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GENERAL NOTICE

NOTICE 166 OF 2007

Department of Trade and Industry

Companies Bill, 2007

Notice of intention to introduce a Bill into Parliament

The Minister of Trade and Industry intends introducing the Companies Bill, 2007 into Parliament during 2007

Explanatory summary of Bill

Background

In 2004, **the dti** published a policy paper, *Company law for the 21st century*, which promised the development of a "clear, facilitating, predictable and consistently enforced law" to provide "a protective and fertile environment for economic activity".

The policy paper proposed "that company law should promote the competitiveness and development of the South African economy" by -

1. Encouraging entrepreneurship and enterprise development, and consequently, employment opportunities by -

   (a) **simplifying** the procedures for forming companies; and

   (b) reducing costs associated with the formalities of forming a company and maintaining its existence.

2. Promoting innovation and investment in South African markets and companies by providing for –

   (a) **flexibility** in the design and organisation of companies; and

(b) a **predictable and effective regulatory environment**.

3. Promoting the **efficiency** of companies and their management.

4. Encouraging **transparency** and high standards of corporate governance.

5. Making company law compatible and harmonious with best practice jurisdictions internationally.

The policy paper promised an "overall review of company law" to develop a "legal framework based on the principles reflected in the Companies Act, 1973, the Close Corporations Act, 1984, and the common law". The review "would be broadly consultative", drawing on the experience of existing company law institutions, professional expertise within the Republic, and advisors on "best practice internationally and the possibilities for their adaptation to the South African context".

Over the ensuing two years, **the dti** has convened and engaged with a reference group of South African practitioners, academics and other experts, consulted with NEDLAC, and sought the advice of a small panel of international experts drawn from South Africa's major trading and investment partners, as well as commonwealth jurisdictions, which share many of our company law traditions.

At every stage, the consultation process endorsed the five-point statement of economic growth objectives, as set out above. In addition, the process generated specific goal statements related to each of those five objectives, best reflected in the following summary of points set out in the report of the NEDLAC consultations.

1. Simplification

(a) The law should provide for a company structure that reflects the characteristics of close corporations, as one of the available options.

(b) The law should establish a simple and easily maintained regime for not for profit companies.

(c) Co-operatives and Partnerships should not be addressed in the reformed company law.

2. Flexibility

(a) Company law should provide for "an appropriate diversity of corporate structures".

(b) The distinction between listed and unlisted companies should be retained.

3. Corporate efficiency

(a) Company law should shift from a capital maintenance regime based on par value, to one based on solvency and liquidity.

(b) There should be clarification of board structures and director responsibilities, duties and liabilities.

(c) There should be a remedy to avoid locking in minority shareholders in inefficient companies.

(d) The mergers and takeovers regime should be reformed so that the law facilitates the creation of business combinations.

(e) The judicial management system for dealing with failing companies should be replaced by a more effective business rescue system.

4. Transparency

(a) Company law should ensure the proper recognition of director accountability, and appropriate participation of other stakeholders.

(b) Public announcements, information and prospectuses should be subject to similar standards for truth and accuracy.

(c) The law should protect shareholder rights, advance shareholder activism, and provide enhanced protections for minority shareholders.

(d) Minimum accounting standards should be required for annual reports.

5. Predictable Regulation

(a) Company law sanctions should be de-criminalized where possible.

(c) Company law should be enforced through appropriate bodies and mechanisms, either existing or newly introduced.

(d) Company law should strike a careful balance between adequate disclosure, in the interests of transparency, and over-regulation.

With those objectives and goals in mind, and drawing on the expertise offered through its consultations, **the dti** has prepared this discussion draft of a proposed new Companies Act for South Africa. As promised in the policy document in 2004 –

> *"It is not the aim of **the dti** simply to write a new Act by unreasonably jettisoning the body of jurisprudence built up over more than a century. The objective of the review is to ensure that the new legislation is appropriate to the legal, economic and social context of South Africa as a constitutional democracy and open economy. Where current law meets these objectives, it should remain as part of company law."*

Overall plan for company legislation

The reform strategy set out in this discussion draft proposes the wholesale repeal and replacement of the Companies Act, 1973, with a new Companies Act. However, in accordance with the undertaking set out above from the policy document, the new Act retains many of the provisions of the current law, which, on analysis, proved to meet the goal of being *"appropriate to the legal, economic and social context of South Africa as a constitutional democracy and open economy"*.

