continued professional development where that individual is not a member of an accredited professional body; is a 'fit and proper person' to act as an auditor; and is resident within South Africa, may be registered as an auditor.
- The Auditing Profession Act states further in section 37(3) that any person who has been removed from an office of trust due to misconduct, has been convicted of theft, fraud or forgery or other act of dishonesty or corruption or has been declared by a court to be of unsound mind and unable to manage his or her own affairs, may not be registered as an auditor.
- To ensure a required level of skill and that the auditor is independent of the company he or she is auditing, the Companies Act disqualifies certain persons from being appointed as the auditor of a company.
- Such persons include 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.
- An auditor may resign at any time during his or her period of office.
- The resignation is effective when the notice of resignation is filed.
- The board of Moonblue Ltd must appoint a new auditor to replace Daniel within 40 business days after the filing of his resignation.
- Since Moonblue Ltd is a public company, it is required to have an audit committee.
- Prior to making an appointment, the board must propose to the audit committee of Moonblue Ltd, within 15 business days after the vacancy occurs, the name of at least one registered auditor to be considered to replace Daniel as auditor.
- The board of Moonblue Ltd may appoint the person proposed if, within five business days of making the proposal, the audit committee does not give notice in writing to the board rejecting the proposed auditor.
- Section 92 of the Companies Act makes provision for the 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 or private companies.
- The Companies Act provides that if an individual has served as an auditor of a company for two or more consecutive financial years and then ceases to be the auditor, that individual may not be reappointed as auditor of that company until after the expiry of at least two further financial years.
- Given would therefore not be able to be reappointed as auditor of Moonblue Ltd after a six-month period.
- Section 93 of the Companies Act provides that at all times, the company auditor has a right to access the company's accounting records as well as all books and documents.
- The auditor may attend any general meeting held by the company.
- 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 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 provides that at all times, the company auditor has a right to access all the company's accounting records and books and documents.
- 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 is further entitled to 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 wilfully 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.
- Section 94 of the Companies Act requires that 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 company's day-to-day management in the preceding three financial years.
- 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 who is knowledgeable or experienced in the relevant laws
- A private company, personal liability company or a nonprofit 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
- 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
- Every company secretary must be a permanent resident of the Republic, and must remain so while serving in that capacity.
- A person who is disqualified to serve as a director of a company, may not be appointed as a company secretary
- In a nutshell, a person is therefore disqualified from being appointed as a company secretary if such a person –
  - . 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,

- Section 87 provides that a juristic person or partnership may be appointed to hold the office of company secretary, provided that every employee of that juristic person, or partner and employee of that partnership, as the case maybe, 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.
- Section 33(3) provides that every company must designate a director, employee or other person as the company's compliance officer in this annual return.
- In the case of a company with a company secretary, he or she will thus automatically be the compliance officer.
- Section 88 provides that a company secretary is accountable to the company's board.
- The company secretary's duties include, but are not restricted to the following:
  - . 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) (ie the person responsible for filing the company's annual return).
- In terms of section 89(1), a company secretary may resign from office by giving the company one month's written notice, or, with the approval of the board, less than one month's 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.
- You should advise Mike that, under section 86 of the Companies Act, a public company is obliged to appoint a company secretary.
- Since it is apparent that Oak Ridge Ltd is a public company, a secretary must be appointed. The duties of a company secretary as set out in section 88 must be explained, and you should also explain that this is not a comprehensive list of duties.
- The secretary is usually the chief administrative officer of the company, but is not involved in the management of the company.
- His or her specific duties will vary in scope and nature according to the size of the company, the nature of its activities and the function that the directors assign to the secretary.
- The secretary should be appointed by the directors of an existing company.
- The first secretary (ie of a new company) should be appointed as provided in section 86
- In addition to the record of company secretaries and auditors that a company must keep section 85 of the Companies Act also requires every company that appoints a company secretary or auditor 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) allows the incorporators of a company to file a notice of the appointment of the company's first company secretary as part of the company's Notice of Incorporation.

