COX | YEATS
attorneys

21 Richefond Circle, Ridgeside Office Park,
Umhlanga Ridge, Durban l Dx 50, Durban
P O Box 913, Umhlanga Rocks, 4320
**Tel:** 031 536 8500 l **Fax:** 031 536 8088
**Website:** www.coxyeats.co.za

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# COMPANIES ACT: PROPOSED AMENDMENTS

In the recent Companies Amendment Bill (**Bill**), several material changes to the Companies Act, 2008 (**Act**) were proposed. This circular discusses the key items. Submissions on the Bill will be accepted up until 20 November 2018 and we are available to make submissions on any aspect on your behalf.

## ACCESS TO INFORMATION

Presently, members of the public are only able to see a company's securities register (share register) and register of directors. The Bill makes significant changes to the public's rights of access to company information, which now allow sight of:

- the Memorandum of Incorporation (**MOI**) and any amendments to it;
- corporate governance rules made by the board and approved by the shareholders or members;
- the register of directors;
- the securities register; and
- notices and minutes of all shareholders meetings including supporting documents, as well as all communications sent to shareholders generally. The Bill does try to exclude annual financial statements and other annual reports from this remit, but poor drafting of the Bill undermines the exclusion.

Any person, including competitors or customers of a company, may simply demand access to these documents. Provided the company receives payment of the prescribed fee, the company is obliged to give the required access within five business days of receiving the request for access.

Since the MOI is a "public document" and now accessible to third parties upon demand and payment of the prescribed fee, sensitive arrangements should rather be contained in a company's shareholders agreement. Existing MOI's will need to be amended to remove any confidential or commercially sensitive information.

Although international corporate governance trends emphasise transparency as a means for improving a company's relationships with its stakeholders, our view is that the Bill goes too far. By giving any member of the public access to potentially sensitive internal documents, the net is cast far wider than the scope of transparency contemplated in the King IV Report on Corporate Governance for South Africa, 2016 (**King IV**). We believe that allowing members of the public access to documents showing shareholder proceedings, debates and resolutions is commercially unacceptable in many contexts and that this aspect of the Bill needs to be revised.

## DISCLOSURE OF REMUNERATION OF DIRECTORS AND TOP MANAGEMENT

The current position is that where a company is obliged by the Act to have its annual financial statements audited, those statements must include details of remuneration paid to directors and prescribed officers. Prescribed officers are usually the very top tier of management after the board.

In terms of the Bill, it is confirmed that remuneration must be disclosed for each director and prescribed officer *by name*.

The Bill also introduces the requirement for *public companies* to prepare a directors' remuneration report for each financial year. The Bill's requirements for the remuneration report mirror those of King IV, covering remuneration policy and details of remuneration paid and benefits awarded to specific directors and prescribed officers. This means that listed and unlisted public companies must now all comply with this aspect of King IV.

The remuneration report is to be signed off by the directors and presented to the shareholders at the annual general meeting.

## ANNUAL RETURNS

Every company registered in South Africa is required to file a return with the Companies and Intellectual Property Commission (**CIPC**) each year to demonstrate its continued existence, to pay a fee which is a form of tax and to update any registered company details which have changed.

Currently, only a company which is required in terms of the Act to have its annual financial statements audited, is required to file a copy of its latest annual financial statements with CIPC with its annual return. The Bill changes the requirement so that *every company* is required to file its annual financial statements with its annual return.

The Bill goes further and requires every company to submit a copy of its securities register with CIPC together with its annual return.

This means that CIPC will become aware of the shareholding of every company registered in South Africa, the voting rights of the different shareholders and the presence or absence of a flow of dividends to the different shareholders. This information could be used by CIPC to assist in the policing of compliance with the Broad-Based Black Economic Empowerment Act, another power which is conferred in terms of the Bill.

