Companies Act 71 of 2008 came into effect on the 1 May 2011

Number of matters that needs to be considered prior to deciding which entity will be most appropriate for a particular business:

1. Number of persons to be involved and
2. The extent of their involvement
3. The capital required to commence the business and
4. The source of that capital
5. Requirements of customers and clients
6. Strategic objectives of those involved
7. Tax issues should also be taken into account, SA tax system is not entity neutral

Advantages of a legal personality:

- A legal person is regarded as **an entity that can acquire its own rights and duties separate from its members.**
- In the Airport Cold Storage Pty Ltd court case it was held that one of the fundamental consequences of incorporation is that a company **is a juristic person separate from its shareholders**.
- A company has **perpetual existence** because it cannot die like a natural person; **and it is unaffected by change in it shareholders.**
- In the Solomon v A Solomon court case:
  - Once a company is legally incorporated it must be **treated like any other independent person with rights and duties appropriated to it.**
  - Motives of promoters during formation of the company are irrelevant when discussing the rights and liabilities of such companies
- Although a company has no physical existence, **it can acquire ownership in assets and is liable to pay its own liabilities.**
  - **In Dadoo Ltd** the court found that **property vest in the company and cannot be regarded as vesting in any or all of the shareholders the company.**
  - **Incorporation entails limited liability** with the result that shareholders are not generally liable for the debts of the company

Lifting the corporate veil:

Ex parte Gore:

Dealt with piercing of the company veil in a group of companies that was in reality run, as if they were just, one company. No distinction was drawn between the affairs and finances of the different companies. The court held as follows:

- Unconscionable abuse was not as extreme as “gross abuse”
- Section 20(9) is not a remedy of last resort – applicant can rely on this section even if there are no other remedies available.
- This provision does not replace common law; therefore previous judgements on piercing the corporate veil may still be used as guidelines

Courts have made it clear they will not allow the use of any legal entity to justify wrong, to protect fraud or to defend or hide crime. Hence courts will pierce or lift the corporate veil and hold directors and others personally liable for acts committed in the name of the company. They will only pierce or lift the veil in exceptional circumstances

Section 20 (9):

If, on **application by any interested person** or in any proceedings in which a company is involved, A court finds that

- the **incorporation of the company or**

- **Any use of use of the company, or**
- **Any act by or on behalf of the company**,

Constitutes *an unconscionable abuse of the juristic personality* *of the company as a separate entity*, **the court may**

a. **declare that the company is to be *deemed not to be a juristic person* in respect of any right, obligation or liability relating to the abuse**

The Companies Act basically adopted the common-law position relating to the lifting of the corporate veil. An offending person can be held personally liable in a variety of circumstances for losses by his or her wrong doing.

Branches or divisions of a company are part of the company itself and a division or branch does not have its own separate legal existence.

Key features of a company's juristic personality:
- Incorporation entails limited liability, shareholders not liable for the debts of the company
- Assets are exclusive property of that company, do not belong to its shareholders
- Where wrong is alleged against the company, it is the company that needs to seek redress and not the shareholders of the company

TYPES OF COMPANIES

Two types of companies:
Profit companies – if it is incorporated for the purpose of financial gain of its shareholders. The Act does not restrict the maximum number of shareholders. **A profit company may be incorporated by one or more persons.**
4 TYPES OF PROFIT COMPANIES:
- A public company (Ltd)
  - Must at least have 3 directors (Section 66(2))
  - Shares may be offered to the public and are freely transferable
  - Can be listed on the JSE (listed or unlisted)
  - The MOI (Memorandum of incorporations) is the sole governing document of the company.
- A State-owned company (SOC Ltd)
  - Registered in terms of the Companies Act and 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, South African airways
  - Chapter 3 of the Companies Act applies except to the extend the company is exempted by the Minister
  - State-owned companies are obliged to appoint a company secretary and an audit committee
  - Majority of provisions that is applicable to a public company is applies to a state-owned company except if exemption has been granted by the Minister.
- A Private Company ((Pty) Ltd)
  - Must at least have one director (Sec 66(2)
  - Its Memorandum of Incorporation prohibits the offering of any securities to the public and restricts the transferability of its securities:
    - Smuts Booyens; Markplaas Pty Ltd v Booysens the SCA held the restriction on the transfer of shares in a private company was compulsory in terms of the Act and any sale or transfer of shares without following whatever procedure the companies articles prescribes to give effect to the restriction, was void from its inception, irrespective of whether the purchaser knew about the requirement.
    - There is no restriction on the number of shareholders in terms of the 2008 Act

- A Personal liability company (Inc)
  - **Memorandum of incorporation must state that it is a personal liability company**
  - **The directors are jointly and severally liable with the company for debts and liabilities contracted during the term of office**
  - Must meet the criteria for a private company
  - Mainly used by professional associations (such as attorneys)
  - Must at least have one director
  -

Non-Profit company: (three or more persons are required for the formation of a non-profit company)

- Must at least have 3 directors (Section 66(2))
- **Must have as at least one of the objectives a public benefit object** or an object relating to social or cultural activities or communal or group interest.
- **All assets and income of a non-profit company must be used to further the companies stated objective**
- A non-profit company may acquire and hold securities issued by a profit company.
- An incorporator, member or director or person appointing a director of a non-profit company **may not directly or indirectly receive any financial benefit or gain from the company other than reasonable remuneration for work done** or compensation for expenses incurred **to advance the state objectives of the company**.
- When a non-profit company is being wound up or dissolved, **no member or director of that company is entitled to any part of the net-value of the company** after its obligations and liabilities have been paid. **The entire net value of the company must be distributed to one or more non-profit companies.**
- **Non-profit companies are not required to have members** but the provision of its MOI may provide for it to have members.
- Members are used for non-profit companies whereas the word shareholders are used for profit companies.
- Incorporators of a non-profit company are its first directors and its first members – if its MOI provides for it to have members.

TRANSITIONAL PROVISIONS

The 2008 Act recognises that existing close corporations should be free to retain their current statuses until such time their members may determine that it is their interest to convert to a company under the Act. The Act therefore provide for the indefinite continued existence of the Close Corporation Act. Formation of new close corporation after the date of the commencement of the 2008 Act is not possible.

EXTERNAL COMPANIES

- This is a foreign company that is carrying on business or non-profit activities within RSA.
- Party to one or more employment contracts within the Republic or
- Engaged in a pattern of activities over a period of at least 6 months such as would lead a person to reasonably conclude that the company intended to continually engage in business or non-profit activities within the Republic

DOMESTICATED COMPANIES

- Is a foreign company whose registration has been transferred to the Republic
- Once a foreign company's registration has been transferred to South Africa it is regarded as if it had originally incorporated in South Africa and will be treated like any other company

COMPANY FORMATION

Key objectives the Companies Act as found in section 7(b) include the **promotion of development of the South African economy via:**

- The creation of **flexibility** in the formation and maintenance of companies;
- **Simplicity** in the formation and maintenance of companies
- Encouragement of **corporate efficiency**
- The encouragement of **transparency**
- **Provision of a predictable regulation** of companies

When incorporating/registration of a company: requires:

- Filing of the Notice of Incorporation (in the prescribed form)
- Filing of a copy of the Memorandum of Incorporation and
- Payment of the prescribe fee

File means to deliver the document to the Companies and Intellectual Property Commission or CIPC. The standard form is optional – Act provides for flexibility, the MOI may be the form provided or it may be specially drafted (unique) for that company.

The Memorandum of Incorporation is the founding document of the company. It sets out the relationship between:

- The company and its shareholders;
- The company and its directors;
- The company and other parties in the company; and
- The company and third parties

The registration of a company is important because it allows for transparency and accountability and the keeping of relevant information about the registered entity.

In terms of section 186 of the Act, one of the functions of the Commission is:
The maintenance of accurate, up-to date and relevant information concerning company, foreign companies and other juristic persons and the provision of that information to the public and to other organs of state.

The MOI as defined in section 1 as a document as amended from time to time, that sets out the rights, duties and responsibility of all stakeholders, directors and others within and in relation to a company and other matters as contemplated in section 15.

STEPS TO INCORPORATE A COMPANY:
A profit company requires one or more persons and a non-profit company requires 3 or more persons to incorporate at company.

Each person should complete and sign the MOI
The notice of incorporation must be filed with the Commission together with the prescribed fee must be companied by a copy of the MOI, unless the company uses the MOI provided for in the 2008 Act

FLEXIBILITY WITHIN THE MEMORANDUM OF INCORPORATION
Each provision of a **company's MOI must be consistent with the provision of the Act**. Any provision that is inconsistent with the provisions of the Act is regarded as void to the extent that it contravenes or is inconsistent with, the Act. The incorporators of a company are free to include any provision in the MOI that are not covered by the Act. The MOI is the founding document of the

company and determines the nature of the company as well as the rights, powers and duties of the stakeholders.

The Act is flexible and makes it possible for each company to have its own unique MOI

In terms of the 2008 Act there as certain:

- **Unalterable provisions** – which an MOI cannot abolish. Not absolute unalterable in the sense they can be altered by a provision in the company's MOI to provide for a higher standard, greater restriction, longer period or more onerous requirement. Thus they cannot be abolished or made more lenient by any provision in the company's MOI
- **Alterable provisions** – which an MOI can change taking into account the specific needs and requirements of those wishing to make use of the company structure
- **Default provision** – which will automatically apply if an MOI does not deal with that specific matter – that is, the default provisions will apply unless they are altered by the company's MOI

The company's MO can deal with a number of different issues, including the following:

- The objects and powers of the company
- The authorized shares and type of shares
- What happens to the assets if the company dissolved
- The composition of the board of directors
- The election and removal of directors
- The frequency of the board meetings
- Rights of shareholders, including voting rights
- Restriction on powers of directors or shareholders
- Powers of directors and powers of shareholders

RULES MADE BY THE BOARD OF DIRECTORS

Any rule made by the board of directors takes effect 10 business days after filing the rules or the date stated in the rules. **The Act makes the file of the rules with the CIPC compulsory in all cases**. As soon as the rules become effective, they are binding on an interim basis, until put to the vote at the next shareholders' meeting.

