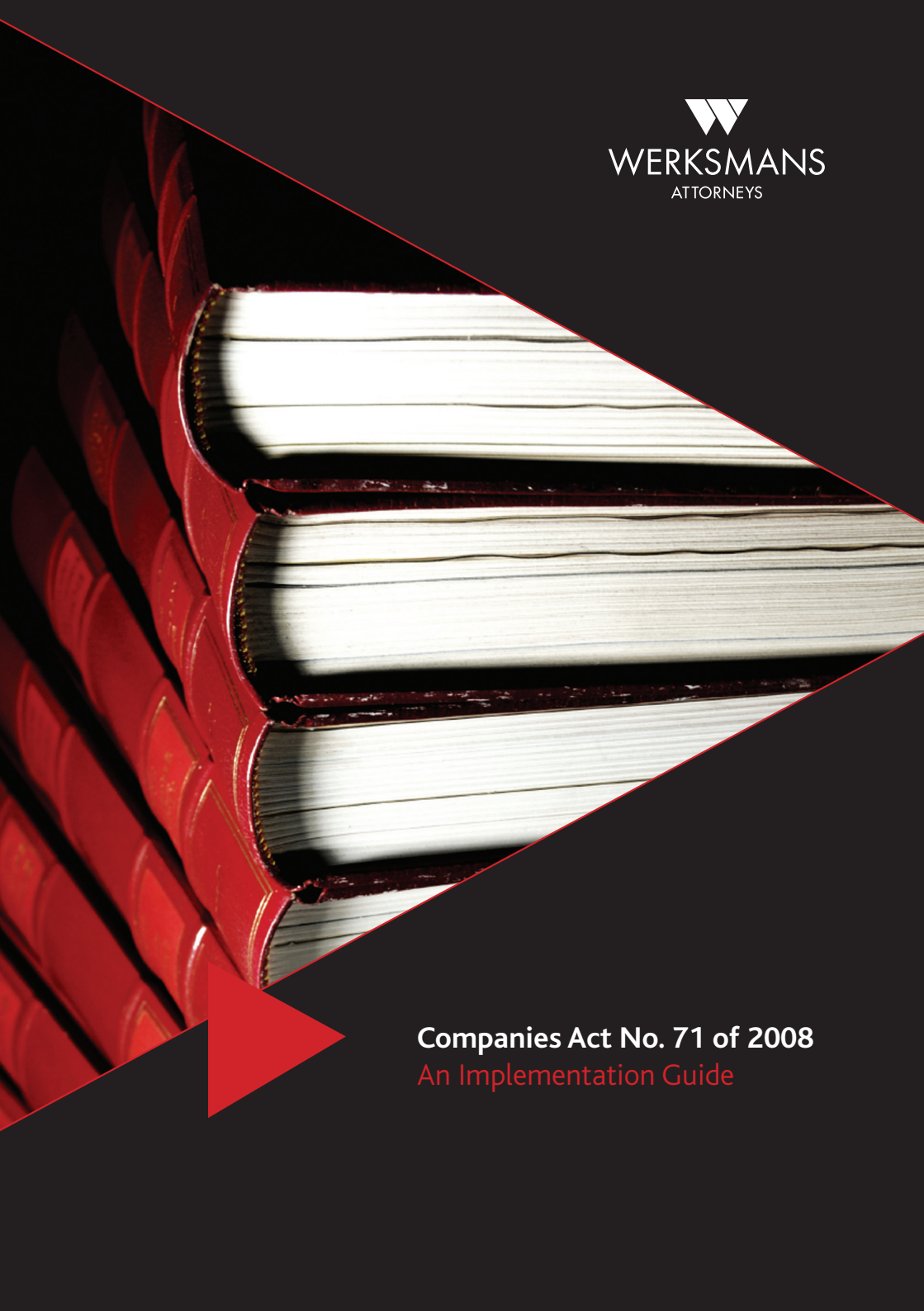

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Companies Act No. 71 of 2008

An Implementation Guide

The New Companies Act – An Implementation Guide

It has been announced that the new Companies Act No. 71 of 2008 (New Act), which will repeal the existing Companies Act No. 61 of 1973 (Old Act), will come into effect on 1 May 2011.

