CONSTITUTIONAL DOCUMENTS OF A COMPANY

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1 CONSTITUTIONAL DOCUMENTS OF A COMPANY

There are various documents that are fundamental to the running of a company. These are;

- ***MEMORANDUM OF INCORPORATION OR MOI***
- ***RULES***
- ***SHAREHOLDERS AGREEMENT***

1.1 MEMORANDUM OF INCORPORATION

Owing to the fact that the New Companies Act 2008 is quite complicated and took practitioners a long time to understand all the ins and outs and especially in regard to the standard form MOI's provided by the CIPC most practitioners started the process of changing the MOI for their clients very **late**. In fact, even today amazingly, there are many companies without new company act MOI's.

It was not necessary for us to have all the MOI's in place by the 1st May 2013 (the act gave a transitional period of two years) despite the persistent rumours that we had to. Many secretarial practices and legal firms used the ***fear factor*** approach to force this change. I think that it was wrong to foister new MOI's onto clients without going through the details of the MOI so that the clients actually understand it. If we do not understand it ourselves how are we going to get our clients to understand it? I think this is a huge risk area in regard to providing clients with a MOI.

1.2 DEFINITION OF THE MOI

The definition of the MOI says that the MOI sets out the ***rights, duties and responsibilities*** of the shareholders, directors and others within and in relation to a company. This applies to any company that was incorporated under the New Act and for any ***pre-existing company*** i.e. a company that existed prior to the effective date of 1 May 2011.

This means that the current Memorandum of Incorporation and Articles of Association of a pre-existing company, a company formed under the old act is in fact a MOI as defined in the New Act. You might say so what, why do we need to know this? Unfortunately, there are many misconceptions regarding the MOI of a pre-existing company. One of the main issues being in regard to the audit – where an old MOI was in place during the transitional period an audit had to be performed, but once the transitional period was over the new act kicked in and the new rules applied and therefore the audit requirement falls away in my view, or so we thought. SAICA and legal experts say that right now if the company still has the old MOI then an audit must be performed.

1.3 THE TURQUAND RULE

Before we deal with the Doctrine of Constructive Notice, we must understand the Turquand rule

"In the recent High Court decision of One Stop Financial Services (Pty) Ltd v Neffensaan Ontwikkelings (Pty) Ltd and Another, the Court confirmed the requirements for reliance on the common law Turquand rule as well as the implications of the statutory Turquand rule in respect of individual directors who purport to bind the company.

The *Turquand* rule is applied by the South African courts when deciding whether a company should be bound to a contract concluded with a third party in the circumstances where the company's representative concluding the contract on behalf of the company is unauthorised to do so due to an irregularity in the company's internal procedures, or failure to comply with all internal approvals before concluding the relevant contract. The rule protects third parties and creates commercial certainty in that it presumes in favour of the third party that all aspects of the company's internal governance have been duly fulfilled.

The One Stop case confirmed the application of the common law *Turquand* rule where a third-party contract with a board of directors (as opposed to an individual director) or a managing director or someone who holds another executive position in the company which carries with it a representation of authority usual to that position. In these scenarios a third party is ordinarily entitled to assume that the requisite authority has been granted for purposes of binding the company. The same assumption does not hold true for an individual director. It is clear that just because the company's constitution permits the board of directors to delegate authority to a single director, this does not entitle the third party to assume that any director with whom he deals has the authority to bind the company. The *Turquand* rule only comes into operation once the third party proves that the individual director (purporting to represent the company) has authority (i.e. ostensible authority) to bind the company. Once this is proved, the *Turquand* rule will enable the contracting party to assume that there has been compliance with the internal requirements of the company in authorising its representative.

The *Turquand* rule has essentially been codified in section 20(7) of the Companies Act, 2008 which provides that a person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company, unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.

The court addressed the codification of the *Turquand* rule as provided for in section 20(7) and (8) of the Companies Act and stated that the Companies Act is not intended to change the well-established principles of the common law *Turquand* rule, and as such cannot be seen to now allow a third party to presume the authority of an individual, ordinary director. The Court emphasised that in order for the third party to presume compliance with the "formal and internal procedural requirements" of the constitution (as provided for in section 20(7)), the third party should have been dealing with the "company". The section does not state that the third party may make any assumption when dealing with a purported representative per se. This reinforces the view that in order for section 20(7) to apply (as with the common law rule), the third party must establish that he was contracting with someone who had actual or ostensible authority to bind the company, only in those circumstance can the third party say that he was dealing with the company."

