SUBMISSIONS
BY THE LAW SOCIETY OF SOUTH AFRICA (LSSA)
REGARDING AMENDMENTS TO AND REVIEW OF THE COMPANIES ACT 71 OF 2008

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1 General note

Many of the sections in the Act are not workable for companies which have only a few shareholders. We recommend an amendment to *Section 6(3)(b)* by inserting a subsection (iii) that in the case of a private company with a public interest score of 100 or less or a wholly owned subsidiary, it should not be necessary to comply with unnecessary requirements, including, without limitation, administrative requirements.

2 General comments on RF companies

Section 20 makes the RF company a dead letter when it sought to limit, restrict or qualify the "purposes, powers or activities" of a company. The prohibition or limitation of a company's capacity to undertake certain transactions is exactly what ring fencing (which was supposed to be the role of the RF company) is intended to achieve. In order to achieve fairness, the third parties dealing with an RF company had to be warned by the use of "RF" after the company's name and the requirement for the prohibition or limitation to be specifically identified by reference to the relevant clause number. It will not be unfair to limit section 20's ambit to the case when third parties could be prejudiced because they had not been given fair warning of a prohibition or limitation on capacity. The changes marked up in the relevant sections **(annexure A)** are intended to bring about that result and in a clearer fashion by dealing with the issue in fewer sections.

3 The definition of "securities" in section 1

3.1 The definition of "securities" creates uncertainty as to what is included or excluded.

3.2 It is suggested that the definition of "securities" be amended by deleting the words "*or other instruments*" and replacing them with "*or instruments convertible to shares or debentures or options to subscribe for shares, debentures or instruments convertible to shares or debentures*". The definition will then read: "'securities' means any shares, debentures or instruments convertible to shares or debentures, or options to subscribe for shares, debentures or instruments convertible to shares or debentures, irrespective of their form or title, issued or authorised to be issued by a profit company".

4 The definition of "state-owned company" in section 1

4.1 This definition also includes subsidiaries of the companies that are listed in Schedule 2 or 3 of the Public Finance Management Act, 1999 (PFMA) which are not named in those schedules. The definition should be changed to cover them although they are not named.

4.2 Further, a non-profit company that is a municipal owned entity in terms of the Municipal Systems Act, 2000, could be classified as a state-owned company per definition. This raises the problem of whether it is a non-profit company or a profit company because state owned companies have to be profit companies, which is untenable. It is proposed that *non-profit companies* be specifically excluded from the definition of "state owned company".

5 Section 15(6)

This section provides that the Memorandum of Incorporation of a company is binding on the company, its shareholders, its directors and prescribed officers.

It is submitted that the section should at least cover all holders of securities. Consideration should be given to whether it should also cover beneficial holders.

6 Section 23

Provision needs to be made for the deregistration of external companies, as "company" does not include an external company. The previous Companies Act, 1973 provided for deregistration of external companies in its section 332, but there is a *lacuna* in this regard under the new Act.

7 Section 30 (and the Regulations)

Uncertainty exists as to whether "indirect beneficial interest" should be interpreted to include shareholders of the holding company. It is suggested that the words "*or indirectly*" in Regulation 26(2)(d)(i) be deleted.

8 Section 36(3)

8.1 Under section 75 of the previous Companies Act, 1973 consolidations and subdivisions of shares were competent.

8.2 Section 36 of the new Act needs to be expanded to expressly permit the board, unless the MOI otherwise provides, to subdivide and consolidate any class of shares, both authorised and issued, by inserting a new subsection (e) as follows: *"(e) subdivide or consolidate any shares*"

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8.3 Further, the Act is lacking a provision to enable cancellation of shares. It is suggested that a new subsection (f) be inserted as follows: *"(f) cancel shares, whether issued or not".*

9 Section 37(1)

9.1 The requirement that a particular class have "identical" rights, etc. is too limiting.

9.2 It should be permitted in the MOI, when designing a class, to allow for shares within that class to have only differing distribution rights if –

9.2.1 the MOI expressly sets out the differing distribution rights; or

9.2.2 allows an *ad hoc* differentiated distribution with the unanimous agreement of the shareholders of the class concerned.

10 Section 37(5)

The reference herein to section 48 should be deleted as, in terms of section 48(1), the redemption of shares in accordance with their terms and conditions is not subject to section 48.

11 Section 38(2)

11.1 Section 97 of the previous Companies Act, 1973 contained a useful mechanism whereby irregular share allotments and issues could be regularised retrospectively.

11.2 There needs to be an equivalent or at least substantially similar provision to the old section 97 introduced in the new Companies Act. Without a section similar to the old section 97, one cannot retroactively regularise the transactions, even where the mistakes were made *bona fide*.

11.3 Section 38(2) which allows for companies or holders to rectify these errors (usually be validating the irregular issue) is inadequate, as it only assists if there is ratification within 60 business days. Shareholders should be permitted to validate invalid issues of shares at any time not limited to 60 days. The section should expressly permit the courts or the Tribunal also to validate.