While the New Act does allow a two year transitional period (Transitional Period) from the date on which the New Act becomes effective (Effective Date) in order to allow pre-existing companies to adjust to the New Act, the Transitional Period only applies to a limited number of issues. In almost all respects, the New Act will be of full force on the Effective Date and so pre-existing companies should not be complacent about the need to comply with the New Act.

The implementation checklist that follows identifies those issues which ought to be addressed or considered by companies in the lead up to, and immediately following, the implementation of the New Act in order to ensure a smooth transition from the old to the new statutory regime.[1]

Implementation Checklist

1	Adopt a new Memorandum of Incorporation	✓
2	Consider the role of existing shareholders agreements	✓
3	Change name to reflect new rules on name endings, if required	✓
4	Identify prescribed officers	✓
5	Check that all directors, prescribed officers, committee members, company secretaries and auditors are eligible and not disqualified	✓
6	Educate directors, prescribed officers and other relevant staff as to their responsibilities	✓
7	Consider whether adequate indemnity and/or insurance has been provided for directors and public officers	✓
8	Establish audit committee and social and ethics committee with correct membership, if required	✓
9	Determine the extent of the company's responsibility to have its financial statements audited and appoint an auditor where necessary	✓
10	Ensure that all notices to shareholders and other documents are in the prescribed form or in plain language	✓
11	Endorse share certificates where the transfer of shares is restricted	✓
12	Optional conversion of par value shares to shares having no par value	✓
13	Companies limited by guarantee must elect to become a profit company and make the necessary consequential changes or become a non profit company	✓
14	Comply with the new Act, especially with the provisions dealing with:	✓
	▶ the duties, conduct and liabilities of directors	✓
	▶ rights of shareholders to receive notices and have access to information	✓
	▶ meetings of shareholders and directors, and the adoption of resolutions	✓
	▶ approvals required for any distributions, financial assistance (including intra-group loans), insider share issues and options	✓
	▶ fundamental transactions, take-overs and offers	✓
	(except to the extent that the transitional arrangements delay its effect)	
15	Listed companies should comply with the amended JSE Listings Requirements	✓

[1] This article is partly based on the published draft of the Regulations to be issued under the New Act (Regulations) and the Companies Amendment Bill No. 40 of 2010 which, as at the time of writing this article, have not yet been adopted and promulgated as law.

Memorandum of Incorporation

The current constitutional documents of a company, being its memorandum and articles of association, will be replaced by a single Memorandum of Incorporation (MOI).

Companies may file a new MOI with the Companies and Intellectual Property Commission in order to bring their constitutional documents into line with the provisions of the New Act. If a company does so within the Transitional Period the new filing will be without charge.

During the Transitional Period, if a conflict exists between the provisions of the New Act and a company's existing constitutional documents, the latter will prevail, except in respect of the provisions of the New Act which deal with the following issues and which will come into effect on the Effective Date (Immediately Effective Provisions):

- the duties, conduct and liabilities of directors
- rights of shareholders to receive notices and have access to information
- meetings of shareholders and directors, and the adoption of resolutions
- approvals required for any distributions, financial assistance, insider share issues and options
- fundamental transactions, take-overs and offers (except to the extent exempted)

Clearly these Immediately Effective Provisions cover a significant proportion of the matters usually regulated by a company's constitutional documents. Therefore, during the Transitional Period, a pre-existing company is not simply able to rely on any provision of its articles of association prevailing over the provisions of the New Act, without an assessment of the extent to which the matter at hand is covered by the Immediately Effective Provisions.

In order to avoid the untenable governance and administrative burden that would result from constantly having to reconcile a number of sources of governance, it is recommended that proper assessment of a company's constitutional documents be undertaken and that all pre-existing companies attend to the formulation and filing of new MOIs as soon as possible after the Effective Date, rather than waiting until the end of the Transitional Period.

A further advantage of adopting a new MOI is that companies are then able to decide where they wish to alter the alterable provisions of the New Act. (Unalterable provisions of the New Act, being those that do not expressly contemplate that their effect may be negated, altered, limited or qualified in substance or effect by a company's MOI, may of course not be altered).