Above is courtesy of Ineke Brink, Partner Bowman Gilfillan Africa Group

1.4 DOCTRINE OF CONSTRUCTIVE NOTICE

The difference between the old Companies Act and the new Companies Act is that in terms of the old Companies Act is that the ***doctrine of constructive notice*** applied to the MOI and that all parties dealing with the company were deemed to know what the contents of the MOI were as there was no reason why anyone dealing with the company did not have access to the MOI at the CIPC.

Under the New Act this has changed in that the Doctrine of Constructive Notice does not apply to the MOI anymore. This means that parties dealing with the company do not need to have knowledge of the contents of the MOI.

The Doctrine of Construction now does however apply where certain conditions are ***Ring Fenced*** or **RF** conditions are placed in the MOI. These RF conditions are specified in terms of s15(2)(b) or (c) of the new act. In terms of s 11(3)(b) the name of the company must be followed by **RF**. This is notice to all parties dealing with the company that there are ring fencing conditions being conditions that they should be aware of before they do any business with the company.

1.5 CONFUSION IN THE RING FENCING PROVISIONS

If one reads the text of Section 15(2)(b) or (c) the ring fencing provisions deals with the situations where in the MOI there is a term that ***impedes the amendment*** or there is a term that ***prohibits the amendment*** of a MOI. The act really does not deal with anything else in regard to ring fencing. The way it is worded has caused a lot of confusion as when to make

use of RF. There also appears to be overuse of RF by many practices where it does not really apply as many practitioners don't really understand RF.

S 13(3) provides that if the company's MOI includes any provision contemplated in 15(2)(b) or (c) the notice of incorporation must include a prominent statement drawing attention to each such provision and its location in the MOI. It is necessary to advise the CIPC as to what the RF conditions are. This is done by Special Resolution and by completing form CoR 15.2 and CoR 15.2 Annexure A.

In reading the text books and the Act it appears that the ring-fence provision really was for any kind of restriction placed on the amendment in the terms of the MOI as well as any kind of prohibition, however in practice this seems to have become a lot more.

Carl Steyn in the ***New Companies Act Unlocked*** talks about the fact that these ring-fence conditions were used as special purpose vehicles in BEE transactions. This could be used in the case where the ***special purpose vehicle*** could be prevented from paying a dividend until the loan or the financing, they received to acquire the stake in a company was repaid. By making this an RF term in the MOI the financiers could protect their investment by making sure that the RF article cannot be changed and making sure that the directors can't declare dividends before the loans are repaid.

There is also no definition of the words ring-fencing, which appear on form CoR 15.2A. Ring Fencing is not mentioned in the act.

To this end the CIPC was asked to put out a ***non-binding opinion*** in terms of section 188(b) of the Companies Act to actually deal with where the term "RF" should be used as there is quite a lot of uncertainty in regard to its usage. In fact, the CIPC issued a further guide a practice note as I think they got the **non-binding opinion** wrong which resulted in more **RF** companies being formed causing much confusion and unnecessary work.

1.6 EVENTS LIKELY TO ARISE IN PRACTICE

As one can see from the ***non-binding opinion*** the scope of ring-fencing has widened to include virtually any kind of disclosure that should be made to third parties, for example let us say that in order for a company to do a transaction of say over R1 million rand and the MOI says that in order for this transaction to be approved it has to be approved by ***all*** the directors of the company. As this is a term in the MOI that may require disclosure to third parties the term RF should be behind the name. If a transaction is done on this basis and only one director signs the resolution and not all the directors, then the third party dealing with the company cannot hold the company bound to the contract because the authority for the transaction is not correct. The courts will need to decide! The question that arises here is does a company

need to involve outsiders in corporate governance issues in a company as it could become a nightmare when things go wrong?

Another example is if the company is prohibited from entering into any transaction with a software company and this is entrenched in the MOI then the third party cannot get out of this contract if there is no RF behind the name. If there is an RF the company may be restrained from performing under the contract, for instance by its shareholders, but the contract is not void, the shareholders may have a claim for damages against the directors. In this instance the third party would have deemed knowledge of the MOI and would not be in a position to claim for damages.