In addition, the strategy envisioned in this draft provides for the possible eventual repeal of the Close Corporations Act, following a 10-year experimental period, during which both laws would be concurrently in force. **The dti** believes that the regime in the new Companies Act for forming and maintaining small companies, which has drawn on the characteristics of the Close Corporations Act, is sufficiently streamlined and simplified as to render it unnecessary to retain that Act. However, it is recognised that time and experience with the alternative regimes will afford the best indication of which best meets the needs of the South African economy. Accordingly, the transition provisions, as set out

in Schedule 6, require a review of the experience under the concurrent regime before a final decision may be taken on repealing or retaining the Close Corporations Act.

During the consultation process, **the dti** was made aware of proposals within the Department of Justice to develop uniform insolvency legislation which, if brought to fruition, would overlap and may conflict with the regime set out in the current Companies Act for dealing with and winding up insolvent companies. In order to avoid any future conflict, **the dti** proposes a transitional arrangement that will retain the current regime, as set out in Chapter 14 of the Companies Act, 1973 without alteration, on an interim basis until such time as any new uniform insolvency law may be enacted and brought into operation.

Finally, the draft incorporates recent amendments to the Companies Act, 1973, and introduces new provisions, as necessary, to ensure harmonization with other legislation, notably, the Security Services Act, 2004 (Act No. 36 of 2004) and the Auditing Profession Act, 2005 (Act No. 26 of 2005).

Institutional reform in the draft Companies Act

The discussion draft proposes the establishment of one new institution, and the transformation of three existing company law entities, which together will provide for a more predictable regulatory and enforcement system.

Under the current Companies Act, regulatory responsibility is variously assigned to the Minister, the Registrar, the Securities Regulation Panel (SRP), and most recently, the Financial Reporting Standards Council (FRSC). In practice, many of the functions of the Minister and the Registrar have long since been exercised by the Companies and Intellectual Property Registration Office (CIPRO), within **the dti.**

Chapter 8 of this draft proposes the migration of CIPRO, as well as the enforcement functions currently within **the dti** ,into a newly established organ of state, with significantly expanded functions and powers, to be known as the Companies and Intellectual Property Commission. In particular, most of the administrative functions currently assigned to the Minister under the Companies Act, apart from the appointment of members of the institutions, and the making of regulations, are placed within the jurisdiction of the Commission, although the Minister would retain the ability to issue

policy directives to the Commission, and to require the Commission to conduct an investigation in terms of the Act.

The draft further proposes the transformation of the existing SRP into an independent organ of state, the Takeover Regulation Panel, with powers similar to those currently vested in the SRP, although its current authority to prescribe rules must now be exercised in consultation with the Minister, who alone would have final authority to make regulations under the proposed Act.

The FRSC is re-established as an advisory committee to the Minister, with responsibilities to advise on regulations governing the form, content and maintenance of companies' financial records and reports.

Finally, the draft proposes one new body, a Companies Ombud, which will be an independent organ of state, with a dual mandate -

(a) First, to serve as a forum for voluntary alternative dispute resolution in any matter arising under the Act; and

(b) Second, to carry out reviews of administrative decisions made by the Commission or the Takeover Regulation Panel, on an optional basis. Those decisions of the Ombud will be binding on the Commission or the Panel, but not on the other party, which has a constitutional right of access to a court for further review.

As is the case under the current Companies Act, the High Court remains the primary forum for resolution of disputes, interpretation and enforcement of the proposed Company Act.

Scope and categorization of companies

The draft creates three categories of companies, as follows:

(a) Not for profit companies, which are the successor to the current section 21 companies, and which are subject to -

(i) a varied application of the Act, as set out in section 10; and

(ii) a special set of fundamental rules, set out in section 11.

(b) For profit companies that are widely held, as determined in accordance with criteria set out in section 8; and

(c) All remaining for profit companies, which are known as "closely held companies".

The draft introduces public interest companies, which have greater responsibility to a wider public, and therefore are subject to more demanding disclosure and transparency provisions. The "public interest" criteria, which are set out in section 9, overlay the three categories of company outlined above, so that it is possible for a company in any of the three categories to be subject to the "public interest" regime, if that company meets the criteria by virtue of its size or the nature of its activities.

In a further effort to create an appropriately flexible regime, a few provisions of the draft make exceptions for companies that operate under the exceptional circumstances that –

(a) all of their shares are owned by related persons, which results in diminished need to protect minority shareholders; or

(b) all of the shareholders are directors, which results in a diminished need to seek shareholder approval for certain board actions.

Unlike the current Act, the draft does not require the registration of external companies operating within the Republic, but they will be required to have a registered office, and the provisions regulating the public offering of securities of those companies within the Republic will apply with respect to them.

The transitional provisions set out in Schedule 6 provide for -

(a) the continuation of existing companies incorporated and registered in terms of the current Act, and provides for them to be governed henceforth in terms of the new proposed Act. Allowances are made for time for them to amend their Articles to conform to the requirements of the new Act; and

(b) the conversion of existing or newly created close corporations into companies under the proposed new Act.