One alterable aspect of the New Act is the threshold of support required for the adoption of shareholders resolutions. Under the Old Act, ordinary resolutions require approval by more than 50% of the voting rights exercised on the resolution, and special resolutions require approval by at least 75% of the voting rights exercised at a specially quorate meeting. The New Act retains these percentages as default thresholds, but allows a company, in its MOI, to adjust these percentages, within certain stipulated parameters. The MOI may require a higher percentage than 50% for the approval of an ordinary resolution (other than the removal of a director). The MOI may also require a percentage other than 75% for the approval of special resolutions, provided that there is a margin of at least 10% between the ordinary resolution percentage and the special resolution percentage. Therefore, during the MOI formulation process, companies will need to consider whether they wish to adjust the default thresholds for adopting ordinary resolutions and special resolutions, either generally or in respect of any specific matter.

Shareholders Agreements

It is common practice for a shareholders agreement to stipulate that in the event of a conflict between the provisions of that agreement and the provisions of the relevant company's articles of association, the shareholders agreement will prevail. The New Act will curtail the ability of shareholders to regulate this issue contractually.

During the Transitional Period, shareholders agreements will continue to have force and effect and the New Act provides that, in the event of a conflict between those provisions and the provisions of the company's MOI or the New Act, the shareholders agreement will prevail, except to the extent provided for in the MOI or the shareholders agreement itself.

However, it is still necessary for companies to review shareholders agreements for inconsistencies with the New Act because, following the Transitional Period, if any provision of a shareholders agreement is inconsistent with the New Act, it will be void to the extent of the inconsistency.

If, however, the shareholders agreement is amended during the Transitional Period, then the paramountcy of the shareholders agreement will be forfeited, and shareholders should therefore be extremely cautious before making any amendment to their shareholders agreement.

Company Rules

The New Act allows the board of directors of a company to make rules, in the prescribed manner, relating to the governance of the company, in respect of matters that are not addressed in the New Act or its MOI. Any such rules made by the board will only be valid on an interim basis, until ratified by an ordinary resolution of the shareholders.

As a consequence, the likely role of rules will be to supplement the MOI on a temporary basis in respect of the issues of a procedural nature which have been omitted from the MOI.

New rules must be consistent with the New Act and the company's MOI. Any existing rules (such as by-laws, although these are uncommon), which are not consistent with the New Act will be void to the extent of the inconsistency - other than during the Transitional Period when they are treated in the same way as shareholders agreements.

Any company which does currently rely on such rules should review them and will, in all likelihood, find it advantageous to incorporate them in the new MOI prior to the end of the Transitional Period.

Categories of Companies

While the essential nature of a company will not change, the New Act introduces a new classification of companies.

Firstly, the New Act distinguishes between profit companies and non-profit companies (the successors to pre-existing "section 21 companies").

A profit company may be:

- a private company, being a company which is prohibited from offering securities to the public and which restricts the transferability of its shares in its MOI
- a personal liability company, being a private company whose directors are jointly and severally liable for debts of the company
- a state-owned company, being a company contemplated in the Public Finance Management Act No. 1 of 1999 or owned by a municipality
- a public company, being a company which is not a private, personal liability or state-owned company

Pre-existing companies incorporated in terms of section 21 of the Old Act, personal liability companies incorporated in terms of section 53(b) of the Old Act, and companies falling within the definition of a "state-owned company" will be deemed to have amended their constitutional documents as at the Effective Date to state that they are non-profit companies, personal liability companies or state-owned companies, respectively.

However, a company limited by guarantee (incorporated other than in terms of section 21 of the Old Act) may file a notice within 20 business days after the Effective Date electing to become a profit company (whereupon it would need to effect consequential changes such as the creation of a share capital), failing which it will be deemed to have amended its MOI as of the Effective Date to expressly state that it is a non-profit company.

Company Name

The name of:

- a private company will end "Proprietary Limited"
- a personal liability company will end "Incorporated"
- a state-owned company will end "SOC Ltd"
- a public company will end "Limited"
- a non-profit company will end "NPC"

Existing companies incorporated in terms of section 21 of the Old Act, companies incorporated in terms of section 53(b) of the Old Act, and companies falling within the definition of "state-owned companies" are deemed to have amended their constitutional documents as at the Effective Date to change their names in order to comply with the provisions of the New Act. A company limited by guarantee (other than in terms of section 21 of the Old Act) will have to file a notice of name change if it elects, within 20 business days after the Effective Date, to become a profit company.