The RF provisions create complexity in the law and may cause litigation where parties believe they can use RF conditions to their advantage!

For the purpose of convenience, I have quoted the important points from the practice note on RF below dated Nov 2012!

4. It is against this background that that it must be considered whether the requirement to use (RF) in the company name is applicable or not in any particular case. In principle, ***if a limitation could have any effect on third parties***, it would be advisable to use (RF) in the name. If on the other hand**, it is of no consequence to third parties** there would also be no need to warn them.

5. Inconsiderate use of the expression "RF" in the name of a company could lead to unnecessary confusion and in the circumstances, it is submitted that the expression "(RF)" be used only in cases where it is evident that —

   5.1 the purpose or objectives of the company are restricted or limited in the MoI of the company;

   5.2 the powers of the company are restricted or limited in its MoI;

   5.3 any other pertinent restricting condition is contained in the MoI of the company;

   5.4 any requirement in addition to those set out in section 16, for the amendment of any of the abovementioned restrictions or limitations is contained in the MoI; or

   5.5 the MoI of a company contains a prohibition on the amendment of any particular provision of the MoI.

6. The CIPC is further of the view that if the Memorandum of Incorporation contains a provision —

   6.1 setting higher standards or more onerous requirements under section 15 (2) (a)

(iii) than would otherwise apply to the company in terms of an unalterable provision of the Act; or

6.2 requiring a special resolution to approve any matter not listed in section 65 (11);such a provision in itself is not a restriction contemplated in section 11 (3) (b) as it does not limit the powers or capacity of the company but rather prescribes a different procedure to perform the activity concerned.

1.7 SHORT FORM MOI

There were quite a few problems with the original short form MOI released with the ACT. Despite the inherent problems of the short form MOI and the fact that it has been widely used there was never a need to panic. Many parts of the short form might be quite adequate especially where the shareholders and directors are common. I will deal with the inherent problems below as there may still be many of these old short forms in circulation. If in your firm, you have any of these original inadequate short form MOI's it would be a good idea to fix them by doing a Special Resolution!

The issue about supplying a short form MOI is that it might be absolutely perfect right now for a smaller business's early requirements, but what happens when down the line the business grows and more shareholders get involved because the company needs capital, will it then be suitable at that point in time. Based on past experience of the old act one never looked at Table B, we just left it as it seemed to be fine because as a rule everyone knew exactly what it contained and they were mostly all the same. In a situation where there was a big share transaction lawyers normally prepared a Shareholder's Agreement to cover the inadequacies of Table B.

Another important aspect of changing the MOI is what do we do about existing Shareholders Agreements as they don't seem to be as important as they used to be? All Shareholder's Agreements prior to April 2011 need to be checked for validity and that they conform to the requirements of the new act. It is suggested that you involve the company's legal advisor to make sure that the original shareholders agreements are up to date and meet with the requirements of the shareholders, that's if they want them or need them.

There is a problem when new shareholders are introduced in that a shareholder's agreement does not apply to the new shareholder unless the new shareholder actual signs the agreement together with everyone else. Each time there is a transaction there needs to be a new shareholders agreement which everyone has to sign.

1.8 DID THE ORIGINAL SHORT FORM MOI MAKE THE COMPANY A PUBLIC CO

There was this persistent rumor going around that said a short form is just not good enough, if you have used the short form the company was then defined as a ***public company*** and not a ***private one***. Personally, I do not think much turns on this because although it could have been a potential problem, I do not think that anybody acted on the basis that a small private company was a public company. No one expected the small one man show to carry out the regulatory requirements of a public company. This does not mean to say that it is right; therefore, if any of these MOI's are still in existence the Secretarial Practitioner should really try and get them sorted out before anything happens.

