

COMPANY LAW MATTERS

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A new dawn for South African Company Law

The Companies Act 71 of 2008 has been assented to by the President and is now a law of the land. The President has yet to set a date on which the new Companies Act (the new Act) will come into operation, which may not be earlier than April 2010. According to the draft King III report it is expected that the new Act will become operative on 1 July 2010.

It was envisaged that the recent reform of South African company law would happen in two stages. Firstly, urgent interim changes were brought about by the Corporate Laws Amendment Act 2006, which came into effect during December 2007. Secondly, the new Act will repeal and replace the entire Companies Act of 1973 when it becomes operational.

This does not, however, mean that we need to forget everything that we have learnt about company law thus far and start from scratch. It was decided during the reform process to retain many provisions of the current law which were found to be “*appropriate for the legal, economic and social context of South Africa as a constitutional democracy and open economy.*” The body of case law making up the common law applicable to companies will also remain intact. Many of the principles introduced in the Corporate Laws Amendment Act will be retained, such as the harmonisation between company law and the laws regulating the auditing

profession, greater transparency and accountability requirements for certain companies, and the permitting of financial assistance.

The new Act will co-exist with the Close Corporations Act, provided that no new Close Corporations (CCs) will be incorporated and no further conversions from private companies to CC will be

permitted after the new Act becomes operational. Existing CCs will continue to operate under the Close Corporations Act until such time as the members decide it is in their interest to convert into a company.

This issue will be the first of a series of newsletters where we will discuss the new Act and highlight some changes to our company law.

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Establishing a Company in terms of the new Act

Principal themes of the company law reform include the simplification of incorporation, aimed at reducing costs in order to encourage enterprise development, and the creation of a predictable regulatory environment which will encourage foreign investment. All are hopeful that the new company law regime, which is in keeping with international best practice, will create an enabling environment for economic growth in South Africa.

In the new Act, familiar terms and concepts such as private and public companies have been retained. The new Act does not include the concept of “widely held companies”, which in terms of the Corporate Laws Amendment Act 2006, extends across the existing categorisation of companies, and serves as a foundation for imposing higher standards of transparency and accountability. The concepts of “public interest companies” and “limited interest companies” based on thresholds that appeared in the first draft of the Bill released in 2007, have also been dropped.

The new Act divides all companies into two broad categories, namely “profit companies” and “non-profit companies”. The non-profit companies are the successor to Section 21 companies. There are four types of profit companies, namely private companies, public companies, personal liability companies (which used to be the old Section 53b companies available to incorporated partnerships), and a new category of companies called “state owned companies”.

The new Act makes incorporation of a company a right. One or more person may incorporate a profit company, and three or more persons may incorporate a non profit company. It will no longer be necessary for every company to have the memorandum and articles of association, but one founding document, the Memorandum of Incorporation, will be required. The incorporation process in its simplest form will entail signing a Memorandum of Incorporation, filing a Notice of Incorporation and paying an incorporation fee. The Memorandum may be pro forma or tailored to suit the specific company, but the form does not suggest or impose any provisions. The Commission must register a company, even if its chosen name is unavailable, by assigning a registration number as well as an interim name of the company. All companies will have all compatible legal powers, unless specifically restricted by a Memorandum of Incorporation. A company will continue to exist as a juristic person until it is de-registered.

The new Act defines a foreign company as an entity incorporated outside South Africa, irrespective of whether it is a profit or non-profit company, or carries on business in South Africa. All foreign companies carrying on business or non-profit activities in South Africa will be required to register as external companies in terms of the new Act.

In terms of the Corporate Laws Amendment Act of 2006, greater accountability and transparency provisions were introduced for widely held companies, which had to amongst other requirements, appoint an audit committee. The new Act provides for certain minimum levels of accountability and transparency for all companies and enhanced transparency and accountability requirements for public companies and state owned enterprises. The enhanced transparency and accountability requirements can also apply to private companies, personal liability companies and non-profit companies that choose to make them applicable and state as much in the Memorandum of Incorporation. Companies that must comply with the enhanced transparency and accountability provisions have to appoint an audit committee who will be responsible for nominating the auditors and determining their remuneration.

