

THE NEW COMPANIES ACT

A GLANCE AT THE IMMEDIATELY EFFECTIVE PROVISIONS

The long awaited Companies Act No. 71 of 2008 (“the New Act”) became effective on 1 May 2011. The New Act introduces significant changes and in certain instances welcome relief for companies and close corporations. It also poses a few challenges for directors, some of which are discussed below. The New Act allows for a 2 year transitional period to allow companies to adjust to the requirements of the New Act. It is important to note that the majority of the provisions of the New Act will be effective immediately, which emphasizes the importance for directors to familiarise themselves with the revised regulations.

During the transitional period, if a conflict exists between the New Act and the company’s current memorandum and articles of association, the latter will prevail, except with regards to the provisions that will become effective immediately as detailed under the “Immediately Effective Provisions” heading below. Under the circumstances where the company’s current constitutional documents do not cater for a specific situation the provisions of the New Act must be applied. After the 2 year transitional period the New Act must be applied to all actions and transactions of a company.

Immediately Effective Provisions

- Approval required for any distributions, financial assistance, insider share issues and options;
- The duties, conduct and liabilities of directors;
- Rights of shareholders to receive notices or have access to any information;
- Meetings of shareholders and directors and the adoption of resolutions;
- Requirements relating to fundamental transactions, takeovers and offers (except to the extent exempted).

Certain of the provisions, effective immediately, that are likely to have a significant impact on the majority of companies are discussed below.

MEMORANDUM OF INCORPORATION AND SHAREHOLDERS AGREEMENTS

A company’s memorandum and articles of association will be replaced by a single Memorandum of Incorporation (“MOI”). Through the adoption of the company’s MOI it will bring its constitutional documents in line with the provisions of the New Act.

Notwithstanding the fact that the New Act provides a company with a 2 year period to adopt the new MOI, early adoption of the new MOI would benefit the company as follows:

- The company will not have to compare the company’s constitutional documents with the provisions of the New Act in order to determine what regulates an action or transaction.
- The company can decide whether they wish to amend the alterable provisions of the New Act (for example thresholds relating to the approval of ordinary and special resolution as noted under the “Financial assistance to directors and related parties” section).

Due to the significance of the above mentioned Immediately Effective Provisions, even if a company has not replaced its current memorandum and articles of association with

the MOI, the company needs to consider the extent to which the New Act regulates a specific situation.

The stipulations of **shareholders agreements** currently in place will remain effective during the transitional period, or until changed by the shareholders, where after any provisions of the said agreement which are inconsistent with the New Act will not be valid to the extent of the inconsistency. **It is therefore recommended that shareholders agreements are renewed for inconsistencies with the New Act and if amendments are required, to obtain professional advice.**

The New Act further makes provision for a company’s board of directors to make rules, in the prescribed manner, governing matters not specifically dealt with in the New Act or the company’s MOI. The rules are additional to the requirements of the New Act and the company’s MOI, and the company is bound to comply with the said rules. These rules will only be valid and enforceable for as long as they are consistent with the New Act and the company’s constitutional documents. The rules made by the board should be ratified through an ordinary shareholders resolution.

FINANCIAL ASSISTANCE TO DIRECTORS AND RELATED PARTIES

The provisions of the New Act will apply to any financial assistance granted by a company to the following persons after 1 May 2011:

- A director or prescribed officer of the company or of a related or inter-related company;
- A related or inter-related company or corporation;
- A member of a related or inter-related corporation;
- A person related to any of the above.

Despite any provisions of a company's MOI the board of directors may not authorise the proposed financial assistance, unless:

1. The financial assistance is **authorised by the shareholders** in terms of a special resolution.

The authorisation by the shareholders for financial assistance can be granted to a specific recipient or generally for a category of potential recipients, with the specific recipient falling within the category. The shareholders can authorise financial assistance for a period of up to 2 years.

The board of directors ought to consider obtaining a special resolution from the company's shareholders granting them permission to provide financial assistance, up to a certain amount, to categories of recipients (for example to group companies, including the holding company, subsidiaries, fellow subsidiaries, associates and joint ventures) for a 2 year period. Without the general authority, the directors will be required to obtain authorisation from the shareholders for each transaction between the company and the recipients.

Under the New Act, similar to the provisions of the previous Act, special resolutions require approval by at least 75% of the voting rights exercised. The New Act allows a company to adjust this threshold,

provided that there is a margin of at least 10% between the ordinary resolution threshold percentage and the special resolution threshold percentage. An ordinary resolution requires approval by more than 50% of the voting rights exercised on the resolution. The MOI may increase the threshold for the approval of an ordinary resolution (other than the removal of a director).