The original short form MOI actually says in Article 1.1 (1) that the company is ***incorporated as a private company*** as defined in the Company's Act, and I think this is in fact strong enough. In fact, what more do you need to specify. The company conforms with all the requirements for a private company as is contained in the company's act, other than a restriction on the transferability of shares. Despite this I would suggest in order to make sure that it is a private company beyond a reasonable doubt we need to put in the ***restriction on the transferability of shares***. S8 (2) (b) says that a company is a private company if the MOI restricts the ***transferability of shares***. In the security section of the Short Form MOI it says in clause 1.1(2) the company must not make an offer to the public of any of its securities in terms of s8 (2) (a). What we need to do is in this section of the MOI is to insert a clause to the effect that there is a restriction on the transferability of the shares which is not dealt with by the act or the standard MOI's. This is a good idea as it will protect the existing shareholders.

We could say that the "shares are not freely transferable". Later on, I deal with what we should have in the MOI.

1.9 SHORT FORM MOI DOES NOT DEAL WITH PAR VALUE SHARES

The short form MOI as published on the CIPC website does not indicate that shares are ***par value shares*** as it only indicates ***no par value shares***. The problem here is that many firms wanting to upgrade the MOI submitted the standard short form without taking into consideration the conversion procedures in regard to Regulation 31. This meant that the MOI which mentioned ***no par value shares*** never went through a conversion of shares in terms of Regulation 31. The short Form MOI as it stands is really aimed at the formation of new companies and should not be used for pre-existing companies with par value shares. In this case, it would be necessary to make a modification of the MOI in regard to its shares.

Regulation 31 sets out the procedure to convert from ***Par Value*** to ***No Par Value Shares***. All pre-existing companies who have Par Value Shares who filed a short form MOI did not realise

that their shares have been listed incorrectly as ***No Par Value.*** In order to rectify this, it is recommended that one just changes the respective clause to deal with par value shares rather than going through the whole conversion of the share capital class in terms of Regulation 31 as a much easier step. Both steps involve a special resolution, but by keeping the par value shares you only have to file the special resolution with the CIPC and not SARS. Only if you increase the authorised shares that you need to run the conversion procedure in terms of Regulation 31.

1.10 WHO HAS THE POWER TO ISSUE SHARES?

Another potential area for conflict in the future is the fact that the issue of shares is in the hands of the single shareholder/director or even in a company where the directors and the shareholders are the same. It may very well be a problem later on down the line where the company grows and where the shareholders are not fully represented on the board and the board has the power to issue shares. So insofar as the Short Form is concerned, I think that this clause is okay. In terms of the Long Form MOI (for a larger company) it may be that it needs to be strengthened. Perhaps it is a good idea to insert a clause to the effect that where the directors and the shareholders do not align then the power to issue shares ***must be with the shareholders by special resolution***. This special resolution does not have to be filed at the CIPC. S41 of the act deals with shareholder approval to issue shares where they are ***issued to a director***, a ***related or interrelated person*** to the company or a nominee of these. A special resolution is also required where the issue is more than ***30% of the company***. Where shares are issued in proportion to existing holdings then a special resolution is not necessary as nothing changes.

1.11 TRANSFERABILITY AND PRE-EMPTION RIGHTS

It should be remembered that the pre-emptive rights in the Companies Act 2008 in itself only deals with the ***issue or allotment of shares***, it does not deal with the ***transferability of shares*** i.e. when one shareholder transfers shares to another shareholder or to an outsider. This is something that needs to be addressed urgently. I have detailed the necessary clauses below which are unfortunately quite lengthy. If anyone has the desire to make changes, please do so.

S39(2) deals with pre-emption rights but only for the ***subscription or allotment*** of shares and basically says that if a private company proposes to issue any of the shares of that private company, each shareholder has a right to take them up before any outsider, provided they take them up in a reasonable time period. This basically means that the voting rights before the subscription of the new shares must be the same as the voting rights after the subscription of the new shares, unless a shareholder declines to take up their share of what is offered.

This is all very well, but what happens where there are a number of shareholders in a private company and things turn a bit sour and a particular shareholder who may hold say 25 per cent or 30 per cent wishes to exit and wants to sell shares. Owing to the fact that it is a private company this becomes a very difficult situation and the way the MOI is configured now and the way the Act is configured it is probably possible for the shareholder to go and offer his shares to any outsider or third party who may in fact be a competitor and it may in fact not be in the best interest of the company concerned, unless there is some kind of restriction of the transferability clause.

The latest short form now has a clause 2.1 (2) (e) which says that a transfer needs to be approved by the company. The original one did not.