Other companies, the names of which are not changed by default as described in the preceding paragraph, will be required to effect name changes themselves. In this regard, a pre-existing company may file, without charge and if necessary, a notice of name change and copy of a special resolution altering its name within the Transitional Period.

If a company's MOI contains any provisions which restrict or prohibit the amendment of any particular provision of the MOI, then the name of the company must be followed immediately by the expression "(RF)".

In all instances, companies should use the correct names, as changed by the New Act if applicable, in their documents.

Conversion of Par Value Shares

Under the Old Act, a company may have shares having a nominal or par value as well as shares having no par value (provided they are not of the same class). Under the New Act, a share will not have a nominal or par value.

Any shares of a pre-existing company that have been issued with a nominal or par value, and are held by a shareholder immediately before the Effective Date, will continue to have the nominal or par value assigned to them when issued, subject to the provisions of the Regulations which will provide for the optional conversion and transitional status of any such shares.

The conversion process, in essence, requires a company to amend its MOI by a special resolution of its shareholders. The proposed resolution must be sent to shareholders along with a report prepared by the board of directors setting out all information relevant to the value of the shares affected by the proposed conversion, identifying the shareholders affected, describing the material effects that the proposed conversion will have on the rights of the affected shareholders, and evaluating any material adverse effects of the proposed arrangement against any compensation that shareholders will receive in terms of that arrangement.

A shareholder who believes that the proposal made by the board does not adequately protect its rights or does not provide for adequate compensation for the loss of any such rights may apply to Court for relief and the Court may make any order that is just and reasonable in the circumstances. The company is also entitled to apply to Court for a declaratory order that the proposal satisfies the requirements of the New Act.

A pre-existing company may not authorise any new par value shares after the Effective Date, but may issue further shares having a par value after the Effective Date from its authorised share capital as at the Effective Date (provided that any shares of the class in question have been issued) until such time as its proposal for conversion has been published.

Since the conversion is not compulsory, there is no time period during which such a conversion is required to take place.

Directors and Prescribed Officers

For the first time in South African company law, the duties and responsibilities of directors have been partially codified, in line with international trends. These provisions of the New Act will apply from the Effective Date, notwithstanding anything to the contrary in a company's constitutional documents, and are intended to supplement, rather than replace, the common law. Accordingly, the existing common law relating to directors' duties continues to apply to the extent that it has not been amended by, or is not inconsistent with, the New Act.

The duties and responsibilities of directors under the New Act will also apply to "prescribed officers" of a company and to members of board committees who are not directors, thus subjecting persons in management positions who are not directors to new obligations and possible personal liability.

A prescribed officer is a person who, despite not being a director of a company and irrespective of his or her title, exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company or regularly participates to a material degree in the exercise thereof.

Thus, it is critical that a company identifies its "prescribed officers" and ensures that they, as well as ordinary board directors and members of board committees, are informed about their required standards of conduct and their duties under the New Act, as well of their statutory liability for any breach thereof; their exposure to claims by third parties as well as from the company; and of the limits of an indemnity which may be granted to them by the company. Other staff who have responsibility for compliance with the New Act should also be educated about its provisions.

It would also be prudent for a company to ensure that it has adequate insurance cover in place to cover not only the liability of directors, but also the liability of all prescribed officers. The New Act now allows a company to indemnify both directors and prescribed officers against liabilities owed to both the company and third parties (subject to certain exceptions, including wilful misconduct and breach of trust) and, subject to those exceptions, gives a company the ability to purchase insurance which benefits both the company and its directors. Directors should consider whether they require any insurance policy to cover them directly instead of indirectly through the company.

It is also recommended that a company scrutinises the provisions of the New Act dealing with the eligibility and disqualification of directors, prescribed officers, company secretaries and auditors. This is because any such person who, in terms of the New Act, is ineligible to hold, or disqualified from holding, the office in question will be regarded as having resigned from that office as from the Effective Date. The company should also ensure that this does not result in vacancies causing the company to have less than the minimum number of directors prescribed by the New Act.

