A corporate revolution in South Africa – The Companies Act No 71 of 2008

The long-awaited new Companies Act No 71 of 2008 was promulgated in April 2009 and is expected to become effective around July 2010.

The Act re-writes South African company law completely, and accordingly will have far-reaching effects. Some of the highlights, from a businessman’s point of view, are:

► the extent to which the burden of the office of a director has been increased; and

► the innovations in the area of the “fundamental transactions” by which mergers and acquisitions are effected.

CORPORATE GOVERNANCE

The Act effects a number of changes to the changes to the rights of shareholders and the duties and liabilities of directors, which are the primary determinants of the balance of power in corporate governance.

Duties of Directors

For the first time in South African company law, the Act attempts to codify the general duties of directors. However, the codification is not complete because the Act does not entirely exclude the application of the common law.

The codified duties of directors in the Act provide that:

► while a director must still disclose any conflict of interest he has in relation to a matter before the board (as was previously the case), the concept of a conflict of interest is extended to include a personal financial interest of a person related to the director and the conflicted director may not take part in the board’s consideration of that matter;

► a director must not use his position as director or information gained in that capacity to (a) gain any advantage for himself or any person other than the company or one of its wholly-owned subsidiaries or (b) knowingly cause harm to the company or any of its subsidiaries;

► a director must communicate to the company any information that comes to his attention, at the earliest practicable opportunity, unless (a) he is bound not to make that disclosure by a legal or ethical obligation or (b) he reasonably believes that the information is immaterial to the company or generally available to the public; and
when acting in his capacity as a director, a director must exercise his powers and perform his functions (a) in good faith and for a proper purpose, (b) in the best interests of the company and (c) with the degree of care, skill and diligence that may reasonably be expected of a person carrying out those functions and having that director’s general knowledge, skill and experience.

These duties are almost entirely an accurate restatement of the common law, with only marginal changes to or clarifications of the duties on conflicts of interests and the disclosure and use of information.

It is also noteworthy that the Act gives directors increased powers and responsibility in relation to corporate finance actions such as the issue of shares and the making of distributions to shareholders. Companies will no longer be able to make distributions with only the approval of shareholders: the approval of the directors will be a necessary prerequisite.

Directors’ liability

The extent of directors’ liability has also been set out in the Act and has become the source of much consternation amongst directors. In addition to explaining that the liability for any breach of the abovementioned duties will still be determined in accordance with the common law, the Act makes a director liable for losses suffered by the company as a result of that director having taken, or failed to act against, certain unauthorized or unlawful actions and situations.

The business judgment rule

The Act includes a modified version of the business judgment rule, which will protect a director from allegations of breach of the duties of care, skill and diligence and the duty to act in the best interests of the company in relation to a matter where that director has (i) taken reasonably diligent steps to become informed about the matter, (ii) either had no conflict of interest in relation to the matter or complied with the rules on conflicts of interest and (iii) had a rational basis for believing, and did believe, that his decision was in the best interests of the company. In addition, a director is specifically entitled by the business judgment rule to rely on the discharge of functions, and information presented by, persons such as employees and advisers who that director reasonably believes to be reliable and competent.

The burden of the director’s office

While the Act only changes the general duties of directors to a small degree, it most certainly increases the burden of the office of director by enhancing the rights of shareholders and other stakeholders. On the other hand, the rules governing insurance and indemnities that companies may take out or provide for the benefit of their directors have been clarified and create scope for increased protection against the consequences of mere negligence on the part of directors.

Enhanced rights of shareholders

Perhaps the single most innovative enhancement is the introduction of appraisal rights for dissenting shareholders. The appraisal rights will be available whenever the company proposes to enter into certain fundamental transactions or to alter its Memorandum of Incorporation in a manner adverse to the rights of any class of shares. Shareholders who unsuccessfully oppose such actions in the prescribed manner will thereafter be able to compel the company to repurchase all of their shares for their fair value, unless a court orders otherwise. However, apart from a situation in which the company would be plunged into illiquidity as a result of that repurchase, the grounds on which the court may order otherwise are not clear.

Shareholders are also likely to invoke the Act’s new procedures for seeking the removal of a director from the board of a company or applying to court for an order declaring a director to be delinquent or under probation. The process of seeking removal is particularly susceptible to use or abuse, because it allows any dissatisfied shareholder to allege that a director has neglected his duties. The other directors will thereupon be required to decide whether the allegedly neglectful director should remain on the board, and their decision will be subject to a court review at the instance of any dissatisfied shareholder or director.