THE LEGAL STATUS OF THE MEMORANDUM OF INCORPORATION AND RULES DEVELOPED BY THE BOARD OF DIRECTORS:

The Memorandum of Incorporation and any governance rules made by the board are binding:

- Between the company and each shareholder
- Among the shareholders of the company
- Between the company and each director or prescribed officer of the company
- Between the company and each member of a committee of the board

RING-FENCED COMPANIES

Section 15 2 (b) provided that the MOI of a company may contain restrictive conditions applicable to the company. Section 15 (2) (c) also allows the Memorandum to prohibit the amendment of any provision in the Memorandum.

If the MOI contains a restrictive condition as contemplated in sections 15(2) (b) or 15(2) (c), the name of the company must be followed by the expression "(RF)". This is the abbreviation for the words "ring fenced" and it 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 MOI.

Section 20 provides that a person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company in making any decisions in the exercise of its powers, **has complied with all the formal and procedural requirements in terms of the Acts, its MOI and any rules of the company**, **unless** in the circumstances **the person knew or reasonably ought to have known of any failure** by the company to comply with any such requirement. However, a third party dealing with an RF company can be presumed to have been made aware of certain special provision in the company's MOI, and therefore ought reasonably to know that the company has to comply with such special provisions..

Section 19(5) specifically provides that a **person must be regarded as having notice and knowledge of any provision of the company's MOI** contemplated in section 15(2)(b) **if the company's name includes the letters "RF"** and **if the company's notice of incorporation or a notice of amendment has drawn attention to the provision.**

AMENDING THE MOI

A company's MOI may be amended:

- In compliance with a court order – an amendment in terms of a court order is given effect via a board resolution and there is no need for a shareholders special resolution
- By the board in terms of section 36(3) and (4) which allows the board to amend the authorised share capital of the company, unless the MOI provides otherwise,
- By special resolution of the shareholders proposed by:
  - The board of directors or
  - Shareholders who collectively exercise not less than 10% of the voting rights
- In terms of the procedure set out in the company's MOI

If an amendment to the MOI of a personal liability company has the effect that the company falls into another category, **company must give at least 10 days prior notice** of the filing of the notice of amendment to any **professional or industry regulatory authority** that has jurisdiction over the business of the company and **to any person who may have relied on the personal liability of the directors in dealings with the company** or **who could suffer prejudice if that liability is terminated**

A company must file a notice of amendment together with the prescribed fee with the Commission and the Commission may require the company to file a full copy of its amended MOI within a reasonable time.

ALTERATION TO CORRECT ERRORS:
For an alteration to be effected:

- A notice of alteration must be published in accordance with the MOI and the rules
- A notice of alteration must be filed

Note: It is the board of the company or an individual, to whom the board has given authority that, may make the changes

TRANSLATION OF A MOI
In the event of a conflict between a provision in the MOI and a provision in the translated version, the provision in the original MOI prevails.

CONSOLIDATED MOI

A Commission may request a company to file a consolidated revision of its MOI together with a sworn declaration that it is a true, accurate, updated and complete representation of the MOI.

AUTHENTICITY OF THE VERSIONS OF THE MOI

If there is a conflict between various versions of the MOI, the latest version that has been endorsed by the Commission prevails.

SHAREHOLDERS AGREEMENT

The Act allows shareholders to enter into agreements on matters concerning the company; such agreements must be consistent with the Act and with the company's MOI. Provisions that are inconsistent with the Act or with the MOI are void to the extent of the invalidity.

THE COMMISSIONERS ROLE IN THE INCORPORATION OF A COMPANY

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

- If the initial **number of directors are fewer than the prescribed minimum number**
- Where **as a result a director's disqualification**, the initial **number of directors becomes fewer than the prescribed minimum number**

A private company must have at least one director and a non-profit company at least three directors

REGISTRATION OF THE COMPANY

Once the Notice of Incorporation has been filed, the Commission:

- Assigns a unique number to the corporation
- Enters the prescribed information on the company in the Companies register
- Issues and delivers a registration certificate to the company if all the other requirements have been complied with.

The date on the registration certificate is the date on which the company acquires legal personality.

PRE-INCORPORATION CONTRACTS

Section 1 of the Act defines pre-incorporation contract as:

- A **written agreement** entered into **before the incorporation of a company**
- **By a person who purport to act in the name 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 2008 Act provides that **the person who enters into a pre-incorporation contract** on behalf of a yet-to-be-formed company **will be jointly and severally liable if the** company **is not later incorporated** or where the **company is incorporated and the company rejects any part of the agreement**. Joint and several liabilities will not apply where after incorporation the contract is replaced by another similar contract.

Once the company is incorporated, the board of directors may within 3 months after the date on which the company was incorporated, completely, partially or conditionally ratify or reject any pre-

incorporation contract. Where a board has not ratified or reject the pre-incorporation contract after 3 months of incorporation, the company will be deemed to have ratified that agreement or action.

Once the agreement has been ratified, the company will be liable in terms of the agreement, as if it had been party to the agreement when it was concluded. Upon rejection the person who will incur liability in terms of the agreement will be allowed to recover form the company any benefit that it has received in terms of the agreement.
Section 21 does not exclude the common law, which means that a promoter may also use the common law alternatives – these are the contracts for the benefit of a third party, benefit is the promoter is not automatically liable if the company is incorporated or does not ratify the contracts

May/June 2012
What is a contract concluded on behalf of a yet to be formed company called (1)
What are the formal requirements to conclude a binding contract on behalf of yet to be formed company in terms of the 2008 Act (5)
Explain the possibility of the promoter incurring personal liability (4)

REGISTRATION OF COMPANY NAMES:
When choosing a company name one must avoid names that:

- Are offensive to people of a particular race, ethnic group, gender or religion in terms of the 2008 Act
- Amount to passing off – occurs when a company makes use of a feature which is associated with another business. Common law prohibits passing off.

CRITERIA FOR NAMES OF COMPANIES IN TERMS OF THE ACT
The name of a company may not:

- Be the same as the name of another company, close corporation or cooperative
- Resemble the name of another company, cc or cooperative to the extent that it may create confusion or create the impression that the two businesses are associated
- Give the impression that the company is associated with the government or with a particular person or government office
- Be the same as the name of a business which has already been registered in terms of the Business Names Act 27 of 1960
- Be the same as a trademark of a business which has been filed for registration in terms of the Trade Mark Act 194 of 1993

The name of a company may:

- Be the registration number of the company, provided it is a profit company. The number has to be followed by the words “South Africa”. **Non-profit companies are NOT allowed to have registration numbers as their names.**
- Be in any language and it may consist of any letters, numbers or punctuation marks and brackets. The company must end with the appropriate expression for that type of company

The registered name of a company must be used at all times and not a modified version, i.e. Epstein v Bell – the court held that the name of the company had not been used properly and an abbreviation was not acceptable.

If the name of the company is prohibited, the commission cannot refuse the registration of a company on the grounds that the submitted name is undesirable – the company will still be registered but with its registration number as its name rather than the submitted name

RESERVATION – is made by filing and application and paying the prescribed fee.

Reservation continues for a period of 6 months.

CAPACITY AND REPRESENTATION

A company is a juristic person from the time of its registration and will continue to exist until its name is removed from the companies register. The MOI may limit or restrict the activities or business in which the company may engage, and does not have to do so.

ULTRA VIRES DOCTRINE

- Refers to acts of a company that fall outside the scope of its powers. The doctrine follows upon the principle that when an act has been performed on behalf of another person and the act is beyond the authority of the actor, it is said that the latter acted ultra vires.
- When applied to a company, the doctrine involves the legal capacity of the company to perform.

Section 20(1) of the 2008 Act has made the doctrine of ultra vires inapplicable between a company and a third party, According to this section, no action of the company is void if the only reason therefor is that the action was prohibited by a limitation, restriction or qualification in the MOI or that the consequence of this limitation was that the directors who purported to act on behalf of the company had no authority to authorise the company's action.

A person other than a director dealing with a company in good faith, is entitled to presume that the company , in making any decision in the exercise of its powers has complied with all the formal and procedural requirements of the Act, the MOI and any company rules, unless in the circumstances of the case the person know or ought to have known of the failure by the company to comply.

CONSTRUCTIVE NOTICE
The ultra vires doctrine is related to the principle of constructive notice. The **doctrine of constructive notice states** that **anyone dealing with the company is deemed to know the contents** of the company's memorandum and articles of association as well as well as other internal documents filed with the registrar's office. The consequence could be detrimental to a third party confronted with an argument that the company had acted ultra vires its powers. In terms of the constructive notice doctrine, it would then be contended that the third party was deemed to have knowledge of the fact of the ultra vires action when so contracted.

Section 19(4) of the Act abolishes this doctrine. Third parties contracting with the company will no longer be deemed to have had the notice of the contents of public documents of the company merely because they have been filed with the Commission or are assessable for inspection at the office of the company. There are however two exceptions:

- A person is deemed to have knowledge of any provision of the company's MOI if the name of the company includes the ending "RF" and
- The company's Notice of Incorporation contains a prominent statement drawing attention to such provision as required by section 13(3)
- Secondly exception applies to a personal liability company
    - 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.

In terms of the common law Turquand rule, third parties who act in good faith may assume that any internal requirement as set out in the Memorandum of Incorporation has been complied with.

Section 20 (7) of the Companies Act 71 of 2008 contains a provision that that resembles the Turquand rule by providing that:

- A person dealing with a company in good faith is entitled to presume that the representative of the company has complied with all the formal and procedural requirements of this Act, the company's Memorandum of Incorporation and any rules of the company,
- Unless the person knew or should reasonably have known of such failure by the company's representative, to comply with such requirement.