If shareholders wish to remain anonymous, they can agree with a third person to hold their shares on their behalf. However, the Act read with the Bill requires that all companies which are required in terms of the Act to have their annual financial statements audited, must disclose the true owners of their shares in their annual financial statements.

If a company fails to file its annual return then CIPC may issue a compliance notice requiring the filing. If the company does not respond and file accordingly, CIPC may obtain an order against the company imposing an administrative penalty of up to 10% of turnover during the period of non-compliance.

The drive towards transparency is notable. If secrecy in shareholding is required, shareholders will have to make use of trusts or partnerships.

## CHANGING A COMPANY'S MOI

Up until now there has been debate and confusion around when a change to a company's MOI becomes binding. The Act states this happens on filing the change with CIPC. CIPC maintained this meant that the change had to be approved and registered with CIPC. Many attorneys maintained that this meant the change occurred on submission of the amending documents to CIPC.

In terms of the Bill, changes to a company's MOI which include a name change will be binding when a new registration certificate is issued and *any other change* will be binding 10 business days after the amending documents are filed with CIPC, *whether CIPC has replied or not*.

This means that if there is something amiss with the amending documents, they will be regarded as binding anyway unless CIPC rejects them within 10 business days of filing. It would then be up to the board and shareholders to correct the documents with a subsequent filing.

This change is useful particularly when a company needs to create new share capital for raising finance or introducing new owners. Often there is a significant delay between the creation of the new share capital by shareholders and the acceptance of the MOI amending documents by CIPC. This leaves the company in limbo, not sure whether the new share capital exists or not. The change proposed by the Bill removes this uncertainty.

## CORRECTING SHARE ISSUES

If a company's board issues shares before they have been validly created in the company's MOI, the shareholders have a short window of time – 60 business days – to ratify the board's actions and properly create the necessary share capital.

The Bill does not extend this time frame but introduces the right of "any interested person" to apply to court to have an allotment, creation or issue of shares by a company validated even if it was irregular. If the court rules in favour of the applicant, the court's order is lodged with CIPC and the relevant shares are deemed to be validly created, allotted or issued, as applicable.

## INTRA-GROUP FINANCIAL ASSISTANCE

One of the biggest disruptions caused by the Act was the introduction of the requirement that any provision of financial assistance by a company to a related company, had to be approved by the shareholders of the company giving the assistance and had to be preceded by the granting company passing the solvency and liquidity test.

These requirements were introduced to secure some kind of capital maintenance for the benefit of third party creditors and shareholders.

In terms of the Bill, a company granting financial assistance to a related party will be exempt from these requirements if it gives financial assistance to *its own subsidiary*. A subsidiary includes a company which the granting company can control, for example by being able to control a majority of shareholder votes or appoint the majority of the board members.

Financial assistance by subsidiaries to holding companies and by subsidiaries to fellow subsidiaries is still subject to the existing requirements.

The new exemption is not drafted as well as it could be and the result is that the burden of compliance applying to intra-group financial assistance is not lightened materially, or as far as it possibly should be.

## SHARE BUYBACKS

The Act requires that share buybacks require approval by the shareholders of a company if shares are purchased from directors, prescribed officers or any person related to them, or if more than 5% of the issued shares in any one class are repurchased.

The Bill casts the net wider, requiring that a special resolution of the shareholders be obtained for every share buyback save where the buyback is offered to every shareholder in a particular class or all shareholders generally, on a *pro rata* basis, or where the transactions are carried out on a recognised exchange in the ordinary course.

Share buybacks are a regular feature of investment transactions. Agreements will need to become even tighter in securing up-front undertakings by shareholders to cooperate in giving special resolution approval for future share buybacks.

## SOCIAL AND ETHICS COMMITTEE

The Act introduced the requirement that state-owned companies, listed companies and companies with a public interest score (calculated with reference to turnover, number of employees, third party debts and number of shareholders or members) of more than 500 points, are required to appoint a committee of the board to oversee their performance in relation to various corporate governance issues. These issues include preservation of the environment, labour relations and adherence to international standards for working conditions, consumer protection, compliance with black economic empowerment legislation and charitable works.