2. The board is satisfied that:

- The company will be **solvent and liquid** immediately after the proposed financial assistance (refer discussion under the "Distributions to shareholders" section); and
- The **terms** under which the financial assistance is granted are **reasonable** and fair to the company;

3. The conditions and restrictions set out in the company's **MOI** have been complied with.

If the board adopts a resolution authorising financial assistance and the total value of the financial assistance, together with any previous such resolution during the financial year, exceeds 0.10% of the company's net worth at the time, the company must **provide written notice** of that resolution within 10 business days after the board adopts the resolution to:

- All shareholders, unless every shareholder is also a director of the company; and
- Any trade union representing the company's employees.

When the total value of the financial assistance, together with any previous such resolution during the year, is equal to or less than 0.10 % of the company's net worth at the time, the company must provide written notice to the aforementioned person(s) within 30 business days after the end of the financial year.



DISTRIBUTIONS TO SHAREHOLDERS

Distributions to shareholders are required to be authorised by the board of directors, similar to the provisions of the previous Act. The New Act stipulates that the directors must formally apply a solvency and liquidity test. They may only approve the distribution if the board reasonably believes that the company will be solvent and liquid immediately after the proposed distribution.

The board is required to formally, by resolution, acknowledge that it has applied the solvency and liquidity test. In order for the board to conclude that the company is solvent it must determine if the fair value of the company's assets exceeds the fair value of the company's liabilities, taking into account any potential contingent assets and liabilities as well as the subordination of loan claims against the company.

The directors' **resolution** authorising the distribution to the company's shareholders must contain the board's application of the solvency and liquidity test. The New Act requires approval by more than 50% of the voting rights exercised by the board for the directors' resolution to be valid.

DIRECTORS AND PRESCRIBED OFFICERS

The duties and responsibilities of directors will apply from the effective date of the New Act and applies to the following persons, irrespective of whether or not that person serves on the board of directors:

- Alternate directors;
- **Prescribed officers** (meaning persons who exercises, or regularly participates to a material degree in the exercise of general executive control over and management of a significant portion of the business and activities of a company);
- Persons who are members of a committee of a board of a company, or of the audit committee.

It is therefore crucial for a company to identify all individuals who are subject to the duties and responsibilities of directors as prescribed in the New Act in order to inform them about their responsibilities and to ensure adequate insurance is taken out by the company to cover not only the potential liability of directors, but also the potential liabilities of all prescribed officers.

Directors are required:

- Not to use their position or information obtained to gain any personal advantage or to cause harm or detriment to the company;

- To disclose any financial interest in any matter to the company;
- To act in good faith, in the best interest of the company with a degree of care, skill and diligence that may be reasonably expected.

A director may be **held liable** –

- For a breach of a fiduciary duty;
- For losses, damages and costs suffered by the company resulting from:
- Taking part in reckless trading by the company;
- Acting on behalf of the company without the necessary authorisation;
- Being party to acts or omissions of the company with the intention to defraud creditors, employees or shareholders;
- Signing, consenting to, or authorising the publication of false or misleading financial statements;
- Being present and failing to vote against:

- ◊ Issuing of unauthorised shares, securities or options;
- ◊ The acquisition by the company of its own shares, or granting of financial

assistance relating to the acquisition of securities of the company, without compliance to the requirements of the New Act;

- ◊ Granting financial assistance to a director or related party which was not in accordance with the requirements of the New Act (see below);
- ◊ A resolution approving a distribution to shareholders contrary to the New Act (see below).

A company may not release a director of the duties imposed by the New Act but the New Act allows a company to:

- Advance funds to a director to defend litigation in any proceedings arising out of the director's service to the company;
- **Indemnify** both directors and prescribed officers against liability owed to the company and third parties (subject to certain exclusions, including reckless trading, fraudulent activities and acting on behalf of the company without the necessary authorisation);
- Purchase **insurance** to cover both the company and its directors against the liabilities the company is allowed to indemnify its directors against.

MOVING FORWARD

The new legislation has changed the manner in which companies will operate. The introduction of the new concepts, regulations and rules is likely to create some uncertainty as to the practical application thereof. It is therefore advised that you consult with your professional advisors on matters regulated by the new Companies Act. The Partners and staff of Greenwoods together with our Secretarial department are here to assist and support you through this transitional period.

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This document contains a discussion of certain sections of the Companies Act 71 of 2008 and must not be read as a summary of the entire Companies Act 71 of 2008. Nothing in this document should be construed as professional advice from Greenwoods. Professional advice should be sought before taking action based on any information in this document.

24th Floor, ABSA Centre, 2 Riebeeck Street, Cape Town, 8001
P O Box 3311, Cape Town, 8000, South Africa
Tel: (021) 410 8500 Fax: (021) 419 6705
Email: info@greenwoods.co.za, Website: www.greenwoods.co.za

24ste Vloer, ABSA Sentrum, Riebeeckstraat 2, Kaapstad, 8001
Posbus 3311, Kaapstad, 8000
Tel: (021) 410 8500 Fax: (021) 419 6705
E-pos: info@greenwoods.co.za, Webtuiste: www.greenwoods.co.za