THE COMPANIES ACT 71 OF 2008, THE FUTURE OF CLOSE CORPORATIONS AND WHY CONVERTING TO A PRIVATE COMPANY SHOULD BE CONSIDERED.


The New Companies Act introduced fundamental changes to South African company law and corporate actions. The purpose of this document is to serve as an overview of some of the key effects of the new Companies Act on both Close Corporations as well as Companies.

The Future of Close Corporations:

The 2008 Companies Act provides that no new close corporations may be incorporated. Close corporations that were in existence at the time that the new Act came into effect may continue to exist indefinitely.

These Close Corporations automatically fall under Private Companies and the Close Corporations Act have been amended to provide for parity with Private Companies. The amended Sections of the Close Corporations Act are attached as Annexure A.

Co-existence of the Close Corporation Act 1984 and the Companies Act 71 of 2008:

Since the Companies Act and Close Corporations Act run concurrently with each other, close corporations have to apply the principles of both acts. This means, for example, that the principles relating to *Business Rescue (Chapter 6) and *Solvency and Liquidity Tests (Section 4) which is addressed in the Companies Act, also apply to Close Corporations.

In addition, the requirements regarding *Financial Statements (Section 29(5)) as addressed in the Companies Act, apply similarly to Close Corporations. As such, all CCs have to
prepare Annual Financial Statements unless the corporation falls within one of the exemptions mentioned in the Companies Act, being:

- if the corporation has not actively carried on business during the particular financial year, it can bring an application for exemption to the Companies and Intellectual Property Commission (the ‘CIPC’, which commission has replaced the CIPRO office); or
- if the close corporation has only one member; or
- if all of the members of the close corporation take part in its management.

*Further details in regard to these sections are attached as Annexure B*

**Close Corporations vs. ‘the new form of a Private Company’:**

The concept of Close Corporations was introduced into our commerce with the purpose to serve smaller businesses by creating a flexible form of corporate entity with the advantages of simplified and inexpensive incorporation, separate legal existence, limited liability and less onerous financial reporting requirements.

Under the new Companies Act, persons seeking these advantages will have to form a Private Company. However, the **new form of a Private Company** (as created in the 2008 Act) is specifically tailored to suit small enterprises.

A comparison, between these two types of Business Entities, is attached as **Annexure C**.

A compelling reason for Close Corporations to convert to Private Companies is that they will enjoy the protection of Section 76(4) of the Companies Act, viz the **Business Judgment Rule**, which is not enjoyed by the members of Close Corporations.

The Business Judgment Rule seeks to protect directors from liability to the company and shareholders as a result of poor decision-making.

The Business Judgment Rule applies if a decision has been made on an informed basis, in good faith and without conflicting financial interest. Therefore, this defense will be available to a director who is found to have:

- taken reasonably diligent steps to become informed about the matter at hand,
- had no material personal financial interest in the matter (and had no reasonable basis to know that any related person had a personal financial interest in the matter), or dealt with those personal financial interest(s) as required by the new Act,
- made or supported a decision of the board or a board committee regarding the matter and
- had a rational basis for believing, and did believe the decision was in the best interest of the company.

* Schedule 2: Conversion of CCs to Companies are attached as Annexure D*
Governance of Private Companies:

Memorandum Of Incorporation (MOI)

The founding document of a company under the Companies Act (71 of 2008) is the MOI. The MOI can deal with any matter that the Act does not address and may alter the effect of any provision in the Act which is an “alterable provision”.

In layman’s terms the MOI is the Constitution of your Company. In terms of the Companies Act definition, “the MoI means the document, as amended from time to time, that sets out rights, duties and responsibilities of shareholders, directors and others within and in relation to a company”. Any limitations on directors should be recorded in the MoI and approved by shareholders.

The MOI will trump the Companies Act as long as it is not in contradiction with it. One such example is: The Companies Act states that an Ordinary Resolution must be approved by a minimum of 50%, the MOI may alter this percentage. There are many other such alterable provisions which must be considered carefully.

Shareholders should consider whether they are happy with the powers directors hold in terms of the new act. For instance, unless the MOI provides otherwise, directors may:

- increase or decrease the number of authorised shares of any class
- reclassify any authorised but unissued classified shares
- classify shares that are authorised but are unclassified and unissued
- determine the preferences, rights, limitations and other terms of “unclassified” shares which have been authorised but not issued.

It is imperative to note that this is the document that the courts will look at should there ever be a dispute.

With this taken into consideration it is clear that, careful consideration must be given when adopting an MoI.

Alterable and Unalterable Provisions

The new Act determines that the MoI must include the so-called ‘unalterable provisions’ laid down in the Act. As the word ‘unalterable’ indicates, these provisions are obligatory and a company cannot choose to exclude any of the unalterable provisions. The unalterable provisions will prevail, even if a company’s constitution states otherwise. Flexibility in the MoI is attained by modelling the so-called ‘alterable’ provisions. The alterable provisions are those provisions in the MoI which, notwithstanding what the Act says, the company can regulate itself.

The MoI is binding between (i) the company and each shareholder; (ii) the shareholders of the company; and (iii) the company and each director and any person serving on the audit committee or as a member of a committee of the Board. Companies will therefore choose to insert provisions which are specifically suitable to their own circumstances, rather than being
forced to follow a prescribed set of rules. The MoI also automatically binds successors-in-title.