Fundamental transactions

The Act regulates fundamental transactions to a greater extent than was previously the case. Apart from takeover offers made to the shareholders of a company, the Act contemplates three kinds of fundamental transaction, namely (i) disposals of the majority of a company’s assets or undertaking; (ii) mergers (also referred to as amalgamations); and (iii) schemes of arrangement (which are freshly defined in an attempt to ensure that their current use for effecting takeovers will never again be contentious).

Mergers and the rights of creditors

While disposals of assets have always been common in South Africa, South African law had not previously adopted the concept of a merger per se, where a company may, provided that solvency and liquidity are preserved, transfer its liabilities (as well as its assets) to another company without the consent of its creditors. The risk that this concept poses to creditors is mitigated by a procedure in terms of which those creditors must be informed of the merger and may challenge it in court if they are acting in good faith, will be materially prejudiced by the merger and have no other remedies. Nonetheless, the availability of the merger as a transaction is likely to open a new issue of contention between creditors and their debtors, where creditors are likely to seek advance contractual protection, by prohibiting mergers in the agreement creating the debt, without having to launch that kind of court challenge.

Shareholder approval

All three of these types of fundamental transaction will require approval of the transaction by a 75% majority of shareholders voting on the transaction at a meeting. In addition, where the transaction involves the disposal of a majority of the assets or undertaking (measured on a consolidated basis) of the holding company of the company contemplating the disposal, the same approval of the shareholders of that holding company will be required.

The manner of giving notice to convene a meeting to approve one of these fundamental transactions will be regulated, and that notice will have to be accompanied by explanations of the rights of shareholders to (a) sell their shares to the company under the appraisal rights mentioned above or (b) have a court review of the transaction.

A court review will now be essential wherever 15% or more of the votes cast at the meeting on the transaction were cast against the transaction or a court grants any shareholder leave to have the transaction reviewed. On a review, the court will be able to set aside the resolution approving the transaction, if the transaction is manifestly unfair to any class of the company’s shareholders or the vote on the transaction was materially tainted by conflict of interest, inadequate disclosure or other irregularity.
Takeover offers

The regulation of takeover offers will also change, with a new, more powerful Takeover Panel set to replace the old Securities Regulation Panel. For the most part, the rules applicable to takeovers are expected to be very similar to the rules that applied under the old Companies Act.

OTHER NOTEWORTHY CHANGES

Other noteworthy changes that are introduced by the Act are:

(i) a more expansive definition of control (covering “negative control”) and the introduction of the concept of related persons;

(ii) the introduction of an anti-avoidance regime aimed at attempts to defeat the Act, as well as a mechanism for granting exemptions from the provisions of the Act;

(iii) a requirement for corporate notices to shareholders, creditors and employees to use “plain language”; 

(iv) increased use of electronic communications for the giving of notices, compliance with formalities and the conduct of meetings;

(v) amendments to the rules on corporate finance, especially the role of the board in issues of shares and the making of distributions to shareholders;

(vi) specific rules on the use of board committees and new requirements for audit committees;

(vii) a new approach to business rescues, which has caused much controversy; and

(viii) provision for mediation and arbitration of certain disputes through a Companies Tribunal.

Although it is not possible to address the other changes in this article, they too will have extensive ramifications.

CONCLUSION

The extent of the change provided for in the Act leads one to conclude that, even where not specifically required by the Act, all South African corporate documents, from the Memorandum and Articles of Association and shareholders’ agreements to the mandates of committees and executives and the appointments of auditors and advisers, will need to be reviewed once the Act has been adopted. Despite the short-term upheaval that is expected, it is likely that the Act will succeed to some extent in its aim of making South African company law simpler and more accessible.

In order to keep in step with the amendments to the Companies Act, the King Code on corporate governance has been updated and the Listings Requirements of the JSE will also be revised.
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Our firm also has a formidable reputation in commercial litigation and dispute resolution, as well as banking and finance. We are distinguished by the people, clients and work that we attract and retain - our more than 160 lawyers are a powerful team of independent-minded individuals who share a common service ethos.

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About the Author

Gareth Driver

Title: Director
Direct tel: +27 (0)11 535 8222
Direct fax: +27 (0)11 535 8622
Switchboard: +27 (0)11 535 8000
Email: gdriver@werksmans.com

Gareth Driver is head of Werksmans’ Commercial department. He advises on commercial transactions, predominantly mergers and acquisitions in a number of sectors, especially financial services and mining. Gareth specialises in black economic empowerment transactions; competition law/merger control; corporate finance and structuring; corporate governance; exchange control; financial services regulation; international transactions; listings/flotations; leveraged and management buy-outs; mining transactions; private equity and public offerings and private placements. Gareth obtained his BA, LLB and LLM with distinction from the University of the Witwatersrand. He is named as a leading lawyer in several well-respected international legal publications.