It should be noted that Section 20 (7) does not replace the Turquand rule and must be interpreted concurrently with it.

A company's MOI determines who has authority to act on behalf of the company
The Turquand rule applies where the authority is subject to an internal requirement.

DOCTRINE OF ESTOPPEL

Estoppel applies only when the agent did not have actual authority to bind the company.
Misrepresentation 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:**

1. The company **misrepresented intentionally or negligently**, that the agent concerned had the necessary authority to represent the company
2. Misrepresentation was made by the company
3. The third party was induced to deal with agent because of the misrepresentation
4. The third party was prejudiced by the misrepresentation

Freeman & Lockyer v Buckhurst Park Properties

May/June 2012 – Indicate what a third party would need to prove in order to be able to rely on the doctrine of estoppel in order to hold the company liable for performance in terms of a contract concluded on its behalf. Refer to relevant case law (5)

CORPORATE FINANCE

Two sources of funding available to the directors of a company, namely debt and equity
When the Act refers **to securities, it refers to both shares and debt instruments such as debentures**.

Equity:

- Shares – a company can obtain funding for its business operations by issuing shares
- Retained income – Instead of paying all profits to shareholders by way of dividends, directors can choose to retain all or some of those profits in the business in order to fund operations and expansions

Debt:

- Debentures
- Long term and short term loans
- Lease agreements
- Credit terms from suppliers
- Overdraft facilities

Powers that are unalterable and my therefore not be taken away from directors by a company's MOI:

- Power to issue shares and in certain circumstances it may be subject to approval by the shareholders and
- Power to declare dividends since dividends are distributions that may only be authorised by the board

In terms of the Companies Act of 2008:

- I**t is no longer possible to issue par value shares – shares with a stated nominal value**
- Pre-existing companies are not compelled to convert their issued par value shares to no par value shares but may voluntarily do so

Solvency and liquidity test

- Must be applied and passed by a company prior to certain transactions taking place..
- Before directors can declare a dividend they have to apply the solvency and liquidity test and confirm that the company passes this test
- Similarly, the solvency and liquidity test must be applied before a company repurchases any of its own shares

DEFINITION OF SHARE:
Section 1 of the Companies Act, 2008 defines "share" as one of the units into which the proprietary interest of a profit company is divided

Coopers v Boyes, the court discussed the nature of the share and held that it represents an interstate in a company, which interest consists of a complex of personal rights: a share is incorporeal movable property that gives rise to a bundle of personal rights. All shares of the same class must have the same rights. It follows then that if the rights attached to the shares of a company differ there are different classes of shares.

Over-capitalisation – when the issue of shares in is in excess of its requirements
Under-capitalisation – when the company finds itself short of funds so that the expansion is curtailed.

Standard bank of SA Ltd v Ocean Commodities – 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.

A company's MOI must set the classes of shares and the number of each class that a company is authorised to issue – this is referred to as the companies authorised share capital.
The board decides when to issue shares and how many shares must be issued.

Shares are divided into classes according to the specific rights a share confers on its holder.

The rights that differ among various classes can 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 shares – provides holders with a preference over other shareholders to dividends and or return on capital on winding-up. If the MOI provides that the preference shareholders

do not have the right to vote, the 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.

- **Cumulative preference shares** – if a dividend is not declared in a specific year, the shareholder's right to dividend is carried over to the next year. When a dividend is declared the preference shareholder will have to be paid 2 years dividend before the ordinary shareholders can receive their dividend
- **Participating preference shares** – After receiving their preference dividends, shareholders could be given the right to also receive normal dividends along with the ordinary shareholders.
- **Preferential right to capital on winding-up** – Preferential shareholders could be given the preferential right to receive repayment of the capital they contributed to the company upon winding up in addition to the right to share in the surplus assets (the latter is the exception rather than the rule)
- **Convertible preference shares** – Holders have the right to convert the preference shares to shares of another class after a certain date

Ordinary shares – shareholders usually receive dividends after the preference shareholders have received theirs,
Deferred shares – Occasionally, shares are issued to the founders of a company that entitle them to dividends, only if the dividend amount exceeds a certain threshold after the ordinary shareholders have been paid. Deferred shareholders are last in line to receive dividends

A profit company has two types of share capital, namely authorised and issued share capital.

ISSUE OF SHARES

The board of directors:

- Has the power to issue shares without the approval of the shareholders but these shares must be authorised by the MOI, either before the shares are issues or within 60 business days after the issue.
- Has the authority to increase or decrease the authorised number of shares except to the extent that the company's MOI provides otherwise.

Shareholders may also amend the authorised share capital by way of amendment to the MIO by special resolution,

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

- Where shares are issued to a current or future director or prescribed officer of the company. "Future" does not include a person who becomes a director or officer more than 6 months after the shares were issued.
- Where shares are issued to a person related or inter-related to the company, a director or prescribed officer of the company. A natural person is related to another natural person if he or she is married to, lives together with that person as if they were married or if they were separated by no more than two degrees of natural or adopted consanguinity, in other words, a person's parents, child, sister, brother or grandparents. A juristic person is related to another juristic person if it directly or indirectly controls the other by either having the majority voting rights or by having the right to appoint the majority of the 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 any of the persons mentioned above
- Where the voting power of the shares to be issued will exceed 30% of the voting power of the shares of that class held immediately before issue.

No special resolution is required or shareholder approval is required where the issue is:

- Under an underwriting agreement
- In the exercise of pre-emptive rights
- In pursuance of an employee share scheme
- In pursuance of an offer to shares to the public
- In proportions to existing shareholders and on the same terms of conditions to all shareholders

A company may not issue shares to itself

Shares can be issued for future payments, future benefits or future service – such shares are held in trust until that future event occurs, whilst in trust voting or appraisal rights are not exercisable

A company that issues shares for future benefits acquires a right and the value of that right must be capable of determination.

The board may approve the issuing of any authorised shares of the company as capitalisation shares on a pro rata basis to the shareholders of one or more classes of chares. Capitalisation shares are bonus shares issued in lieu of dividends and arise as a result of the capitalisation of the profits of the company rather than their distribution – **is not regarded as a distribution and is therefore not subject to the solvency and liquidity test - Considered as reclassification of equity. Payment of cash in lieu of a dividend is regarded as a distribution.**

Shareholder approval is required for issuing of shares in certain circumstances:
If the shares, securities, options or rights are issued to a director/prescribed officer, future director/prescribed officer

PRE-EMPTIVE RIGHTS
Existing shareholders has the right before any other person who is not a shareholder of that company to be offered and within a reasonable time to subscribe for new shares to be issued by the company in proportion to their voting power.

Private company:
Shareholders in a private company automatically have this pre-emptive right (default position).
Every shareholder in a private company has the right before any other person who is not a shareholder of the company to be offered and to subscribe for a percentage of any shares issued or proposed in proportion with their voting power.

Right of pre-emption prevent the dilution of shareholding interest held by existing shareholders of the company and are therefore aimed at protecting such shareholders.

The default position for a public and state-owned company is that the shareholders do not have these automatic rights.

A company is allowed to repurchase its shares –this is considered as distribution which means the solvency and liquidity tests must be met.
If the company repurchase 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, remain enforceable:

- The company must apply for a court order to suspend the repurchase of shares, and bears the burden of proof that it did meet the financial requirements of the Act.
- 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 and the company will have to issue shares to that person, in return.

The solvency and liquidity test must be applied in each of the following circumstances:

- When a company wishes to provide financial assistance for subscription of its securities (section 44)
- If a company grant loans or other financial assistance to directors and others as contemplated in section 45
- Before a company makes any distribution as provided for in section 46
- If the company wishes to pay cash in lieu of issuing capitalisation shares in terms of section 47
- If a company wishes to acquire its own shares as provided for in section 48

In terms of section 4, **a company will satisfy the solvency and liquidity test** considering all the 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; and
- **It appears that the company will pay its debts as they become due in the ordinary course of business for a period of 12 months after the date on** which the test is considered or in the case of **distribution 12 months following that** distribution

DISTRIBUTIONS

A distribution is **any direct or indirect transfer by the company of money or other property** to one or more of its shareholders whether:

- payment of dividends,
- payment for the purchase by a company of its previously issued shares,
- incurrence of debt for the benefit of one or more shareholders of the company or
- the forgiveness of a debt owed to the company by one or more of the shareholders of the company

A distribution may be made in the following circumstances:

- The board of directors must authorise distribution
- Must reasonably appear that the company will able to satisfy the solvency and liquidity tests immediately after the distribution has been made
- The board must acknowledge by way of a resolution that it has applied the solvency and liquidity tests and reasonably concluded that the company will satisfy the tests immediately after completion of the proposed distribution.

FINANCIAL ASSISTANCE:

Section 44 sets out the requirements if a company provides financial assistance:

A company may assist a person in acquiring shares and other securities in the company, provided that such assistance is not prohibited by the MO and that certain requirements are met.

1. The particular provision is
   a. pursuant to an employee share scheme or
   b. Where a special resolution by the shareholders authorised such assistance to a specific person or persons falling in a specific class or category; and
2. The board is satisfied that
   a. immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test and
   b. That the assistance is given under terms that are fair and reasonable to the company.
3. Any condition or restriction in respect of financial assistance set out in the MOI has been satisfied.

In the Lipschitz it was held that:

- Firstly, it had to be ascertain whether there was financial assistance.
  - In Gradwell, the impoverish test was formulated to assist in determining whether financial assistance was provided. In terms of the impoverish 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 company stood surety for that loan it would count as financial assistance.
    If the company buys an asset from a person to enable that person to purchase shares in the company it will depend on the facts whether there was financial assistance – factors that emerged from case law in this regard are whether the company needs the asset in its normal business and whether it paid a fair price for it.
- Secondly, must be determined whether that assistance was for the purpose of acquiring shares in the company

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

SHAREHOLDERS AND COMPANY MEETINGS

One of the unalterable provisions include once impacting on who may act on behalf of a company The Act confers powers exclusively on shareholders in respect of certain decisions and transactions. Section 71(1) is unalterable and enables shareholders to remove a director at any time by ordinary resolution. This section entrenches the rights of shareholders in this matter.