Company formation, naming and dissolution

The reform consultations recognised and articulated as a core essential principle that formation of a company is an action by persons in the exercise of their constitutional right to freedom of association combined their common law right to freedom of contract. That being the case, the draft reflects, in both its language and its substance, the principle that incorporation of a company is a right, rather than a privilege bestowed by the state. As such, the draft provides for incorporation as of right, places minimal requirements on the act of incorporation, allows for maximum flexibility in the design and structure of the company, and significantly restricts the ambit of regulatory oversight on matters relating to company formation and design.

Under Chapter 2 of the draft, a company is incorporated by the adoption of a Memorandum of Incorporation, which is the sole governing document of the company. The Act imposes certain specific requirements on the content of a Memorandum of Incorporation, as necessary to protect the interests of shareholders in the company, and provides a number of default rules, which companies may accept or alter as they wish to meet their needs and serve their interests. In addition, the Act allows for companies to add to the required or default provision to address matters not addressed in the Act, but every provision of every Memorandum of Incorporation must be consistent with the Act, except to the extent that the Act expressly contemplates otherwise. In other words, a company cannot fundamentally "contract out" of the proposed Act.

For companies wishing to, the Act will provide for the simplest possible form of incorporation by use of a standard form Memorandum of Incorporation, to be set out in Schedule 1 (but not included in this discussion draft), which will permit the incorporators to accept the required provisions, and the default provisions without alteration.

This draft retains the broad outlines of the existing regime for company names, in particular continuing the practice of name reservation and registration, with some significant alterations. In particular, name reservation will be available to protect one or more names, but it will not be required. In addition, the draft proposes reforming the criteria for acceptable names in a manner that seeks to give maximum effect to the constitutional right to freedom of expression. Specifically, the draft will restrict a company name only as far as necessary to -

(a) protect the public from misleading names which falsely imply an association that does not in fact exist;

(b) protect the interests of the owners of names and other forms of intellectual property from other persons passing themselves off, or coat-tailing, on the first person's reputation and standing; and

(c) protect the society as a whole from names that would fall within the ambit of expression that does not enjoy constitutional protection because of its hateful or other negative nature.

Beyond those purposes, there will be no further administrative discretion to reject names, as is found in the existing Act.

Transitional provisions will allow for names registered or reserved under the current regime to continue to be so registered or reserved under the new Act.

As noted above, the winding up of insolvent companies will remain as currently governed by Chapter 14 of the Companies Act, on an interim basis. Apart from that, Chapter 2 retains a number of the existing grounds for dissolving a company, adds additional grounds not found in the current law, and more narrowly restricts the grounds on which the Commission may seek to have a company dissolved.

Company finance

Chapter 3 addresses all matters of company finance, giving effect to the goals outlined above by creating a capital maintenance regime based on solvency and liquidity and abolishing the concept of par value shares and nominal value (although the transitional provisions continue any existing par value shares as such for so long as they are extant).

In addition, the interests of minority shareholders continue to be protected by requiring shareholder approval for share and option issues to directors and other specified persons, or financial assistance for share purchase.

Part B of Chapter 3 replaces the existing, archaic provisions relating to specific forms of debenture, with proposals for a general scheme designed to protect the interests of

debentures holders without making unnecessary distinctions based on artificial categorization of the debt instrument they hold.

Part D of Chapter 3 retains the existing scheme for registration and transfer of uncertificated securities as found in section 91A of the current Act.

Similarly, Part E of Chapter 3, read together with Schedule 3, presents a simplified and modernised scheme with respect to the primary and secondary offering of securities to the public, based on the principles of the current Act.

Company governance

Chapter 4 addresses all matters relating to company governance, introducing changes to enhance flexibility, while retaining much of the existing regime designed to promote transparency and accountability.

In particular, the draft introduces flexibility in the manner and form of shareholder meetings, the exercise of proxy rights, and the standards for adoption of ordinary and special resolutions.

The draft retains existing qualifications and disqualifications for directors, with some enhanced flexibility, particularly for very small companies where the sole shareholder may be the only director.

A major innovation of the draft is the introduction of a regime allowing for a court, on application, to declare a director either delinquent (and thus prohibited from being a director) or under probation (and restricted to serving as a director within the conditions of that probation). The core of the regime is set out in Chapter 7, as one of the remedies available to shareholders and other stakeholders to hold directors accountable.

Part B of Chapter 4 introduces new law in the form of a codified regime of directors' duties, which includes both a fiduciary duty, and a duty of reasonable care, which operate in addition to existing common law duties.

The provisions governing directors' duties are supplemented by new provisions addressing conflict of interest, and directors' liability, indemnities and insurance.