- 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).
- Since the common-law derivative action was unsatisfactory for a number of reasons, section 266 of the 1973 Act introduced a statutory derivative action as an alternative to the common-law remedy.
- *Thurgood v Dirk Kruger Traders (Pty) Ltd* 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.
- The second category concerns statutory remedies for shareholders.
- Three remedies can be classified under this category, namely relief from oppressive or prejudicial conduct in terms of section 163, dissenting shareholders' appraisal rights in terms of section 164 and an application in terms of section 161 to protect the rights of the holders of securities.
- 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 that 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* 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)* in the is an example of a situation in which section 252 would have brought appropriate relief.
- 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, referred to as dissenting shareholders' appraisal rights.
  - . An appraisal right is the right of a shareholder to require his or her company to buy his or her shares at their fair value if his or her company takes any of the listed triggering actions.
  - . A specific procedure must be followed by the shareholder once his or her company has taken a triggering action. The holder of issued securities may apply to court for a declaratory order regarding his or her rights.
  - . Alternatively, the holder of the securities can apply for an appropriate order to protect his or her rights or to rectify any harm done to him or her 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.

- The third category refers to the liability for abuse of the separate juristic personality of a company.
- Effectively, this remedy refers to the lifting of the corporate veil and the consequent imposition of personal liability if the separate juristic personality of a company has been abused.
- The court may declare that the company is to be deemed not to be a juristic person in certain respects.
- The 2008 Act, unlike the 1973 Act which extensively provided for criminal sanctions, 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 with regard to 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, and so forth.
- 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.
- The Close Corporations Act 69 of 1984 introduced a new and cheaper option for the incorporation of small enterprises.
- The Act combines some of the partnership attributes with the corporate attributes of legal personality and limited liability.
- It provides a simple, inexpensive and flexible form of incorporation for the enterprise consisting of a single entrepreneur or small number of participants.
- The aim was to deregulate the system of incorporation of enterprises and to create an enabling business environment for the South African small business sector.
- A close corporation, like a company, acquires legal personality upon incorporation.
- A legal person is regarded as an entity that can acquire rights and duties separate from its members.
- Close corporations also enjoy perpetual succession, which means that, unlike partnerships, close corporations remain in existence even if the members should change.
- Clearly, with all the benefits attached to incorporation, in addition to the fact that running the business is unstifled by onerous regulation, entrepreneurs and owners of micro- and small businesses were presented with a most viable option appropriate to their business.
- Although it cannot be said that the future of close corporations is under threat, with the inception of the New Companies Act 2008, this business form will no longer be an option for businesses.
- Although existing close corporations will continue to exist alongside companies, no further registrations in terms of the Close Corporations Act will be permitted.
- *Legal personality*: Also known as juristic personality. To be acknowledged in law as a person/ bearer of its own rights, with liability for its own debts.

- *Founding statement* (Form CK 1): Constitutive/ registration document for close corporations.
- *Perpetual succession*: Indicating independence from the members of the close corporation.
- The close corporation will continue to exist even if the members should change.
- In the case of close corporations, separate legal personality is acquired upon registration of the founding statement.
- Close corporations also enjoy perpetual succession, which means that the entity exists separately from its members and changes in membership will not influence its future existence.
- Sometimes the court may be called upon to "pierce the corporate veil" or disregard the separate legal personality of the close corporation.
- Close corporations are a simpler, cheaper option specifically aimed at entrepreneurs and small businesses.
- A close corporation enjoys separate legal personality and will therefore generally be liable for its own debts.
- However, there are instances in which the courts will disregard the juristic personality of a close corporation.
- Existing close corporations will continue to exist, but after the promulgation of the new Companies Act, new close corporations can no longer be formed.
- Danny will not be able to form a new close corporation.
- He needs to make use of one of the business forms allowed by the new Companies Act.
- *Testamentary trust*: A trust established in a will which will come into operation after the death of the testator.
- *Trust inter vivos* a trust established by someone during the person's life.
- Since close corporations were intended mainly for small businesses, the number of members is limited to ten.
- Because only natural persons are permitted to be members of a close corporation, juristic persons are excluded from membership.
- A company or another close corporation may not be a member of a close corporation.
- A minor, insolvent or person under legal disability may become or remain a member of a close corporation with the necessary assistance from a guardian, trustee or the court.
- A trustee, in his or her capacity as trustee of a testamentary or *inter vivos* trust, may become a member of a close corporation.
- However, the restriction in membership to the maximum of ten members still applies.
- Should the membership in a close corporation change, an amended founding statement must be lodged for registration.
- Most natural persons may become members of a close corporation.
- 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.
- However, no juristic person (ie another close corporation or a company) may 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 who is disqualified from membership become a member, he or she bears the risk of being held personally liable for all the close corporation's debts.
- *Founding statement* (Form CK 1): The only constitutive document required for registration of a close corporation.