In terms of the Bill, only state-owned companies and *any public company* are required to appoint a social and ethics committee. This change expands the ambit of public companies subject to the requirement but now excludes private companies. This change is most helpful for private companies with small operations which have a high turnover due to the price of the commodities they deal in.

The Bill does not change the mandate of the social and ethics committee but it does expand on the committee's obligation to prepare a report on its activities. The committee's report must now comply with prescribed requirements (which are yet to be set out in revised regulations). To date there has been no required form or content for these reports.

The social and ethics committee's report is also required to be "externally assured", meaning: audited. This is very much in line with King IV which emphasises the value of external assurance not only of annual financial statements but also of other aspects of a public company's integrated annual report, such as the sustainability report. It can be assumed that the requirements for the social and ethics committee's report will be fairly in-depth.

## AUDITOR INDEPENDENCE

The Act prescribes criteria to ensure the independence of an auditor appointed by a company which is required by the Act to have its annual financial statements audited. Presently the Act prevents a person who has been intimately involved in the company's business in the previous five years, from being appointed as the company's auditor.

The Bill reduces this time frame to two years, opening the scope for who may be appointed as auditor of a company required by the Act to have its annual financial statements audited.

## TAKEOVER REGULATIONS

Since the commencement of the Act, many transactions have been plagued by the need to obtain exemption from the takeover regulations because of the application of the regulations to public companies, state-owned companies and any private company where more than 10% of its shares had been transferred at arms-length in the previous two years. This requirement caught many private companies arbitrarily.

The Bill proposes to rectify the situation by providing that the takeover regulations apply to transactions affecting public companies, state-owned companies and only those private companies which are obliged in terms of the Act to have their annual financial statements audited or which elect in their MOI to comply with the enhanced accountability requirements of the Act.

This will still catch a large number of private companies, but the application will be less arbitrary and more in accordance with the policy intention of regulating companies with more "public significance", more strictly.

## WHEN DOES THE ACT REQUIRE AFS TO BE AUDITED?

A few matters in the Act read with the Bill apply only to companies required by the Act to have their annual financial statements audited. These include the requirement to disclose the remuneration of directors and prescribed officers in the annual financial statements, the obligation to disclose true owners of shares who are represented by nominee registered shareholders and the requirement to comply with the takeover regulations when affected transactions arise (see under the headings "Disclosure of Remuneration of Directors and Top Management", "Annual Returns" and "Takeover Regulations" above).

Under the Act, it is compulsory for the following companies to have their annual financial statements audited:

- public companies;
- state owned companies;
- profit or non-profit companies of such significance that public interest dictates that auditing is desirable (i.e. they have a sufficiently high **Public Interest Score**);
- profit or non-profit companies which are in the business of holding significant assets in a fiduciary capacity for unrelated persons;
- certain categories of non-profit companies (the inclusion of these companies goes to the protection of public interest).

A company's Public Interest Score is determined with reference to a point system set out in the Companies Regulations. A company which, having regard to the:

- average number of employees of the company during the financial year (one point for each employee);
- number of individuals who the company knows to have a "beneficial interest" in the any of the company's issued securities, directly or indirectly, as at the financial year end (one point for each holder);
- value of the turnover of the company during the financial year (one point for each R1 million or part); and
- value of the company's liability to third parties as at the financial year end (one point for each R1 million or part),

has a Public Interest Score of **350** or more points in a particular financial year, must have its annual financial statements for that financial year audited.

The term "beneficial interest" is so broad as to include a right to receive or participate in any distribution in respect of a company's securities, including by way of ownership or even agreement.

A company which, having regard to the factors set out immediately above, has a Public Interest Score of between 100 and 349 points (both inclusive), must have its annual financial statements audited only if they were internally compiled. In terms of the Companies Regulations, annual financial statements are "internally compiled" unless they are prepared by an independent accounting professional on the basis of financial records provided by the company in question, in accordance with relevant financial reporting standards.