- **Alterable Provisions:**

  The alterable provisions in the Act are those that relate to the allocation of power between shareholders and directors, the procedure relating to convening shareholders and directors meetings, the quorums required for the meetings and the majority vote requirements to pass ordinary and special resolutions at the meetings.

  The following are examples of alterable provisions, i.e. those that a company may alter in its MoI:

  - Section 16(2) – requirements for amending the MoI;
  - Section 36 – authorising and classifying of shares, decisions on the numbers of shares of each class and the preferences, rights, limitations and other terms associated with each class of shares;
  - Section 44 – financial assistance for subscription of securities;
  - Section 45 – loans or financial assistance to directors;
  - Section 47 – approval to issue capitalisation shares;
  - Section 56 – whether shares may be held by and registered in the name of one person for the beneficial interest of another person;
  - Section 58 – shareholders right to be represented by proxy;
  - Section 62 – notice of meetings;
  - Section 64 – with regard to quorum requirements, the company may specify a lower or higher percentage in place of the 25% required; and
  - Section 65 – with regard to the passing of shareholder resolutions, the company may require a higher percentage of voting rights than for an ordinary resolution.

- **Unalterable provisions:**

  The following provisions are unalterable:

  - Sections 75, 76, 77 - that relate to directors’ liabilities;
  - Section 78 – that deals with director indemnification and insurance; and
  - Section 159 – which provides that a company may not limit protection for whistle-blowers.

**Directors and Prescribed Officers**

A private company requires at least one director. The MOI may set out minimum qualifications for directors. A profit company must allow for shareholders to elect a minimum of 50% of the directors and the alternate directors. The remaining directors may be appointed by any other person stipulated in the MOI.

According to the Regulations to the Companies Act, a prescribed officer is anyone who:

- 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 of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.
Any person who holds a senior office in a company should be aware of the potential exposure to personal liability as well as to some of the specific offences and penalties prescribed by the Act. Simply ‘acting on instructions’ of the directors or other senior officers is no longer a defence. Anyone whose position can be defined as that of a ‘prescribed officer’ is required to question whether his actions are in the best interest of the company.

The prescribed officer is subject to exactly the same standards of conduct and is exposed to the same liability as a director, not only for non-compliance with the requirements of the Act, but for any breaches of fiduciary duty or the failure to act with due care and skill in the best interests of the company. This is evident when noting that in terms of personal financial interest, standards of conduct and liability, found in Section 75 to 77, a director is considered to include a prescribed officer, among others.

Prescribed officers can find themselves jointly and severally liable with the directors for loss or damages suffered by the company. However a director/prescribed officer will have satisfied the standards applied to his or her conduct with regard to a matter, if he or she took reasonably diligent steps to become informed about the matter, has no material financial interest in the matter or had properly disclosed such interest, and made a decision rationally in the belief that it was in the best interests of the company.

**Disqualification of Directors / Prescribed Officers / CC Members**

There are certain exceptions to who may be appointed as a director or a prescribed officer. Section 69 of the Act lists the persons who are ineligible or disqualified. The following persons are disqualified or ineligible:

- a person placed under probation in terms of the Act or the Close Corporations Act, except to the extent that the order of probation provides otherwise
- juristic person
- unemancipated minor, or is under similar legal disability
- does not satisfy any qualification set out in the companies’ MOI
- the court has prohibited a person to be a director or prescribed officer or declared the person a delinquent
- unrehabilitated insolvent
- prohibited in terms of any public regulation
- has been removed from an office of trust, on the grounds of misconduct involving dishonesty
- has been convicted and imprisoned without the option of fine, or fined more than the R1000, for theft, fraud forgery, perjury or an offence involving misrepresentation or dishonesty.
Shareholders Meetings

Only public companies and state-owned companies are obliged to have an annual general meeting.

However, a Shareholders meeting (General Meeting) can be called for certain resolutions to be approved.

**Resolutions at General Meetings:**

Except if otherwise required by the MOI, **Ordinary resolutions** must be approved by more than 50% of the voting rights exercised in respect of the resolution and **Special resolutions** must be approved by 75% of the voting rights exercised in respect of the special resolution.

Special resolutions are required:

- To amend the MOI or ratify a consolidated revision of the MOI
- To ratify actions by the company or directors in excess of their authority
- To approve an issue of shares or grant of rights to directors and related companies
- To approve an issue of shares or securities in excess of 30% of the voting power of the shares or securities in that class
- To authorise the board to grant financial assistance to directors or prescribed officers or related or inter-related companies
- To authorise the board to provide financial assistance for transactions in connection with the securities of the company or related or inter-related companies
- To approve the acquisition by the company of its own shares in certain circumstances
- To authorise the basis for compensation of directors of a profit company (Directors remuneration)
- To approve a voluntary winding-up
- To approve the winding-up of a solvent company by the court
- To approve the transfer of the company’s registration to a foreign jurisdiction
- For “fundamental transactions”
- To revoke a previous special resolution that gave rise to appraisal rights
- For such other matters that the MOI requires a special resolution.

*Note that not all Special resolutions have to be filed with CIPC.*

*An explanatory Guide to the Companies Act No. 71 2008 is attached as Annexure E*