Corporate Finance

The approval of any distribution, financial assistance, issue of shares or options is subject to the New Act, even

if any such action had been approved by a company's shareholders before the Effective Date.

The New Act's definitions of these concepts have in some respect broadened their traditional meanings and companies should take note thereof. For example, section 45 dealing with financial assistance now also appears to require shareholder approval for intra-group loans. Consequently, unless any existing approval obtained prior to the Effective Date meets the requirements of the New Act, a new approval will have to be obtained for any distribution, financial assistance, insider share issues or options not implemented before the Effective Date.

Obligation to Audit Financial Statements

Each company must establish its obligation to have its annual financial statements audited. While every company is required to prepare annual financial statements, the New Act limits the companies required to be audited to:

- public companies
- state-owned companies
- any profit or non-profit company which (in the ordinary course of its activities) holds assets (exceeding R5 million in value) in a fiduciary capacity for any unrelated party
- any non-profit company incorporated by the state or an organ of state, an international entity or a foreign state entity or company, and certain other non-profit companies having public functions
- any other company which has a "public interest score" for a financial year, which falls within the parameters prescribed by the Regulations. This score takes account of the company's number of employees, unsecured debt, turnover and beneficial shareholders

A company not otherwise required to be audited may elect in its MOI to be subject to the extended transparency and accountability requirements set out in the New Act, which include the auditing of financial statements.

Even if a company is not subject to audit obligations, it may nevertheless elect to assume the audit obligation voluntarily (without assuming this obligation in its MOI), perhaps due to the requirements of its external funders or its corporate governance policies, for example.

Should a company not be required to have its annual financial statements audited, and not have elected to undertake this obligation voluntarily, then those statements will either have to be independently compiled and reported or independently reviewed depending on certain stipulated thresholds, and subject to specific exemptions.

A private company is exempt from the obligation to have its annual financial statements audited or independently reviewed if every beneficial holder of its securities is also a director.

Audit Committee

A company must assess whether or not it is required to appoint an audit committee (the functions of which will include the nomination of the company's auditor and the determination of its fees and independence, and responsibility for accounting practices and internal financial controls).

Under the New Act, each public company, state-owned company and other company which is required to do so by its MOI, must appoint an audit committee by way of shareholders resolution passed at the company's Annual General Meeting, in accordance with the provisions of the New Act which regulate the composition of audit committees and the independence of their members. However, a subsidiary of another company that has an audit committee which will perform the prescribed audit committee functions on its behalf need not appoint an audit committee.

The New Act requires that audit committees must consist of three independent, non executive directors as opposed to the two member committee that is required under the Old Act. The size of the audit committee has therefore been expanded.

The Regulations require that at least one-third of the members of the audit committee must have academic qualifications or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource management.

Companies will have 40 business days from the Effective Date to reorganise their audit committees. Since this re-organisation will, in most instances, involve the appointment of an additional member to the audit committee to fill a vacancy, it may be done by the board, subject to confirmation at the next Annual General Meeting of the company.

Company Secretary

Each company will need to assess whether or not it is required to appoint a company secretary. The obligation to do so is imposed on any public company, state-owned company and company which is required to do so in terms of its MOI.

Company secretaries should acquaint themselves with their duties under the New Act, including the somewhat onerous obligations to guide directors as to their duties, responsibilities and powers, to make them aware of any

law relevant to or affecting the company and to report to the board on failures to comply with the MOI or the New Act.

Social and Ethics Committee

Each company will need to assess whether or not it is required to appoint a social and ethics committee.

Listed public companies, state-owned companies and other companies having a "public interest score" within the parameters prescribed by the Regulations are required to appoint a social and ethics committee. The social and ethics committee must comprise not less than three directors of the company, at least one of whom must be a non-executive director, and must be appointed by pre-existing companies within twelve months after the Effective Date.

The main function of the social and ethics committee will be to monitor the company's activities and compliance with legislation relating to equality, black economic empowerment, good corporate citizenship, the environment, health, public safety and consumer and labour relations; to report to the shareholders at Annual General Meetings; and to advise the board of directors, where necessary.

Further Advice

The New Act re-writes South African company law completely and will have far reaching effects. Accordingly, companies should take immediate action in order to ensure their compliance with the New Act and in order to benefit from the advantages it offers.

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