Record date is the date on which a company determines the identity of its shareholders and their shareholdings for the purposes of the Act. Such record date may not be earlier than the date on which the record date is determined or more than 10 business days before the date on which the event or action for which the record date is being set. The record date determines shareholder rights.

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

The Companies Act uses only the term “shareholder” in respect of a profit company. The term member of a company is reserved for a non-profit company who do not have shareholders.

NOTICE OF MEETINGS:

- Must be in writing
- Must include the date, time and place of the meeting
- Must explain the general purpose of the meeting and any other specific purposes
- With regards to a public or non-profit company – **notice should be given 15 business days before the date of the meeting**
- With regards of any other company, notice should be sent 10 business days before the date of the meeting
- Notice should indicate the percentage of voting rights required for the resolution to be adopted
- Notice must contain a prominent statement that a shareholder is entitled to appoint a proxy to attend, participate in and vote at the meeting in the place of the shareholder
- A copy of any proposed resolution received by the company, and which is to be considered at the meeting must accompany the notice convening the meeting.

- Notice of the annual general meeting of a company must contain a summary of the financial statements that will be tabled at the meeting. The notice should also explain the procedure for the shareholder to obtain a complete copy of the financial statements of the preceding financial year.
- Should indicate that participants will be required to provide satisfactory proof of identity at the meeting

Where the company has failed to give notice of a meeting or where there has been a defect in the giving of the notice, the meeting may proceed:
- If the persons who are entitled to vote in respect of each item on the agenda are present at the meeting, and
- Acknowledge actual receipt of the notice and
- Agree to waive notice of the meeting or
- In the case of a material defect, ratify the defective notice

Postponement and adjournment of meetings:
A meeting may be postponed or adjourned for a week under the following conditions:
- **If within one hour after the scheduled starting time, quorum is not formed**
- **When a quorum is not present at the postponed or adjourned meeting, member of the company present in person or by proxy will be deemed to constitute a quorum**

Notice of adjournment must be given only where the meeting was postponed until further notice – may not be adjourned for more than 120 business days . This is an alterable provision and can be altered by the provisions of a company's MOI

PROXY
A proxy is a person appointed to represent a shareholder at a meeting

An appointment of a proxy:
- Must be in writing and signed by the shareholder
- The appointment remains valid for one year after it was signed
- It may be for a specific period of time
- A proxy may delegate to another person, authority to act on behalf of the shareholder
- A copy of the proxy form must be delivered to the company before the shareholders' meeting
- 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 company cannot compel a shareholder to make an irrevocable proxy
- The proxy is entitled to vote as he or she thinks fit unless the shareholder has indicated on the proxy appointment whether the proxy should vote in favour or against a particular resolution
- Shareholders could be invited by the company to appoint a proxy from a list provided by the company, however the shareholder is not obliged to choose one or more persons from the list
- May appoint to one or more proxies currently who will exercise voting rights attached to different shares held by him

QUORUM
In aggregate **at least 25% of all the voting rights need to be present** before a shareholders meeting may begin. An MOI may specify a lower or higher percentage; default quorum of the Act is 25%. **If a company has more than 2 shareholders, a meeting may not begin or a matter may not be debated unless at least 3 shareholders are present** at the meeting provided that the members can exercise at least the required percentage of voting rights.

CONDUCT OF MEETINGS

Where voting is conducted by show of hands, any person present and entitled to exercise voting rights must **have only one vote irrespective of the number of shares** held by that person. Where **voting is by poll**, must be entitled to exercise **all the voting rights attached to the shares held**.

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

A company may provide shareholders' meeting to be conducted entirely by electronic communication or may allow one or more shareholders or proxies to participate by electronic communication in all or part of the shareholders meeting that is being held in person. The electronic communication used must enable all persons participating in that meeting to communicate concurrently with each other without an intermediary and to participate reasonably effectively in the meeting.

MAJORITY RULE – When a person becomes a shareholder in the company he or she agrees to be bound by the decisions of the majority.

EXCEPTIONS TO RULES:

Where every shareholder is also a director of a particular company (not a state-owned company):
Shareholders may decide on any matter to be referred by the board at any time without notice or compliance to any internal formalities except when the MOI provides otherwise

A profit company (other than a state-owned company) with only one director – may exercise any power of perform any function of the board at any time, except where the MOI provides otherwise

A profit company with only one shareholder:
- Shareholder may exercise all the voting rights
- Rules of setting a record date etc., do not apply

SHAREHOLDERS ACTING OTHER THAN A MEETING
The 2008 Act makes it possible to take decisions without convening a meeting:
- The company must submit a proposed resolution to every person who is entitled to vote on the resolution. The shareholders are then entitled to exercise their vote in wring within 20 days from receiving the proposed resolution and to return the written vote to the company**. If adopted it has the same effect if it had been approved by voting at a meeting**
- An election of a director may instead by conduct by written polling of all the shareholders entitled to vote.
- Within 10 business days after adopting the resolution, the company must deliver a statement, describing the results of the vote, consent process or election to every shareholder who was entitled to vote.

Any business of a company that must in terms of the Act or MOI be conducted at the AGM may not be conducted by means of this procedure

ANNUAL GENERAL MEETING
Only public companies have a statutory obligation to convene annual general meetings.
The first AGM meeting of a public company must occur no more than 18 months after incorporation.
Subsequent meetings must occur no more than 15 months after the previous general meeting.
Section 61(8) stipulated that at least the following matters must be transacted at the Annual General Meeting: (exam question)

- Election of directors
- The appointment of an auditor for the following financial year
- The appointment of an audit committee
- Presentation of the audited financial statements for the immediately preceding year
- The presentation of audit committee
- The presentation of the director's report
- Any matters raised by shareholders

CONVENING A MEETING IN SPECIAL CIRCUMSTANCES

Company is unable to convene a meeting because:

- It has no directors or all its directors are incapacitated
- For reasons other than the above fails to convene its AGM or a meeting required by its MOI

Shareholder may request the Companies Tribunal to issue an administrative order for a shareholder's meeting to be convened

For any other reason, the shareholder may apply to court for an order requiring the company to convene a meeting on a date, subject to any terms that the court may consider appropriate in the circumstances. Failure to hold a required meeting does not affect the existence of the company or the validity of any action by the company

SHAREHOLDER RESOLUTIONS

Ordinary resolution

- Requires more than 50% of the voting rights exercised
- MOI may provide for a higher percentage
- The Act provides that there must be at all times be a margins of at least 10 percentage points between the requirements for adoption of an ordinary resolution and that of a special resolution
- In the removal of a director however cannot require a higher percentage greater than 50% and it cannot require a lower than 50% for any transaction

Special resolution

- Requires at least 75% of the voting rights exercised
- The MOI may provide for a lower percentage on condition that
- There must be at least 10 percentage points between the requirements for a special resolution and an ordinary resolution

A special resolution is required for:

- Issue of shares to directors
- Financial assistance and issue of securities
- Share buybacks and the 5% rule
- Remuneration to directors
- Voluntary winding-up
- Share buybacks form directors
- Amendments of the company's MOI

Shareholders of their company exercise their rights and functions entrusted to them in the companies Act 71 of 2008 or the MOI by adopting resolutions at a meeting of shareholders.

DIRECTORS AND BOARD COMMITTEES

A director is a member of the board of the company as contemplated in section 66 or is an alternate director. Section 66 recognises different types of directors and specifically provides that a person becomes a director only when that person has given his or her written consent to serve as a director after having been appointed or elected or who holds office in accordance with section 66.

The Companies Act 2008 includes as a director all the following:

- Directors
- Alternate directors
- Prescribed officers
- Members of board committees – even if they are not board members
- Members of the audit committee – who all have to be board members

Section 66 provides that the:

- Business and affairs of a company must be managed by or under the direction of the board, which
- Has the authority to exercise all the powers and
- Perform any of the functions of the company, except
- To the extent the 2008 Act or the company's MOI provides otherwise

Types of directors

1. **An ex officio director**
   Is a person who holds office as a director solely as a result of that person holding another office or status. Not appointed by the shareholder
2. **An MOI appointed director**
   The MOI can specify how and by whom such a director is appointed
3. **An alternate director**
   A person elected or appointed to serve as occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company
   In a profit company at least 50% of alternate directors must be elected by shareholders
4. **An elected director**
   In a profit company at least 50% of alternate directors must be elected by shareholders
5. **A temporary director who is appointed in order to fill a vacancy**
   MOI can provide for the appointment of a temporary director. Unless the MOI provides otherwise, directors may appoint a temporary director

A **director who is also an employee is referred to as an executive director,** other directors are **non-executive directors and are not employees of the company.**

In Howard v Herrigel case it was held that:

- It is **unhelpful or even misleading to classify company directors as executive and nonexecutive** for the purposes of determining their duties to the company.
- 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.**

DIRECTORS AND MANAGERS

A prescribed officer is defined as any person who:

- **Exercises general executive control** over and management of the whole or significant part of the company's business and activities
- **Regularly participate to a material degree in the general executive control over and management** of the whole or significant part of the company's business and activities

The Regulation states that it applies to a person who meets these requirements irrespective of any particular title given by the company to an office held by the person in the company or a function performed by the person for the company

Manager	**Director**
Carry out strategy set by directors	Gives direction at the top

Accountable to directors or management	Accountable to shareholders
Dismissed and appointed by Management	Dismissed and appointed b Shareholders
Control exercises in terms of employ contract	Can be disqualified in terms of Act