- **Amended founding statement** (Form CK 2): The document which must be lodged should particulars of members or the business change after registration of the founding statement.
- **Member's contribution:** A contribution must be made by each member. It can consist of money, a thing or services contributing to the business of the close corporation.
- Before a close corporation can be registered, a name has to be reserved.
- After name reservation, the founding statement must be lodged in triplicate at the registration offices (CIPRO), accompanied by a letter of the accounting officer accepting his or her appointment as such and payment of the prescribed fee.
- The founding statement indicates the following particulars of the business:
  - (1) the full name/translations any abbreviation of the business name
  - (2) the principal business
  - (3) the number of members
  - (4) the date of the end of the financial bookyear
  - (5) the aggregate members' contribution
  - (6) the postal address
  - (7) the address of the registered office
  - (8) the name and postal address of the accounting officer
  - (9) particulars of the founding members (names, copies of IDs and addresses).
  - (10) member's interest of each member expressed as a percentage.
- After registration, the Registrar certifies the Certificate of Incorporation.
- Should any of the particulars in the founding statement change after its registration, an amended founding statement must be lodged.
- Each founding member is required to sign the founding statement or provide written authorisation (a power of attorney) for it to be signed on his or her 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 he or she signs the document.
- The purpose of registration of close corporations is mainly for the purpose of name reservation.
- The founding statement is not a public document. The doctrine of constructive notice is therefore not applicable to close corporations.
- **NOTE: The following transitional provisions apply:**
- After the coming into effect 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.
- A close corporation is distinct from a partnership in various ways.
- Close corporations are registered by one to ten natural persons, whereas partnerships are formed by an agreement between two or more persons (up to an unlimited number once the Companies Act 2008 comes into effect).
- Upon registration, a close corporation acquires separate legal personality.
- Unlike in partnerships, where no legal personality exists, the existence of a close corporation will not be terminated by changes in membership, insolvency or the personal circumstances of its members.
- A close corporation also holds its asset separate from its members and is therefore not severely affected should the estate of a member be sequestered.
- To become a member of a close corporation, the prospective member has to make a contribution in the form of money or assets or anything with an economic value, or acquire an existing member's interest.
- Because a member's interest is part of a member's estate, it can be sold or bequeathed in a will.
- If a member dies, the remaining members must consent to the transfer of the member's interest to the legatee, otherwise the member's interest must be sold subject to a pre-emption in favour of the corporation and other members.