Under the new Act, shares will no longer have a nominal or a par value. All shares will therefore effectively be treated like no par value shares. Section 36(3) of the Act represents a major shift, since except to the extent that the Memorandum provides otherwise, a company’s board may increase or decrease the number of shares, or reclassify any shares that have been authorised but not issued, or determine the rights that attach to shares in a specific class. This is in stark contrast to Section 75 of the 1973 Companies Act, which provides that a company may, if authorised by its articles, alter its share capital and shares by way of special resolution. The apparent motivation for this provision is to enable South African companies to compete for capital more effectively in world markets with companies whose boards already have the power to finance their businesses quickly and efficiently.

The new Act will create a variety of new regulatory agencies that will be responsible for administering the Act. A Companies and Intellectual Property Commission (the Commission) will be established to attend to registration of companies and intellectual property rights and maintain proper records, and the enforcement

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of the Act. The Commission will essentially take over the role currently fulfilled by CIPRO.

There will also be a Companies Tribunal which will adjudicate any applications made in terms of the Act and also assist in the resolution of disputes. The Takeover Regulation Panel will regulate affected transactions and offers in terms of chapter 5 of the new Act. A Financial Reporting Standards Council will advise and

consult with the Minister of Trade and Industry about developing financial reporting standards.

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Directors' duties and board governance

The most important provisions in the new Act from a corporate or board governance perspective, are those creating a new dispensation of statutory duties for directors. Section 76 (under the heading “*Standards of directors conduct*”) creates a dispensation of statutory fiduciary duties for directors (to act in good faith for a proper purpose and in the best interest of the company) and the duty of reasonable care (to act with the degree of care, skill and diligence of a director that may reasonably be expected of a person, measured both objectively and subjectively).

The statutory duties can be described as an attempt to partly codify the well-known common law duties of directors and brings our company law in line with other jurisdictions (for example Chapter 2D of the Australian Corporations Act 2001).

An important and unique difference from other jurisdictions contained in the new Act is, however, a positive duty found in section 76(2) that a director must disclose any material information (not only confidential information) to the board. This obligation can be seen as more onerous than the common law duties.

The question arises, if the new statutory duties are in general more onerous than the common law duties?

The most important consideration in responding to this question is that section 76(4) contains a very helpful defence for a director to alleviate any of these perceived more onerous duties. This provision is substantially similar to section 180 (2) of the Australian Corporation Act 2001 - the so-called “*business judgment rule*”.

The rule consists of both an objective and subjective element. A director will have fulfilled these duties if the director has:

- taken “*reasonably diligent steps to become informed of the matter*”;
- had “*no material personal interest*” in the subject matter (or has complied with the disclosure requirements as contemplated in section 75); and
- had “*a rational basis for believing and did believe*” that the decision is in the best interest of the company.

A director is further entitled to rely on the performance of and information supplied by third parties when making such decisions, which include for example any delegated person, competent employees, professional advisors and board committees.

The statutory duties of directors are supplemented by new provisions addressing conflicts of interest in section 75. This section contains a fairly comprehensive procedure to be followed by a director to disclose any personal financial interest, or if the director knows that a related person has a personal financial interest. These procedures and obligations are more onerous than the current provisions in the Companies Act of 1973.

Section 77(2) deals in a consolidated and concentrated way with the liability of a director who breaches these duties. When a fiduciary duty is breached, the principles of the common law will apply. Where the duty of reasonable care is breached, a director will be held liable in accordance with the principles of the common law relating to delict for any loss that the company may suffer.

A director can further in terms of section 162(5)(c) be declared by a court to be a delinquent director. This procedure is available to the company, a shareholder, director, company secretary or prescribed officer, a registered trade union or another representative of the employees of a company. A declaration for delinquency

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may in terms of section 162 (6) be made subject to any conditions the court considers appropriate and subsists for seven years or longer.

An important provision from a board structure perspective is section 72, which specifically entitles a board to appoint board committees.

The only prescribed committee (for a public company, state-owned company or company that voluntarily chooses to do so) will be an audit committee.

An interesting new provision is that of section 72(4) that will require the implementation of a social and ethics committee, which will be compulsory for companies as prescribed by the Minister. The powers and objective of this proposed committee is unclear at this stage.

The new Act further contains provisions which aim to promote transparency and accountability. A summary of some of these provisions is:

- flexibility in the manner and form of shareholders meetings, the exercise of proxy rights and the standards for the adoption of ordinary and special resolutions;

- retaining the existing qualifications for directors with enhanced flexibility for very small companies with a single shareholder or director;
- recognition of alternate directors, directors who may be appointed by designated persons and *ex officio* directors; and
- the introduction of a more certain and nuanced scheme for the removal of directors - section 71 provides that both shareholders and directors are entitled to remove a director.