12 Section 40(1)(a)

12.1 The section requires shares to be issued for "adequate consideration".

12.2 The Act should provide that the issue of shares on any terms may be ratified or approved by the shareholders by special resolution.

13 Section 40(5)

13.1 Section 40(5)(b)(ii) provides that the shares must be held "in trust".

13.2 It needs to be clarified that this trust agreement is not required to be registered with the Master of the High Court under the Trust Property Control Act, 1988.

13.3 The provision should be rephrased so that it does not refer to the shares being held "in trust", but rather for the shares to be held in escrow or by a nominee of the company.

14 Sections 41(3)

This section is problematic from a number of perspectives and it is suggested that it be amended as follows:

"An issue of shares, securities convertible into shares, or rights exercisable for shares in a transaction, or a series of integrated transactions, requires approval of

(a) the shareholders holding voting rights by special resolution if the voting power of the class of shares issuable as a result of the transaction or series of integrated transactions will be equal to or exceed 30% of the voting power of all classes of shares in issue existing;

(b) holders of the class of shares issuable as a result of the transaction or series of integrated transactions, by special resolution, if the issue of that class of shares will be equal to or exceed 30% of the voting powers of all issued shares of that class held by shareholders of that class;

immediately before the transaction or series of transactions, or both special resolutions in subsections (a) and (b)."

15 Section 41(4)(a)(ii)

15.1 The application of this section is problematic in relation to convertible issues, in particular where the conversion occurs based on future uncertain events (e.g. changing share prices).

15.2 Some alternative measurement should be provided for convertible securities and it is suggested that a proviso be added to section 41(4)(a), namely "*provided that if the issue is in respect of securities convertible into shares, or rights exercisable for shares in a transaction, and the voting power of such shares to be so issued is not immediately determinable, then section 41(3) shall be deemed to be applicable"*.

16 Section 51(1)(b)

This section requires that two persons authorised by the board must sign share certificates. This can be a problem for the sole shareholder and director company, which usually includes the shelf company providers. If the company has a sole director and no other officers, it should be the case that a single signatory on a share certificate is sufficient, being that of the sole director.

17 Section 60(2)(a)

17.1 There needs to be clarity on the number of votes required for purposes of passing a round-robin resolution.

17.2 It is suggested that the words "*at a properly constituted shareholders meeting*" be replaced with "*based on all voting rights exercisable on that resolution*".

18 Section 61(7)

It is suggested that section 61(7) be expanded to include *a private company that is required to appoint an auditor.*

19 Section 61(10)

19.1 This provision states that each shareholders meeting of a public company "*must be reasonably accessible within the Republic for electronic participation by shareholders*".

19.2 South Africa is not yet able to accommodate this level of sophistication. Section 63(2) is enabling and should suffice. Having both section 61(10) and section 63(2) leads to uncertainty as to what is intended.

19.3 Consideration should be given to deleting section 61(10) or make section 61(10) and alterable provision in a public company's Memorandum of Incorporation so as to align the provisions of section 61(10) with those of section 63(2) which contemplated a prohibition in the company's Memorandum of Incorporation.

20 Section 62(1)

Section 62(1) requires a company to deliver a notice of meeting to all shareholders in the prescribed form. Regulation 36(2) prescribes that form CoR 36(2) be used. That form states that use of the form is "voluntary"; this conflicts with the imperative of section 62(1). It is suggested that the words "*and form*" be removed from section 62(1).

21 Sections 64(3) and 64(9)

21.1 It is submitted that there is an inherent contradiction between the provisions of sections 64(3) and 64(9).

21.2 The words "*or a matter begin to be debated*" in section 64(3) should be deleted.

21.3 It is further suggested that section 64(3) be amended by inserting the words "*entitled to exercise voting rights in respect of at least one matter to be decided at the meeting*" after the words "*two shareholders*", to read "Despite the percentage ... if a company has more than two shareholders entitled to exercise voting rights in respect of at least one matter to be decided at the meeting, a meeting may not begin … "

21.4 The word "such" should also be inserted after the word "three" in section 64(3)(a) so that the sentence reads "at least three such shareholders are present …"

22 Section 65

It is proposed that a section 65(13) be added to provide that a company's MOI may determine how an abstention should be dealt with.

23 Sections 66(2) and 66(12)

23.1 The words *"in addition to the minimum number of directors that the company must have to satisfy any requirement … to appoint an audit committee, or a social and ethics committee as contemplated in section 72(4)*" could be interpreted as suggesting that the number of directors required for audit and social and ethics committees should be added together, and further added to the number of directors. Furthermore, the second part of section 66(12) does not assist with resolving this interpretation problem and creates more confusion by providing that, when calculating the minimum number of directors in terms of section 66(2), any director who has been appointed to more than one committee must only be counted once, which cannot be correct.

23.2 It is suggested that the words "*in addition to the minimum number of directors that the company must have to satisfy"* be replaced with *"provided that that is sufficient to satisfy"*.