- A member's interest is expressed as a percentage (out of a total of 100%) in the founding statement.
  - . A member's interest may not be jointly held.
  - . The aggregate members' interests must at all times be 100%. A member's interest in a close corporation is similar to a share in a company.
  - . A member's interest is an incorporeal moveable thing.
  - . A member's interest is a personal right to share in the profits of the close corporation after its creditors have been paid. A member's interest can be acquired by becoming a member upon registration of the founding statement acquiring a member's interest from existing members
  - . making a contribution to the close corporation
- Since a close corporation is intended for small businesses with few members in a close relationship with one another, changes in membership may have an extremely negative effect on the operations of the business.
- Hence the members largely control the disposal of a member's interest..
- Note the following requirements for disposal of a member's interest:
  - . The process must be made in accordance with the association agreement. or
  - . All the members must consent. Because a member's interest is part of his or her estate and has an economic value, it is essential to establish the manner in which it will be dealt with should the member die, become insolvent or if judgment is taken against a member by his or her creditors.
- 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.
- Section 34(1) of the Close Corporations Act 69 of 1984 prescribes a mandatory procedure for the disposal of an insolvent member's interest.
- The purpose is to balance the rights of the other members with the rights of creditors of the insolvent member's estate.
- 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.
- Section 34A of the Close Corporations Act applies in instances where a member's interest is attached after judgment is taken against a member.
- 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.
- Members owe the following two duties to the close corporation:
  - (1) a fiduciary duty (duty of good faith) in terms of section 42 of the Close Corporations Act 69 of 1984
  - (2) a duty of care and skill
- A member's fiduciary duties towards the close corporation are similar to the fiduciary duties 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
- Note the following with regard to **contracts concluded between a member and a close corporation**
- As indicated above, a member of a close corporation is in a fiduciary relationship to the close corporation and the other members of the close corporation.
- Should a member have a material interest in a contract of the close corporation, it must be disclosed to the other members and all material facts regarding the interest must be divulged as soon as possible.
- Should a member fail to disclose his or her interest, the contract would be 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.
- In the event that 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
- The member would in such an event have to repay any profit made by him or her.
- Note the following regarding **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.
- However, personal liability can 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.
- A member will be liable only if the close corporation suffers a loss as a result of the breach of this duty
- The member's conduct is 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).
- In case of a breach, another member may institute action against the close corporation or its members in his or her personal capacity.
- the contract would be voidable at the option of the close corporation.
- However, if the member disclosed his interest and made all material facts known to the other members, the contract could be valid.
- The member has also acquired a financial gain in competition with the close corporation
- You can now conclude that this may be a breach of the member's fiduciary duty.
- In this set of facts, no such disclosure had taken place.
- The close corporation can thus reclaim the benefit the member acquired.
- Note the following with regard to **section 50 of the Close Corporations Act 69 of 1984:**
- This section provides for an action to be instituted by a member against 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.
- This is thus a statutory derivative action.
- The duties of members of a close corporation are similar to those of directors of companies.
- Members must act in good faith and perform their functions with a reasonable degree of care and skill.
- If a member breaches his or her duty any other member may institute proceedings against such member on behalf of the close corporation.

- The fact that the person instituting the action will be liable for the legal costs if the claim is unsuccessful and found to have been without prima facie grounds, is aimed at preventing abuse
- Note the following two remedies for members against other members: section 36: order of court terminating membership (2) section 49: assistance from court regarding unfairly prejudicial conduct
- 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.
- *Solvency*: The corporation's assets, fairly valued, must exceed its liabilities.
- *Liquidity*: The corporation must be able to and remain able to pay its debts as they become due in the normal course of business. It is possible for a close corporation to acquire a member's interest from one of its members.
- Note the following **requirements for acquisition of member's interest by a close corporation**:
  - . The close corporation must have at least one other member.
  - . The aggregate members' interests must remain 100%.
  - . There must be written consent from all members prior to payment.
  - . The corporation must be solvent and liquid.
- It is also possible for a close corporation to render financial assistance to a person to enable him or her to acquire a member's interest in the close corporation.
- In order to do so, section 40 of the Close Corporations Act 69 of 1984 require prior written consent from every member
  - . solvency and liquidity of the close corporation
- *Association agreements*: This a noncompulsory agreement to arrange internal affairs within the close corporation.
- *Internal relationships*: These are the relationships between members *inter se* (amongst each other) and the relationship between the close corporation and its members.
- Although it is advisable for members to conclude such an agreement, it is not compulsory. The internal relations between members may be regulated by an association agreement. The members of the corporation may change provisions to suit their specific needs in an association agreement on condition that it is not inconsistent with the Act.
- They may arrange
  - . the rights of the members to conduct business and manage the close corporation
  - . the requirements for making a decision and voting
  - . the procedure and proportions of payments to members
- An association agreement is not lodged with the Registrar and is not a public document. However, should such an agreement be concluded, it must be held at the registered offices of the business.
- Close corporations have only one compulsory constitutive document, namely the founding statement.
- Although association agreements are optional, it is preferable for members to conclude such an agreement to regulate internal relationships in the management of the business.
- An association agreement must be in writing and signed by or on behalf of each member.
- This document is not viewed as a public document and only members may inspect it.
- In the association agreement, the members may agree how the corporation will be managed, how decisions will be taken and establish the proportion of payments to members.