These provisions should all be welcomed and will in due course be enhanced by possible additional corporate governance guidelines to be contained in the King III Report, which was published for comment in early 2009. The statutory duties of the new Act of directors are certainly one of the more controversial parts of the new Act and their practical implementation and their effect will most certainly be lively debated.

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Fundamental transactions, takeovers and offers

Chapter 5 of the new Act contains provisions under the heading “*Fundamental Transactions, Takeovers and Offers*”, which introduces a new dispensation for transactions that fundamentally alter a company. A high level summary of these transactions is as follows:

Disposal of all or the greater part of assets or undertaking

- This type of transaction is dealt with in section 112 and is substantially the same as section 228 of the current Companies Act of 1973.
- If a company wishes to dispose of all or the greater part of its assets or undertaking, the disposal has to be approved by a special resolution of its shareholders and the requirements of section 115 have to be met.
- The notice to shareholders to consider the proposed disposal must include a written summary of the precise terms of the transaction and comply with section 164, which gives a dissenting shareholder appraisal rights that include the right to be paid the fair value of the shares by the company.

Amalgamation or merger of two or more profit companies

- Section 113 is a completely new innovation and requires that two or more companies proposing to amalgamate or merge must enter into a written agreement setting out the terms and means of effecting the transaction, meeting fairly extensive prescribed disclosure requirements, as set out in section 113(2).

The matters to be disclosed include, for example, details of the proposed allocation of the assets and liabilities, subsequent management and the estimated cost of the proposed amalgamation or merger.

- Section 113(3) provides that the transaction could include the cancellation or conversion of securities, which will make the use thereof quite flexible.
- Section 113(4) requires that the board of each company must first consider if the proposed merger will meet the solvency and liquidity tests and if they reasonably believe so, the proposal

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has to be approved by special resolution as contemplated in section 115.

Schemes of arrangement

- The procedures for schemes of arrangement have been substantially amended.
- Section 114 is limited to a scheme between the company and holders of any class of securities and includes a reorganisation in several ways, for example a consolidation, division, expropriation, exchanging, re-acquisition (or any combination) of securities.
- Section 114(2) requires that an independent duly qualified expert must be retained to prepare a report to the board of the proposed arrangement, containing comprehensive information as prescribed in section 114(3).

Required approval

- Section 115(2) requires that any of the previously mentioned transactions in sections 112 to 114 must be approved by a special resolution at a meeting called for that purpose.
- A company may (in terms of section 115(3)), however, not proceed to implement the resolution without the approval of the court, if:
 - the resolution was opposed by at least 15% of the voting rights that were exercised on that resolution, and any person who voted against it requires the company to seek court approval. In this instance the company has to make the application or treat the resolution as a nullity; or
 - the court, on application by any person who voted against the resolution, grants that person leave to apply to a court to review the transaction. The court will only grant leave if it is satisfied that the applicant is acting in good faith, appears prepared and able to sustain the proceedings and has alleged facts which would support the court to reach a decision.
- The court may in terms of section 114(7) only set a resolution aside if there was a significant and material procedural irregularity, and if it was, for example, manifestly unfair to

any class of security holders, or the vote was materially tainted by conflict of interest or if there was inadequate disclosure.

A holder of securities is further entitled to make use of the appraisal rights provisions contained in section 164, if the holder notified the company in advance of its intention to oppose a special resolution and was present at the meeting and voted against the resolution.

Any person may also in terms of section 115(9) apply to a court for an order to properly implement the amalgamation or merger.

The last step in the merger process is that of section 116, which requires a notice to be given to all known creditors. Any creditor may within 15 business days after delivery of such notice approach a court for review, if it will be materially prejudiced by the amalgamation or merger. The notice must contain specifically prescribed information and confirmations that there was compliance with required legislation and must be filed with the Commission.

The previously known Securities Regulation Panel becomes, in terms of section 196, a statutory body known as the Takeover Regulation Panel. The most important effect of this is that the Takeover Regulation Panel will in future regulate affected transactions by way of Takeover Regulations with statutory powers.

The most important changes to the current takeover provisions is the introduction of an amalgamation and merger mechanism (section 113) and the fact that court approval will only be required when there was a significant minority (at least 15%) opposed to the transaction, or if there was a procedural irregularity or a manifestly unfair result. These changes will substantially affect the takeover and merger mechanisms and will be discussed more fully in future newsletters.

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