It is quite probable that the obligation to disclose true owners of shares who are represented by nominee registered shareholders and the requirement to comply with the takeover regulations when affected transactions arise, will also apply to companies which *elect in their MOI's* to have their annual financial statements audited. This election is not necessary because the board or shareholders of a company may resolve at any time to have the annual financial statements of the company audited. In our view it is prudent to remove the election for an audit from the MOI wherever possible.

## LANDLORDS AND BUSINESS RESCUE

The Bill provides protection to landlords who continue to pay utilities, rates and taxes on a property leased to a company in business rescue, after business rescue proceedings have commenced and in circumstances where they are receiving no rent from their tenant company.

In terms of the Bill these payments by a landlord are treated as post-commencement finance and will rank for repayment above all unsecured claims against the company.

## ADJUDICATION OF BLACK ECONOMIC EMPOWERMENT MATTERS

The Bill expands the functions of the Companies Tribunal (**Tribunal**) recorded in section 195 of the Act by providing that the Tribunal may adjudicate on matters affecting a company as may be referred to it by the B-BBEE Commission.

This links in with the memorandum of understanding concluded between the B-BBEE Commission and CIPC and the B-BBEE Commission and the Competition Commission, respectively, which regulate, *inter alia*, the exchange of information and collaboration between these regulatory bodies in an attempt to promote the objects of the B-BBEE Act and deter unlawful practices.

As mentioned above, in theory CIPC will have enough information available from mandatory disclosures to assess the shareholding of every company registered in South Africa, the voting rights of the different shareholders and the presence or absence of a flow of dividends to the different shareholders. This is highly sensitive information which gives CIPC, the Competition Commission and the B-BBEE Commission remarkable insight into previously private company affairs.

## STAKEHOLDER ARRANGEMENT FOR SHARES NOT FULLY PAID FOR

Section 40(5) of the Act provides for shares that have been issued but not fully paid for by the subscribing party to be transferred to a third party to be held in trust.

The Bill proposes an amendment to this section which clarifies that the position of the "third party" will be one of an independent stakeholder, and not a trustee "as agent for either the company or the subscribing party".

## CONCLUSION

The stated objects of the Bill are to clear up errors or areas of confusion which have become apparent since the Act came into effect and to align the Act with international trends in corporate governance. Although the Bill goes a long way to achieving these objects, we propose that it needs some material refinement before being passed into law.

In many respects the Bill includes inaccurate or confusing drafting and it is necessary to deduce the meaning of the amendments from the context. This has the opposite effect of what was intended, namely clarity.

The forced expansion of transparency in companies is profound and we suggest could be a serious hindrance to normal business interactions.

To avoid unnecessary regulation, companies which are able to do so should remove from their MOI's any election to audit their annual financial statements. Their MOI's should contain more flexible language, allowing the board or shareholders to resolve to have an audit or an independent review.

## FURTHER ADVICE

Should you require advice or assistance, please contact Michael Jackson on 031 – 536 8512 email : **mjackson@coxyeats.co.za**, Keren Watson on 031 - 536 5818, email : **kwatson@coxyeats.co.za** or Simon Watson on 031 - 536 8530, email : **swatson@coxyeats.co.za** or Jason Goodison on 031 -

536 8517, email : **jgoodison@coxyeats.co.za** or Jenna Padoa on 031 - 536 8529, email : **jpadoa@coxyeats.co.za** or Wade Ogilvie on 031 - 536 8527, email **wogilvie@coxyeats.co.za** or Benjamin Meadows on 031 - 835 3109, email : **bmeadows@coxyeats.co.za** or Xola Madikizela on 031 - 835 3113, email : **xmadikizela@coxyeats.co.za** or Arnold Mbeje on 031 - 835 3119, email **ambeje@coxyeats.co.za**