- No stipulation in contravention of the Close Corporations Act, which is included in the association agreement, will be valid.
- The Close Corporation Act clearly sets out certain issues that may not be varied by any agreement between the members.
- A clause stating that certain members will not be permitted to call a meeting, or allowing disqualified members to participate in the management, or specifying how the member's interest of an insolvent member will be disposed of will therefore be void.
- 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. This means that even if the association agreement (which is in any event not a public document) states otherwise, every member can conclude contracts on the corporation's behalf. It does not matter whether or not the transaction falls within the scope of the corporation's main business.
- A close corporation will therefore be bound to most agreements concluded on its behalf by its members. However, corporations will not be held liable if the 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.
- Note that section 51 applies only to instances where payments are made to members in their capacity as members and not if the payment is made to a member in his or her capacity as creditor.
- Before any type of distribution can be made to members in their capacity as members, the requirements set out in section 51 must be adhered to. If a payment has to be made to a member in his or her capacity as a creditor, these principles will not apply.
- Should a creditor claim payment when it is due and payable, the close corporation will be liable.
- Should the close corporation be unable to pay, such creditor may apply for the winding up of the corporation.
- The Close Corporations Act contains a prohibition against the provision of loans and security to members. Only if all the other members consent in writing may such loan or security be extended. Should the requirements of section 52 not be adhered to, any loan or security provided will be invalid and members who permitted the transaction will incur liability.
- Close corporations are not exempt from financial reporting.
- An annual financial statement must be drawn up. The annual financial statement must be approved by or on behalf of members holding at least 51% of the members' interest in the close corporation. The appointed accounting officer must compile a report.
- A close corporation need not appoint an auditor. However, it must appoint an accounting officer.
- 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 crucial reporting function.
- If an accounting officer becomes aware of irregularities in the accounting policies or practices in the corporation, he or she must disclose this information to the members.
- The Registrar must also be informed if the accounting officer is removed, the corporation is not conducting business or if its liabilities exceed its assets at the end of the financial year.
- A close corporation is a separate legal person. Despite this fact, the court at times may "pierce the corporate veil" to hold the guilty parties liable.

- In some instances the members and/or other guilty parties (such as the accounting officer) incur personal liability (and in other circumstances they are held jointly liable for the losses incurred as a result of their actions).
- 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.

#### *Salomon v Salomon & Co Ltd:*

- Estate of the company is assessed separately from the estates of individual shareholders or members
- Debts of the company are the company's debts and separate from those of its shareholders or members.
- Shareholders/members enjoy limited liability;
- Profits of the company belong to the company and not its shareholders
- Only after the company has declared a dividend may the shareholders claim that dividend
- Assets of the company are its exclusive property and the shareholders have no proportionate proprietary rights therein

No one is qualified by virtue of his or her shareholding to act on behalf of the company. Only those who are appointed as representatives of the company in accordance with the articles (which has been replaced by the Memorandum of Incorporation) can bind the company.

#### *ABSA Bank Ltd v Bignaut and Another and Four Similar Cases*

The **branches or divisions** of a company are part of the company itself and do **not have their own separate legal existence**.