The remaining parts of Chapter 4 largely retain existing law with respect to financial records and statements, auditors, audit committees and company secretaries.

Takeovers and fundamental transactions

Under Chapter 5, the transformed Takeover Regulation Panel (currently the SRP) retains its status as the regulator of affected transactions, and it is intended that the current Takeover Code will be re-enacted as a regulation, subject to any changes the Panel may advise.

The chapter makes significant changes to the existing law governing the required notification of share purchases, and introduces a remedy for compulsory acquisition of minority shareholding in a takeover scenario, fulfilling one of the reform goals.

The regime for approval of transactions that fundamentally alter a company - the disposal of substantially all of its assets or undertaking, a scheme of arrangement, or a merger or amalgamation - is also significantly reformed, and is supported by a remedy of appraisal rights for dissenting minority shareholders.

In particular, such fundamental transactions will require court approval only if there was a significant minority (at least 15%) opposed to the transaction, or the court grants leave to a single shareholder on the grounds of procedural irregularity or a manifestly unfair result.

Finally, as implied above, the draft introduces the concept of amalgamation of companies to provide flexibility and enhance efficiency in the economy.

Business rescue

In accordance with the reform objectives and specific goals, Chapter 6 proposes replacing the existing regime of judicial administration of failing companies with a modern business rescue regime, largely self-administered by the company, under independent supervision within constraints set out in the chapter, and subject to court intervention at any time on application by any of the stakeholders.

In particular, the Chapter recognises the interests of shareholders, creditors and employees, and provides for their respective participation in the development and approval of a business rescue plan.

Notably, the chapter protects the interests of workers by -

(a) recognising them as creditors of the company with a voting interest to the extent of any unpaid remuneration,

(b) requiring consultation with them in the development of the business rescue plan,

(c) permitting them an opportunity to address creditors before a vote on the plan, and

(d) according them, as a group, the right to buy out any dissenting creditor who has voted against approving a rescue plan.

Remedies

As noted above, the High Court remains the principal forum for remedies in terms of the proposed Act. Chapter 7 establishes certain new general principles, including an extended right of standing to commence an action on behalf of an aggrieved person, and a regime to protect "whistle blowers" who disclose irregularities or contraventions of the Act.

As well as retaining certain existing remedies, the Chapter introduces -

(a) A new general right to seek a declaratory order as to a shareholder's rights, and seek an appropriate remedy.

(b) A right to apply to have a director declared delinquent or under probation, as noted above.

(c) A right for dissenting shareholders in a fundamental transaction to have their shares appraised and purchased.

(d) A codification and streamlining of the right to commence or pursue legal action in the name of the company, which replaces any common law derivative action.

Enforcement

In accordance with the objectives and goals, the proposed Act de-criminalizes company law. There are very few remaining offences, those arising out of refusal to respond to a summons, give evidence, perjury, and similar matters relating to the administration of

justice in terms of the Act. Any such offences must be referred by the Commission to the National Public Prosecutor for trial in the Magistrate's Court.

Generally, the Act uses a system of administrative enforcement in place of criminal sanctions to ensure compliance with the Act. The Commission, or the Takeover Panel, may receive complaints from any stakeholder, or may initiate a complaint itself. Following an investigation into a complaint, the Commission or Panel may -

(a) end the matter;

(b) urge the parties to attempt voluntary alternative resolution of their dispute;

(c) advise the complainant of any right they may have to seek a remedy in court;

(d) commence proceeding in a court on behalf of a complainant, if the complainant so requests;

(e) refer the matter to another regulator, if there is a possibility that the matter falls with their jurisdiction; or

(f) issue a compliance notice – but only in respect of a matter for which the Act does not provide a remedy in court.

A compliance order may be issued against a company, or against an individual if the contravention of the Act was by that individual, or if the Act holds them equally liable with a company for the contravention.
A person who has been issued a compliance notice may of course challenge it in court, but failing that, is obliged to satisfy the conditions of the notice. If they fail to do so, the Commission may either apply to the court for an administrative fine, or refer the failure to the National Prosecuting Authority as an offence. In the case of a recidivist company that has failed to comply, been fined, and continues to contravene the Act, the Commission may apply to the Court for an order dissolving the company.

Finally, to improve corporate accountability, the draft proposes that it will be an offence, punishable by a fine or up to 10 years imprisonment, for a director to sign or agree to a false or misleading financial statement or prospectus, or to be reckless in the conduct of a company's business.

Public Comment

Copies of the Bill can be obtained from the Dti website: http:www.thedti.gov.za and from:

The Department of Trade and Industry

Consumer and Corporate Regulatory Division

Contact Person: Linda Van Dieman

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Persons wishing to comment on the proposed Bill may do so by addressing initial comments in writing no later than 19 March 2007, to -

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