DUTIES AND LIABILITIES

There are 4 sources from which duties of directors arise:
1. Contracts with the company
2. The company's constitution (MOI)
3. The Companies Act
4. The Common law

At common law:
- Directors are subject to fiduciary duties to exercise their powers bona fide (good faith) and to the benefit of the company and
- To the duty to exercise their powers with care and skill

Newly codified duties of directors in the Companies Act of 2008:
Section 75 – To disclose to the board any personal financial interest in matters of the company
Section 76 – STANDARDS OF DIRECTORS CONDUCT
76 (2)(a) Not to use the position of director or information obtained as director to gain an advantage for himself or another person, or to knowingly cause harm to the company or subsidiary
76 (2)(b) To disclose to the board of directors any material information that comes to the director's attention
76(3)(a) To act in good faith and for a proper purpose
76(3)(b) To act in the best interest of the company
76(3)(c) To act with a reasonable degree of care, skill and diligence

When interpreting the provisions of the Companies Act, the courts must still have regard to the common law, including past case law

TO DISCLOSE TO THE BOARD ANY PERSONAL FINANCIAL INTEREST IN MATTERS OF THE COMPANY:
If a director has a personal financial interest in respect of a matter to be considered at a meeting or knows that a related person has personal financial interest in the matter, must disclose the interest and its general nature before the matter is considered at the meeting
The director is compelled to disclose to the meeting any material information relating to the matter that is known to the director
Must leave the meeting immediately after making any disclosure and the director is not allowed to take part in the consideration of the matter

A decision by the board is valid despite any personal financial interest of a director, if it was approved by the board or shareholders, despite failure of the director to satisfy the disclosure requirements.

Regal Hastings v Gulliver – the court held that the directors should **avoid placing themselves in a position where their duty to the company conflicts with their own interests**
Robinson v Randfontein Estate Gold Mining – court held that where one man stands in a position of confidence involving the duty to protect the interest of another, **he or she is not allowed to make as secret profit at the other's expense** or place himself in a **position where his personal interests conflict with his duty.**

STANDARDS OF CONDUCT

Business judgement rule states that a director will be regarded as having acted in the best interest of the company and with the required degree of care, skill and diligent if he or she:

- Took reasonable diligent steps to become informed about the matter
- Had no material financial interest in the subject matter of the decision or know of someone else having a financial interest in the matter or disclosed his interests as required by the Act
- Made or supported a decision in belief it was in the best interest of the company/ the director has a rational basis for believing or did believe that the decision was in the best interest of the company

The test is an objective and subjective tests:
Objective – what a reasonable director would have done in the same situation
Subjective – Taking into account the general knowledge, skill and experience of the particular director.

More is expected of a director who is qualified and experience than is the case if the director is new and inexperience.

The director is also entitled to rely on information provided by certain person specified in the Act:

- On one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed
- On the information, opinions, reports provided by legal counsel, accountants or other professional persons retained by the company
- On the board or a committee

The **business judgment rule** entails that for **a director should not be held liable for** decisions that **lead to undesirable results**, **where such decision were made in good faith**, **with care** and on an **informed basis** and **which the director believed were in** the interest of the company

Fisheries Development Corporation of SA court case it was held that:

- The extent of a directors duty skill and care largely depends on the **nature of the company's business;**
- The law **does not require of a director to have special business acumen**;
- **Directors may assume that officials will perform their duties honestly**

A director must communicate to the board any information that comes to the directors' attention, unless the directors reasonably believe the information is:

- Immaterial to the company
- Generally available to the public
- Known to the other directors

Kukama v Lobelo – 2008 Act creates a duty on part of a director to communicate to his board at the earliest practicable opportunity any information that comes to his information.
Bhagwandas v GMO Imaging – Shareholders do not have fiduciary duties to the company

CyberScene Ltd v I-Kiosk Internet and Information – Director clearly breach his fiduciary duty to the company where he sabotage the company's contractual opportunities for his own advantage or where he uses confidential information to advance the interest of a rival concern or his own business to the prejudice of those of his company.
Robinson v Randfontein Estates Gold Mining - court held that where one man stands in a position of confidence involving the duty to protect the interest of another, **he or she is not allowed to make as**

secret profit at the other's expense or place himself in a **position where his personal interests conflict with his duty.**

Ghersi v Tiber Developments – the court held that there are limits to the duties a director owes to his or her company or that such a person automatically are obliged to offer all property development to the company

Employees and managers also have certain fiduciary obligations or responsibilities towards their company.

Daweoo Heavy Industries v Banks – court confirmed that there is at most if not in all contracts (employment or contract of agency) an implied fiduciary duty
Phillips v Fieldstone Africa – in the confirmation of the liability of an employee, confirmed the principles set out in the Robinson case that a person who has a duty to protect the interest of another is not allowed to make secret profit at the expense of another.
Dorbyl Limited v Voster – Failed to inform the plaintiff of the offer and he (director) took the opportunity for himself without consent – court ordered defendant to pay the benefits that he had obtained to the plaintiff

MMA Architects v LuyandaMpahlwa/ Ultrafram UK ltd v Fielding:

- Director may not make unauthorised profit
- Director cannot abdicate his responsibilities or abandon his status without formally resigning

LIABILITY OF DIRECTORS

In terms of section 77 of the Companies Act, 2008, a company may recover loss or costs sustained by the company from a director under the following circumstances:

1. In terms of the **principles of common law relating the breach of fiduciary duty**
2. In accordance with the principles of the common law relating to a delict of breach to act with the required care skill and diligence
3. Where a director acted in the name of the company or signed anything on behalf of the company, while knew that he or she **lacked the necessary authority**
4. Where the **director is party to an act or omission by the company** despite knowing that the act or omission was **calculated to defraud** a creditor, employee or shareholder or had another fraudulent purpose
5. A director submitted on carrying on the business of the company knowing that it was being conducted recklessly or fraudulently
6. Signed, consented to or authorised the publication of financial statements that were false or misleading in a material aspect
7. Director failed to vote against the issuing of an unauthorised shares despite knowing that those shares were not authorised
8. Director participated in the decision to grant financial assistance despite knowing that it was inconsistent with the section 44/45 or company's MOI
9. Participated in the resolution approving distribution, knowing it was contrary to the provisions of section 46

The director will be jointly and severally liable with any other person who is or may be held liable for the same act. Proceeding to recover any loss, damages or costs may not be commenced more than 3 years after the act or omission occurred.

INDEMNIFICATION AND DIRECTORS INSURANCE

A company cannot undertake not to hold a director liable for breach of fiduciary duties.

A company can thus not indemnify a director in respect of liabilities arising, i.e. breach of fiduciary duties.

Company may take out indemnity insurance to protect a direct against any liability or expenses for which the company is permitted to indemnify. The company may also take out indemnity insurance to insure itself against expenses that the company is permitted to advance to a director .
A company may not directly or indirectly pay any fine that may be imposed on a director of the company, who has been convicted of an offense in terms of any national legislation

NUMBER OF DIRECTORS AND CONSENT
Private companies and personal liability company – at least one director
Public company or non-profit company – at least 3 directors,
In addition to the minimum number of directors that the company must have to satisfy any requirements to appoint an audit committee and or social and ethics committee

MEMORANDUM OF INCORPORATION MAY VARY CERTAIN PROVISIONS OF THE 2008 ACT

A public company may in terms of its MOI specify a higher number than the minimum number of directors required.

MOI of a profit company must provide that the shareholders will be entitled to elect at least 50% of any alternate directors. MOI can provide that any person will have the power to appoint or remove one or more of the directors

A MOI may provide for the payment of remuneration to its directors and term of office. If not provided for in the MOI, it must be approved by special resolution within the previous 2 years.

A director may be removed by an ordinary resolution adopted at a shareholder's meeting. The MOI cannot entrench the position of any director and cannot override the will of ordinary shareholders as expressed in an ordinary resolution.

INELIGIBLE AND DISQUALIFIED PERSONS

If a person is ineligible to be appointed as a director, **he or she is absolutely prohibited from becoming a director without any exceptions:**

- **A juristic person**
- **An un-emancipated minor**
- **A person who does not satisfy any requirement in the company's MOI**

If a person is disqualified from being appointed as a director means that, with the exception of a person who has been prohibited from being a director by court of law, a person may still be appointed as a director of the company with the permission of the court. The court has discretion as to whether to allow such disqualified persons to be appointed as a director. The following persons are disqualified from being appointed as a director:

- A person prohibited by a court of law
- A person who has been declared delinquent by a court of law
- An un-rehabilitated insolvent
- A person who is prohibited in terms of any public regulation from being a director
- A person who has been removed from an office of trust because of dishonesty

- A person who has been convicted and imprisoned without the option of a fine for theft, fraud, forgery, perjury or other offences
- A person disqualified in terms of the company's MOI

A person who become ineligible or disqualified while serving as a director of a company ceases to be a director and should immediately vacate office

Applies to:
- A director
- An alternate director
- A person who is a member of a committee of a board of a company or the audit committee, irrespective of whether such person is also a member of the company's board

EXEMPTIONS TO DIRECTOR DISQUALIFICATION

Section 69 (11) gives a court a discretion to grant exemption from being disqualified from appointment as a director. The following persons may apply to court for such exemption:
An un-rehabilitated insolvent
A person who was removed from an office of trust for dishonest misconduct
A person who was convicted of a crime with an element of dishonesty

The person will have to make an ex parte application to court for permission to act as a director despite the disqualification:
The applicant will have to prove that he or she is rehabilitated from his or her wrongful ways and can be trusted with the responsibility of directorship

Ex Parte Tayob:
It was held that bribery and corruption pose a serious threat to an open and honest community. The court concluded that too little time lapsed between the date of the conviction and the date of application to prove that the applicants had been rehabilitated from their dishonest ways.