*Dadoo Ltd and others v Krugersdorp Municipal Council* held the following:

*"...This conception of the existence of a company as a separate entity distinct from its shareholders is no merely artificial and technical thing. It is a matter of substance; ... cases may arise concerning the existence or attributes which in the nature of things cannot be associated with a purely legal persona. And then it may be necessary to look behind the company and pay regard to the personality of the shareholders, who compose it."*

#### *Botha v Van Niekerk*

- The seller must have suffered an "unconscionable injustice" before the court could lift the veil

#### *Cape Pacific*

- The court confirmed it has no general discretion simply to disregard a company's separate legal personality.
- The separate legal personality of a company should not be easily ignored.
- Circumstances do exist for example fraud, dishonesty or other improper conduct where it would be justifiable to pierce the corporate veil.
- *Botha v Van Niekerk* was too rigid.
- The court indicated that it would adopt a more flexible approach namely of taking all the facts of each case into consideration when determining if the veil should be pierced.

- A balance should also be struck between the need to preserve the separate legal identity of the company against policy considerations in favour of piercing the corporate veil. The veil could also be pierced in relation to a specific transaction.

#### *Hülse-Reutter:*

- Agreed that court has no general discretion simply to disregard a company's separate legal personality.
- The corporate veil would only be lifted if there was evidence of misuse or abuse of the distinction between the company and those who control it and this has enabled those who control the company to gain an unfair advantage
- Therefore a dual test was introduced: by adding the element of unfair advantage.
- The court further confirmed that much depended on a close analysis of the facts of each case and considerations of policy.

#### *Die Dros (Pty) Ltd and another v Telefon Beverages CC and others*

- Where fraud, dishonesty and other improper conduct is present, the need to preserve the separate legal personality of a company must be balanced against policy considerations favouring piercing the corporate veil.

#### *Le'Bergo Fashions CC v Lee and another*

- The Court will pierce the corporate veil where a natural person, who is subject to a restraint of trade uses a close corporation or a company to front to engage in the activity that is prohibited by the agreement

#### *Peregrine Group (Pty) Ltd & others v Peregrine Holdings Ltd & others*

In *Peregrine Group (Pty) Ltd & others v Peregrine Holdings Ltd & others* the seven applicant companies and eleven respondent companies were all registered under names with the word 'Peregrine' as the first and dominant word. The applicants sought an order directing the first to eighth respondents to change their names by excluding the word 'Peregrine' and restraining them from passing off their businesses as that of or associated in the course of trade with that of the applicant.

The Registrar of Companies (who was also a respondent) stated that he did not, as a matter of principle, 'allow the monopoly of an ordinary generic word'. He had thus permitted the registration of no fewer than 29 entities bearing some designation of the name 'Peregrine'.

The court looked at the activities the companies engaged in to decide whether the similarity in the names would cause confusion. In addition the client bases of the two companies were considered to see whether there is an overlap.

A court may direct a company to change its name if the name is undesirable and calculated to cause damage to the applicant.

It was held that the court enjoyed wide discretion to hold that a company's name is undesirable. Where the names of companies are the same or substantially similar and where there is a likelihood that members of the public would be confused in their dealings with the competing parties, these would be important factors to be taken into account in deciding whether or not a name was undesirable. However, the mere fact that the names of companies are the same or similar is not a conclusive factor in determining whether or not a name is objectionable.

The court also considered whether or not 'Peregrine' could be described as generic or descriptive of the services they offered. If so, the name could be subject to a monopoly. The court however held that 'Peregrine' is an ordinary English word with no secondary meaning that could be associated with the companies' functions.

In determining whether or not there was a likelihood of confusion which would have the effect of deceiving or misleading the public, the type (degree of sophistication) of customer catered for by the businesses of the respective parties and the extent and ambit of the competing activities of the two groups had to be considered. In this latter regard the absence of a common field of endeavour was not conclusive.

The date of registration of the companies would also play a role. The company who registered the name first would enjoy preference over companies who later changed their names.

In order to prove passing off, it has to be proven that the applicant had acquired a reputation in the services which it offered with the name and that the respondent had made a representation which would lead members of the public to associate the respondent's business with the applicant's.