24 Section 66(6)

In order for there to be certainty that the authority of the board is not tainted by the fact that one of the directors is ineligible or disqualified in terms of section 69,a further provision should be included as follows: "*Any election or appointment of a person as a director which is treated as a nullity in terms of section 66(6) does not limit or negate the authority of the board, or invalidate anything done by the board or the company*"

25 Section 67(1)

The words "*or taken office as ex officio directors"* should be added to section 67(1)(a).

26 Section 67(2)

26.1 The reference to filling all vacancies on the board is misplaced (particularly given that a company's MOI may not prescribe a maximum number of directors, in which case "vacancies" will not be determinable, or that shareholders may choose to keep a "vacated" position open and not to fill it).

26.2 The reference to "*to fill all vacancies on the board at the time of the election*" should be replaced with a reference to *"to constitute the minimum number of directors required for that company in terms of this Act or the company's Memorandum of Incorporation".*

27 Section 72(2)(a)(ii)

There is no reason why non-directors appointed to committees should not be entitled to vote on those committees. This cuts across the normal manner in which boards delegate functions and is causing a difficulty in practice. The default position should be that non-directors are entitled to vote, unless the MOI says otherwise.

28 Section 75

28.1 As a general comment, we note that the provisions of section 75 are difficult to apply in practice, particularly in group companies, where instances of "mirror boards" are common, and where, very often, directors of one company may all sit as directors of another group company, which second company may have a personal financial interest in a matter to be decided by the first board. If this section applies in this scenario, none of the directors of the group companies will be able to vote.

28.2 It is not clear whether this section also applies to written resolutions of directors as conducted under section 74, as section 75(5) refers only to a "meeting of the board".

28.3 For proposed wording for section 75(2) and (5) see **Annexure A**.

29 Section 75(7)(b)(i)

29.1 It is not clear why prior approval (as opposed to subsequent ratification) by shareholders (following disclosure of the interest) should not be permitted.

29.2 It is suggested that section 75(7)(b)(i) be amended as follows: "*has been approved or* has subsequently been ratified by an ordinary …"

30 Part G – creditors voluntary winding-up

This mechanism was deleted from the Companies Act, 1973, but not included in this Act. It should be included.

31 Section 82

The effect of the re-registration of a company must be clarified. Under the Companies Act, 1973, it was clear that a re-registration was with retrospective effect, meaning that all actions taken by the company during the period it was de-registered become valid acts upon the company's re-registration. Re-registration ought to be with retrospective effect. Consideration could be given to including a right of action for parties that may be prejudiced by the effect of making such conduct valid with retrospective effect.

32 Section 112

It is proposed that an additional exemption be included by inserting a new subsection 112(1)(d) be added as follows: "(d) *approved by all shareholders entitled to exercise voting rights in relation to that transaction".*

33 Section 114

33.1 The requirement for an independent expert's report for the re-acquisition by a company of its own securities is onerous.

33.2 There should be a provision allowing shareholders to elect (by unanimous or 95% consent) to waive the requirements for an independent expert's report in regard to a share repurchase.

34 Section 115(4)

34.1 If shares are being acquired *pro rata* from all shareholders, it is conceivable that all the shareholders are in concert with the "acquiring party" and so no special resolution can be passed.

34.2 A provision should be inserted exempting a company from compliance with the requirements of sections 114 and 115 where all shareholders resolve to dispense with those requirements.

35 Section 122

The acquisition of a beneficial interest in the circumstances contemplated in section 122(1) should not be included in the definition of "*affected transaction*" in section 117(c).

36 Section 128(1)(f)

The meaning of "financially distressed" is not entirely clear and it is suggested that subsection (f)(ii) be replaced with: "*it appears to be reasonably likely that, within the immediately ensuing six months, the liabilities of the company, as fairly valued, will exceed the assets of the company, as fairly valued*". This accords with the definition in section 4 and clarifies the intent of the section.

37 Section 154

37.1 The discharge of debts in terms of section 154(2) could trigger capital gains tax implications and/or value added tax recruitment claims.

37.2 In this regard, it is suggested that the words "… *or arising out of its approval* …" be inserted after the words "*business rescue process*" in section 154(2). Consequential amendments to the Value-Added Tax Act and Income Tax Act will be required.

38 Schedule 5, item 4(1)(d)(ii)

The reference to section 11(3)(b) is wrong. It should be a reference to section 11(3)(c)((iv).

39 Standard form Memorandum of Incorporation

The private company MOI published on the CIPC website (which we understand emanates from the Regulations) remains defective, despite amendments to it on 20 August 2013. The amendments included a restriction on the transferability of shares.

A restriction on the transferability of all securities (not only shares) must be included in the MOI for the company to qualify as a private company.

40 Regulation 86(4)

This regulation provides that shareholders may whitewash and dispense with the obligation requiring a mandatory offer following the issue of securities as consideration for an acquisition, a cash subscription or a rights offer if independent holders of more than 50% waive the requirement.

The regulation should be expanded to enable a majority of independent shareholders to waive the requirement for a mandatory offer in any situation. In other words, it should not be limited to those currently described in the regulation.