Ex parte Barron:
The court held that the factors that affect the discretion of the court are the following:
- The type of offence
- Whether or not it was a first conviction
- The type of punishment imposed
- Whether it was a public company or whether it was a private company
- The attitude of shareholders, whether the shareholders supported the application

The court held that it could be more lenient in the case where a private company is affected than where a public company is involved, because in the case of a public company a director obviously deals with funds in which a vast number of people may have an interest.

APPLICATION TO DECLARE A PERSON DELINQUENT OR UNDER PROBATION:

Depending on the grounds on which a person has been declared to be a delinquent:
- He or she will be subsequently be either unconditionally disqualified from being a director for the rest of his life or
- Disqualified for a period of at least 7 years and subject to any conditions the court consider appropriate

An order of probation, however may not exceed 5 years

The following persons may apply to a court to declare a person delinquent or to be placed under probation:

- A company
- A director
- A shareholder
- A company secretary or prescribed officer
- A registered trade union that represents employees of the company
- Any other representative of the employees of a company
- The Commission
- The Takeover Regulation Panel

Grounds for application:

- Person consented to serve whilst he or she was ineligible or disqualified – life time of the person
- Person acted as a director whilst under probation and in contravention of such order – life time of the person
- Grossly abused the position of director – declaration of delinquency may be made subject to conditions (remedial education; carry out a designated programme community service; pay compensation to any person adversely affected by the person's conduct)
- Person took personal advantage of information or an opportunity
- The person intentionally or by gross negligence inflicted harm upon the company
- Acted in a manner that amounted to gross negligence, wilful conduct or breach of trust
- Acted in a reckless unauthorised or fraudulently
- Failure to vote against a resolution taken at a meeting despite the fact the company did not satisfy the solvency or liquidity test - Probation
- Acted in a manner materially inconsistent with the duties of a director – probation
- Supported a decision in an oppressive or unfairly prejudicial manner – probation

SUSPENDING OR SETTING ASIDE ORDERS OF DELINQUENCY

This application may only be made in those cases where declaration of delinquency was not made unconditional and for a lifetime of the person.

- The person must first apply to suspend the order of delinquency and substitute an order of probation with or without conditions at any time from 3 years after the order of delinquency was made or
- To set aside an order of delinquency at any time 2 years after it was suspended

The court needs to be satisfied that

- The applicant has demonstrated satisfactory progress towards rehabilitation and
- The is reasonable prospect that the applicant would be able to serve successful as a director of a company

FIRST DIRECTORS OF THE COMPANY

- Every incorporator is deemed to be a director of such company until sufficient directors have been appointed to meet the required minimum number of directors
- If the number of incorporators of a company together with ex officio directors and appointed directors is fewer than the minimum number of directors required for that company, the board must call a shareholders meeting within 40 business days after the date of incorporation for the purpose of electing sufficient directors to fill all the vacancies on the board

VACANCIES ON THE BOARD

Circumstances in which vacancies on the board of a company can arise:

- Person resigns
- Person dies
- Person declared delinquent or placed under probation
- Person becomes ineligible or disqualified
- Person becomes incapacitated
- Directors fixed term agreement expires
- Person is removed from office by resolution of the shareholders, by resolution of the board or by order of the court

In the Rosebank Television & Appliance case, the court confirmed that a resignation becomes effective once it has been communicated to a company, irrespective whether it was any subsequently accepted

A vacancy must be filled within 6 months after the vacancy arose. A company must file notice with the Commission within 10 business days after a person becomes or ceases to be a director of a company.

REMOVAL OF DIRECTORS

A director may be removed by an ordinary resolution adopted at the shareholders meeting

- With regards to a public or non-profit company – notice should be given 15 business days before the date of the meeting
- With regards of any other company, notice should be sent 10 business days before the date of the meeting

Notice of a shareholders meeting to remove a director and the resolution must be given to the director prior to considering the resolution to remove the director.

The director must be allowed the reasonable opportunity to make presentation in person or through a representative to the meeting before the resolution is put to vote. Thus not possible to remove a director by round-robin resolution because the director must be given the opportunity to address the meeting.

Grounds of removal by board of directors: Company has more than 2 directors and it is alleged by a shareholder or by a director that the director has become ineligible or disqualified, a director may be removed by a resolution of the board of directors if:

- Director has become incapacitated, unable to perform the functions of a director and is unlikely to regain capacity within a reasonable time
- Director has neglected or been derelict in the performance of the functions of director

The director may apply for a review by the court within 20 business days from the decision taken by the board.

The director will retain the right to institute any claim that he or she had in terms of the common law for damages or other compensation for loss of office as a director or loss of any other office as a consequence

NOTICE OF BOARD MEETINGS

Where the board has:

If required to do so by the percentage as specified in the MOI

If the board has at least 12 directors, meeting called by 25% of the directors
If board has less than 12 directors, meeting requested by at least 2 directors

No board meeting may be convened without notice to all the directors. If all directors are present and acknowledged receipt of notice or waive notice of the meeting – meeting may proceed.
Every member has one vote. Majority of vote cast on resolution is sufficient to approve resolution. In the event of a tied vote, the chair may cast deciding vote if chair did not initially vote otherwise matter being voted fails
Minutes of all the board and committee meetings must be kept by the company.
Decision can be adopted by written consent of the majority of the directors in person or by electronic communication.

APPOINTMENT OF AN AUDITOR

Public companies as well as state-owned companies and certain private companies must appoint an auditor every year at the annual general meeting:

- Are obliged to have their annual financial statements audited.
- These companies must appoint an audit committee which has certain statutory functions.
- Is required to appoint an auditor every year at the annual general meeting

Companies that are obliged to appoint an auditor:

- Public Companies
- State-Owned companies
- Any private company that, as its primary activity holds assets in a fiduciary capacity for persons not related to the company where the aggregate value of the assets exceeds R5 mil at any time during the financial year.
- Any private company with a public interest score in that financial year of 350 points or more
- **Any private company with a public interest score in that financial year, of between 100 and 349 points, if its annual financial statements were internally compiled**
- A company whose MOI requires it to be audited
- A company that voluntary has its annual financial statements audited either as a result of a directors or shareholders resolution
- Any non-profit company that was incorporated by the State, an organ of the state, a state-owned company, an international entity……..

All other companies, with the exception of an owner-managed private company that are not required by the regulations to be audited, require an independent review of their financial statements.

Incorporators of a company are required to file notice of the appointment of the companies 1st auditor as part of the company's Notice of Incorporation. Every company who appoints an auditor must file notice of appointment within 10 business days after the appointment.

Companies with an audit committee is required to nominate for appointment a registered auditor who is independent of the company and determine the auditor fees and terms of engagement

To be appointed as an auditor of a company, a person or firm:

- Must be a registered auditor
- Must not be a director, company secretary or prescribed officer of the company or an employee or consultant of the company who was or has been engaged for more than one year in either the maintenance or preparation of the company's fin records
- Cannot be a person who regularly performs the duties of accounted, bookkeeper or related secretarial work,

- Must not be a person who, at any time during the 5 financial years immediately preceding the date of the appointment, was acting in a capacity that would have precluded that person from being appointed as the auditor of the company.
- Must be acceptable to the company's audit committee as being independent of the company

Vacancy must be filled within 40 business days after the date of the AGM

RESIGNATIONS OF AUDITORS AND VACANCIES
- Resignation of an auditor is effective when the notice of resignation is filed.
- Must appoint new auditor within 40 business days after the filing of the resignation. .
- Within 15 business days after vacancy occurs the name of at least one registered auditor must be considered.
- The board may appoint the person proposed if, within 5 business days of making the proposal, the audit committee does not give notice in writing to the board rejecting the proposed auditor.

ROTATION OF AUDITORS
The same auditor may not serve as the auditor for more than 5 consecutive financial years. This does not mean that the same firm cannot be appointed for longer than 5 years – the restriction applies to any individual person within the firm – purpose of this 5 year rule is to ensure the auditor of a company remains independent of the board of directors so he or she can express an objective opinion on a company's annual financial statements.

If an individual has served as an auditor of a company for 2 or more consecutive financial years and then ceases to be an auditor , that individual may not be reappointed as auditor **until after the expiry of at least 2 further financial years.**

RIGHTS AND RESTRICTED FUNCTIONS OF AUDITORS
- The auditor of the company has a right of access at all times to the accounting records, books and documents of the company
- Is entitled to require from the directors or prescribed officers any information and explanations necessary for the performance of the auditors' duties
- Is also entitled to attend any general shareholders meeting and to receive all notices of and other communications relating to any general shareholders meeting and to be heard at any shareholders meeting on any part of the business of the meeting that concerns the auditors duties and functions
- Can apply to a court for an appropriate order to enforce its rights as auditor and the court may make any order that is just and reasonable
- An auditor appointed by the company may not perform any services for that company that would place the auditor in a conflict of interest

AUDIT COMMITTEES
At each annual general meeting a public company, a state-owned company and any other company which has voluntary decided to have an audit committee, must appoint an audit committee for every financial year and MUST have at least 3 members and must be a director (non-executive director) of the company but must not been involved in the day to day management of the company in the preceding 3 financial years.

Have a number of duties:
1. Nominate for appointed a registered auditor
2. Determine the fees to be paid to the auditor and the auditors term of engagement
3. Prepare a report to be included in the annual financial statements
4. Receive and deal with concerns relating to accounting practices and internal audit of the company;
5. The internal financial controls of the company or any related matter

6. Development and implementation of a policy and plan to improve the effectiveness of risk management within the company.

COMPANY SECRETARY

Every public company or state-owned company must appoint a company secretary. The MOI of a private or state-owned company, personal liability company or a non-profit company may also require the company to appoint a company secretary.

The company secretary is the principal/chief administrative officer of his or her company. Every company secretary must have requisite knowledge of or experience in relevant laws and must be a permanent resident of the Republic and remain so while serving in that capacity.

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

- The incorporators of the company or
- Within 40 business days after incorporation of the company, by either the directors of the company or 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.

The company secretary is accountable to the company's board. His or her duties include but are not restricted to the following:

1. Providing the directors of the company collectively and individually guidance as to their duties, responsibilities and powers
2. Making the directors aware of any law relevant to or affecting the company
3. Reporting to the company's board any failure on the part of the company or a director to comply with this Act
4. Ensuring the minutes of all shareholder meetings, board meetings and meeting of any committee of the directors or of the company audit committee, are properly recorded in accordance with this Act
5. Certifying the company's annual financial statements, whether the company has filed required returns and notices in terms of the act, and whether all such returns and notices appear to be true, correct and up to date
6. Ensuring that a copy of the company's annual financial statements is sent in accordance with the Act to every person who is entitled to it
7. In the case of a company with a company security, he or she will automatically be the compliance officer

A juristic person or partnership may be appointed secretary, provided that every employee of that juristic person or partner and employee of that partnership is not disqualified from being appointed company secretary

Every company that appoints a company secretary or auditor is required to maintain a record of its secretaries and auditors. Companies Act also requires every company that appoints a company secretary or auditor to file notice of the appointment or termination within 10 business days after appointment of termination.

REMEDIES

The 2008 Act aims to decriminalise company law where possible and instead of criminal sanctions, the Act largely provides effective private law remedies that seek to discourage gross mismanagement and abuse of power and to uphold the enforcement of stakeholders' rights.

Criminal sanctions still exists for certain matters, however. In terms of section 26, it is an office to fail to provide access to any record that a person has a right to inspect or copy. Section 214, if any financial statement of a company is false or misleading, any person who is party to the preparation approval, or publication of that statement is guilty of an offence.

REMEDIES AGAINST DIRECTORS WHO HAVE ABUSED THEIR POSITION
Section 162 – Application to declare director delinquent of under probation
Includes a director who was a director of the company within two years to the application. The person who may bring this application include the company, shareholder, a director, a representative of the employee of the company or the commission

The court is obliged to make an order declaring a person to be delinquent director if one of the statuary grounds is established. These grounds are:
Consenting to act as a director while ineligible or disqualified
While under probation, acting as a director in a manner that contravenes the relevant order
While a director, acting in a manner that amounts to gross negligence, wilful misconduct or breach of trust

A declaration of delinquency may be unconditional and for life or it may be made subject to any conditions a court considers appropriate. A conditional declaration of delinquency subsist for a period of 7 years or a longer period determined by the court

A court may place a director under probation when:
- Acting in a manner materially inconsistent with the duties of a director or
- Being present at a meeting and failing to vote against a resolution despite the inability of the company to satisfy the solvency and liquidity test where it is required by the Act

DERIVATIVE ACTION IN TERMS OF SECTION 165

Foss v Harbottle:
Court established the proper plaintiff rule, which states:
That a wrong done to the company, may be vindicated by the company alone. The company itself must be the plaintiff and not shareholders of that company. The company itself must be the plaintiff and not shareholders of that company.

A statutory derivative action as provided in Section 165, provides the persons who may use the statutory derivative action are:
(a) A shareholder or a person entitled to be registered as a shareholder, of the company or of a related company;
(b) A director or prescribed officer of the company or of a related company;
(c) A representative of employees of the company (normally a registered trade union)
(d) Any other person with permission of the court

The remedy is typically available against the alleged wrongdoer who is in control of the company.

The following 5 steps need to be taken to use the section 165 derivative actions:
- To serve demand on the company requiring it to commence or continue legal proceedings to protect the interest of the company
- Unless the company successfully applies to the court to set aside the demand on the grounds that it is frivolous, vexatious or without merit, the company must appoint an independent impartial person or committee to investigate the demand and report to the board

- Within 60 business days of receiving the demand, the company must either initiate or continue legal proceedings or must serve on the person who made a demand a notice refusing to company with the demand
- If a notice refusing to comply is served, that person may then apply to court for leave to bring or continue proceedings on the company's behalf
- To grant such leave, the court must be satisfied that the company failed to comply with the statutory requirements and that the applicant for leave is acting in good faith, that the proceedings will involve the trail of a matter of material consequence to the company and that it is in the best interest of the company that leave be granted

STATUTORY REMEDIES FOR SHAREHOLDERS

1. **Relief from oppressive or prejudicial conduct in terms of section 163**
   Allows shareholders and directors who are victims of oppressive or unfairly prejudicial conduct to apply to court for an appropriate order to end the conduct complained of. This could include an order appointing a liquidator if the company appears to be insolvent
2. **Dissenting shareholders appraisal rights in terms of section 164**
   Allows for an independent remedy for dissenting shareholder – that an appraisal right entitling a shareholder to require the company to pay it a fair value of its shares in exchange for the shares. This remedy provides minority shareholders with some protection against actions of majority shareholders
3. **Additional remedy to protect rights of security holders in terms of section 161**
   Allows the holder of issued securities to apply to court for a declaratory order regarding his or her rights in terms of 2008 Act, the company MO any rules of the company or any applicable debt instrument

LIABILITY FOR ABUSE OF SEPARATE JURISTIC PERSONALITY OF COMPANY

In terms of section 20 (9) whenever a court finds that the incorporation of or any act by or on behalf of or any use of the company constitute unconscionable abuse of juristic personality of the company as a separate entity, the company may declare that the company is deemed not to be a juristic person in respect of any right, obligation or liability of the company

ENFORCEMENT OF RIGHTS AND ENSURING COMPLIANCE WITH THE ACT

The aggrieved party can:

- Attempt to resolve the dispute using Alternative Dispute Resolution procedures
- Apply to the Companies Tribunal for adjudication
- Apply to the High Court
- File a complaint with the Companies and Intellectual Property Commission

CLOSE CORPORATION

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
Enjoy perpetual succession, thus remain in existence even if the members should change
Liability for its own debts
A simpler cheaper option specifically aimed at entrepreneurs and small businesses
Existing close corporations will continue to exist but no new close corporations can be formed

The founding statement is the document that establishes a close corporation and sets out details about the corporation, including the name of the corporation, its financial year, details of members, details of accounting officers and the principle business of the corporation.

- A close corporation can have from 1 to 10 members.
- Close Corporation is meant for smaller businesses, a simpler cheaper option specifically aimed at entrepreneurs
- There is no separation between ownership and control
- The Act allows for every member to participate in the business and to make legally binding decisions on behalf of the corporation
- Only natural persons may be members of a close corporation
- A company or close corporation cannot be a member of a close corporation

No Juristic person may hold a members' interest in a close corporation

A trustee of either an inter vivos trust or of a testamentary trust can be a member of a close corporation in the capacity of a trustee – one requirement that no juristic person can be a beneficiary of that trust – if at any time the number of beneficiaries of the trust who are entitled to receive any benefit from the trust, when added to the number of members of the corporation is greater than 10, the membership of the trustee will cease. Once membership ceases in terms of this condition, no trustee of that trust will ever again be eligible for membership of the trust even if the numbers becomes 10 or fewer

The members interest is expressed as a percentage in the founding statement and must be at all times 100%

A close corporation are:

- Simple
- Deregulated
- Flexible
- Limited liability entities
- Suitable for small businesses

No company can be converted into a close corporation after the commencement of the 2008 Act. Close corporations that existed on 1 May 2011 are allowed to continue indefinitely, but no new close corporations can be formed. The Close Corporation Act will continue to govern existing close corporations

It is impossible to register a new close corporation. The Companies Act, Schedule 2 provides the procedure for conversion of close corporations into company:

There must be notice of conversion and should be accompanied by the following:

- A written statement of consent approving the conversion of the close corporation, signed by members holding at least 75% of the members interest in the corporation

- A MOI consistent with the requirements of the Companies Act 2008.
- The prescribed filing fee

Every member of a close corporation that has been converted is entitled to become a shareholder of the company and furthermore shares to be held in the company by the shareholders individually need not necessarily be in proportion to the members' interest as stated in the founding statement of the close corporation

The ultra vires doctrine has no application in respect of close corporations. The statement of the principle business of corporation in the founding statement does not affect the corporation's capacity and powers.

There is no constructive notice of any particulars stated in the founding statement, and therefore 3rd parties will not be adversely affected by any limitation in a close corporation's founding statement. Consequently all contracts entered into by a close corporation with outsiders will be valid, even if the transaction goes beyond the stated business of the corporation.

The founding statement is the sole compulsory document for close corporations
An association agreement is an optional agreement that can be concluded by members of a close corporation

Each member of a close corporation has a members' interest in the corporation; the members' interest is expressed as a percentage. A member's interest may not be held jointly this is to ensure that the member number restriction is not evaded through joint holding of members' interest.

A person becomes a member of a close corporation when the founding statement reflecting that members' member was registered. Each member is entitled to be issued with a certificate of members' interest, signed by or on behalf of the members of the corporation, stating the current percentage of that members' interest in the close corporation – dual function, reflecting membership and the member's interest. There is no securities register as in the case of a company. The statement and any amended founding statement is filed with and kept by the Commission.

A member ceases to be a member after disposing his or her members' interest and after the registration of an amended founding statement reflecting loss of membership.

A member's interest is a personal right against the corporation, entitling the member to a proportionate share in the aggregate members' interest to participate in the distribution of profits and to share in a distribution of assets on liquidation once the creditors have been paid.

An association agreement – a written agreement between members regulating internal relationships and other lawful matters

POWER OF MEMBERS TO CONTRACT ON BEHALF OF THE CLOSE CORPORATION

Every member of a close corporation has the authority to conclude contracts on behalf of the close corporation (be agent of the corporation) in relation to a person who is not a member.

Any act of a member shall bind a corporation whether such act was performed in connection with the business of the close corporation or not, unless

The member lacked authority to act for the close corporation in the particular matter and the person with whom the member deals has or ought to have had knowledge of the member's lack of authority.

Will a close corporation be bound by a contract where a person went beyond its authority (Nov 2014/2012 exam):

- Every member of a close corporation has to authority to conclude contracts, act as an agent of the close corporation.
- The doctrine of constructive notice does not apply to close corporations, therefore third parties are not deemed to have knowledge regarding the close corporations' registered documents
- Close Corporations are generally bound to any contract concluded with outsiders, regardless whether or not the transaction falls within the scope of the business main business.
- A close corporation may however escape liability if the third party new or reasonably ought to be aware that the member in fact did not had the authority to do so.
- J&K Timbers (Pty) Ltd, the court held that a member is an agent, even though no authority, express or implied has been conferred on him by the close corporation. The close corporation is bound by the related act unless the third party know or reasonably ought to known of the absence of power.
- The close corporation will be bound by the contract

ACQUISITION AND DISPOSAL OF MEMBER'S INTEREST

The act makes specific provision for the disposal of a member's interest in the event of:

- the death or
- insolvency of a member and
- where a member's interest in attached and sold by way of sale in execution.
- It also provides for the termination of membership pursuant to a court order

Disposition can either be to another person qualifying for membership or to the corporation. It is advisable for the disposal of a member's interest in the association agreement – i.e. by making it subject to right of pre-emption in favour of other members of the corporation

Otherwise, consent of all the other members to the disposal are required, which means that any member objecting to the disposal has in effect right to veto and may result in the necessity of obtaining a court application to resolve the matter.

Acquisition:

- By becoming a member upon registration
- Acquiring a member's interest from existing members
- Making a contribution to the close corporation

Disposal:

1. Must be made in accordance the association agreement or
2. All members must consent

In the event of an insolvent member or a sale in execution of a member's interest pursuant to an attachment to satisfy, a judgment debt. The Act contains a mandatory procedure for the disposal of the insolvent members' interest:

- Members interest may be sold to the corporation;
- To other members or
- An outsider who qualified for membership which is
    - Subject to right of pre-emption in favour of the corporation and other members.

The money will thereafter be paid over to the creditors

Procedure is aimed at striking a balance between the interests of the other members in controlling who can become a member of a close corporation on the one hand and the creditors of the insolvent member on the other.

Death of a member:
A member may bequeath his or her member's interest to his heir or legatee in a will.

- In terms of section 35 of the Close Corporations Act, the law applies unless it is determined otherwise in an association agreement.

Before the members' interest may be transferred to the heir, **the other members of the close corporation must consent.**

If permission is not granted by the other members, the executor may:

- Sell the membership interest to the corporation,
- To another member or
- To a third party subject to a right of pre-emption in favour of existing members

DUTIES MEMBERS OWES TO THE CLOSE CORPORATION

The act imposes two specific duties on members towards the corporation (these statutory provisions are based on common-law duties):

1. A Fiduciary duty; and
   - To act honestly and in good faith
   - Not to exceed his or her powers
   - Not compete with the corporation's business activities in any way
   - Disclose any material interest in a transaction to other members as soon as possible (Where a member fails to do so the contract is voidable)
   - Avoid conflict of interest between his own and those of the close corporation
   - Not to derive any personal gain to which he or she is not entitled by virtue of being members of the close corporation

   A member who breaches a duty arising from his or fiduciary relationship is personally liable to the corporation for any loss suffered by the corporation or for any economic benefit derived by the member. Must repay any benefit obtained as a result of breaching that duty. Conduct will not constitute breach if the conduct has the written approval of all the members and if they were aware of all the material facts
2. A duty of care and skill
   A member will be liable for a breach of duty care and skill, **only if this has resulted in a loss for the corporation.** The standard care is that which may reasonably be expected from a person with that member's knowledge and experience. This introduces a subjective element into the test. Liability will not be incurred if the conduct has the written approval of all the members.

   LEGAL PROCEEDING FOR BREACH OF DUTY
   Requires the authorisation of member's resolution by at least 51%. In certain circumstances, any other member may institute proceedings on behalf of the corporation, irrespective size of that person's member's interest. Proceeding may be brought against a member or a former member through the breach of his or her fiduciary duty or duty of care or skill. Section 51 provides a statutory derivative action with the corporation being the plaintiff.

CESSATION OF MEMBERSHIP BY COURT ORDER

- Termination by order to the court:
  Grounds for termination:
  The permanent inability of the member to perform (not sound of mind)
  Conduct of member has prejudicial effect on carrying on the business

Conduct makes it reasonably impossible for other members tin the carrying on of the business Where there a circumstance it is just and equitable to do so

- Assistance from the court is available to a member if there was a single act or omission in conduct by the corporation or other members that was unfairly prejudicial to such member

In the Gatenby case it was held that the court enjoys a wide discretion in the order it make to provide relief to the victim of oppressive conduct. Court ordered the sale of the corporation's sole asset **to place the close corporation in a financial position to buy back an aggrieved member's interest**.

In De Franca case the court held that it enjoyed discretion to order the purchase of any member's interest by other members or by the corporation **if the court finds it just and equitable to do so**. The court however requires **proof of the value of the member's interest to order to establish a fair price for the member's interest.**

ACQUISITION OF MEMBER'S INTEREST BY THE CORPORATION
Special requirements in the application of the solvency and liquidity test apply when:
A member's interest is acquired by the close corporation itself. This is to ensure creditor for the corporation are not prejudiced by the buyback

The members' interest acquired by the corporation must be added to the respective interest of the other members as agreed or in proportion to their existing interests in order to keep the aggregate at 100%. The corporation may pay for the interest only if it has the previously obtained written consent of the other members to the specific payment and if they comply with the statutory solvency and liquidity requirements.

The solvency and liquidity requirements are:

- After payment has been made the corporation asses fairly valued must exceeds its liabilities;
- Corporation must be able to pay its debts as they become due in the ordinarily course of business and
- The payment must not render the corporation unable to pay its debts in the ordinary course of business

Special requirements also apply where the corporation gives financial assistance to any other person to enable that person to acquire a member's interest in the corporation:
Written consent of every member to the specific assistance and compliance to the solvency and liquidity requirements.

INTERNAL RELATIONS AN ASSOCIATION AGREEMENTS
Association agreements are optional. It is however highly desirable for corporations with more than one member. It is a written agreement signed by or on behalf of each member. A new member is bound by an existing association agreement, as if he or she signed it as a party. Amendment or dissolution must be in writing and signed by all. Non-members are not entitled to inspect it and no person dealing with the corporation is deemed to have constructive knowledge of that agreement. Not lodged with the Commission.

It cannot change:

- Manner in which an insolvent member's interest is disposed of
- Cannot override the Act disqualification rules to which disqualifies a member
- Every member have unalterable right to call a meeting

Default rules between members:

- Every member is entitled to participate in the carrying on of the business

- Member have equal rights to management of the business, however consent in writing of members holding at least 75% of the members interest are required for:
  - Change in the principle business
  - Disposal of the whole or substantial part of the undertakings of the corporation
  - Disposal of all or the greater portion of the assets of the corporation
  - Any acquisition or disposal of immovable property
- Differences between members are decided on by majority vote
- Number of votes that correspond to their interest in the corporation
- Corporation must indemnify every member in respect of expenditure incurred in the ordinary course of business or anything done for the preservation of the business or property
- Payment to members by reason only of their membership as agreed are made in proportion of their respective interests

PROHIBITION ON LOANS TO AND SECURITY ON BEHALF OF MEMBERS
Without the express prior consent of all its members in writing, a corporation may not make a loan directly or indirectly:

- To any of its members
- To any other corporation in which one or more members hold together more than 50% interest
- To a company or other type of juristic person controlled by one or more corporation members

A loan or security in breach of the restriction is invalid and cannot be subsequently ratified.

ACCOUNTING OFFICER, ACCOUNTING RECORDS AND ANNUAL FINANCIAL STATEMENTS

A Close corporation need not appoint an auditor, it must however appoint an accounting officer.

There must be approval of the annual financial statements by at least 51% of the members' interest.

Annual financial statements need to be audited if the close corporation falls within the categories of a private company that requires auditing.
The accounting officer must report to the Commission if:

- Found that the fin statements indicate liabilities exceeds its assets
- Fin statements incorrectly indicate assets exceeds liabilities
- If he or she believes that such an in-corrective indication is given

PAYMENT BY CORPORATION TO MEMBERS (Nov 2014/June 2012 exam)
Section 51 of the Close Corporation provides:
Any payment by a close corporation by reason only of his or her membership may be made only:
If the corporation meets the solvency and liquidity requirements after payment is made.

A payment includes distribution or repayment of the whole of part of any distribution to a member. A distribution of income requires approval by way of formal resolution of members holding at least 51% of the members' interest. A member is liable to the corporation for any payment received contrary to the solvency and liquidity requirements.

Payment to a member in his or her capacity as a creditor or employee are excluded

PERSONAL LIABILITY FOR A CORPORATION'S DEBTS

A member of a close corporation can be personally liable for the debts of a close corporation. This is to ensure compliance with the provisions of the Close Corporation Act by providing for personal liability when there has been abuse of the separate juristic personality of the corporation.

Common law position is that in which a court can lift the corporate veil of a company.

A member of a close corporation who does not make the agreed upon contribution to the close corporation can be held personally liable for debts of the corporation (Section 63 of the Close Corporation Act)

When a close corporation acted operated recklessly, gross negligent and fraudulent manner Section 64 applies. A court can declare any person who was knowingly party to carrying on the business in such a manner personally liable for debts or other liabilities.
If the business carried on when a reasonable man would've recognised there was risk of non-payment of the loan, it can be said the business was being carried recklessly. Non-disclosure could be considered as fraudulent. Determination of whether all the members were knowingly party to the conduct. Potentially all the members could be liable.