If one looks at the standard Articles of Incorporation used in the old act, table B together with various amendments that lawyers made in regard to the transferability of the shares where they put in a number of articles preventing a shareholder from basically selling the shares to a third party where the Directors do not approve. Detailed below is my version of what should go into the MOI

1.12 PRE-EMPTIVE RIGHTS AND TRANSFERABILITY OF SHARES

These clauses can be put into a shareholder's agreement which each shareholder must agree to and sign. In a smaller company, it is probably better to just put it into the MOI and then one does not need to get agreement from future shareholders. Can one put this into the rules?

1. Notwithstanding anything to the contrary contained in this MOI, a shareholder **"offeror shareholders"** shall not be entitled to sell, alienate or in any other manner dispose of or transfer any security in the company unless all the securities are beneficially owned by that shareholder and that those securities have first been offered **"the offer"** in writing to the other shareholders **"offeree shareholders"** in the company who have 30 days after receipt to accept this offer.

2. **The offer** shall not be subject to any other term or condition except that the whole and not a part of the offer must be accepted. If offers to purchase are accepted by the **offeree shareholders** for a greater number of shares than those offered for sale, the shares shall be divided amongst the **offeree shareholders** in the proportions as nearly as possible in which they already hold shares in the company, provided that no **offeree shareholder** shall be obliged to acquire more shares than he shall have offered to purchase.

3. Should the **offeree shareholders** not accept the whole of the offer, then the **offeror shareholders** shall be entitled, within the thirty days after such non-acceptance, to obtain a written offer from a bona fide third party to purchase all of the securities, but at not less than

the price at and on conditions which are more favorable than those at which the **offeree shareholders** were entitled to purchase the shares in terms of 1.

4. Should the **offeror shareholder** obtain an offer from a bona fide third party in terms of 3, then the **offeror shareholders** shall furnish the **offeree shareholder** a copy of that offer showing the name and address of the bona fide third party and all the terms and conditions of that offer; and the **offeree shareholders** shall, within fourteen days after the receipt of the **third party offer**, be entitled, but shall not be obliged, to purchase the shares on the same terms and conditions as set out in that offer.

5. Should the **offeree shareholders** not purchase the shares within the fourteen days referred to in 4 then the **offeror shareholder** will be entitled, within seven days after the expiry of those fourteen days, to sell and transfer all (but not a part only) of the shares to the bona fide third party on the same terms and conditions as set out in the written offer referred to in 3.

6. Any provision condition or restriction in these clauses 1-10 may be waived if all the shareholders consent in writing thereto.

7. Should any transactions be effected by the **offeror shareholder** in terms of this MOI, the directors shall be obliged to register the transfer of the shares in question unless they have not been satisfied in such manner as they may reasonably require -that the sale and/or transfer of those shares is bona fide and conforms to the requirements of those special requirements; or they have good grounds (which shall be given) for stating that the admission of the proposed transferee is not in the interests of the company.

8. Should the **offeror shareholder** not sell all the shares in question in terms of this article, then all the provisions of these clauses 1-10 shall again apply, with the necessary modifications, should the **offeror shareholder** still wish to sell any share in the company.

9. Subject to provisions of this clauses 1-10, the directors may, in their absolute discretion and without assigning any reason, decline to register any transfer of any shares to a person of whom they do not approve.

10. If the directors refuse to register a transfer they shall send notice of that refusal to the transferee within ten days after the date which the transfer form was lodged with the company.

The above is quite complex and could part of the rules. It could be just as good to insert the clause:

All share transfers must be approved by the board of directors and all share transfers must be approved by way of special resolution.

1.13 RULES OF THE COMPANY

The **Rules** of a company is a new concept that comes out of the United States or Canada. Rules are very similar to bi-laws in a City Council. They are an addition to the constitution of the city council and would probably deal more with operational details not contained in the constitution of the city council.

The rules of a company are in fact an extension of the MOI and are designed to govern the internal affairs of the company. The problem with rules are that there are no examples and no definition of what should be included in the rules. The rules may deal with any corporate governance issues not contained in the act or in the MOI. The rules cannot be in conflict with the act or the MOI.

The rules and the MOI are in fact binding on the following in terms of S15(6);

- between the company and each shareholder
- between or among the shareholders
- between the company and each director or prescribed officer of the company in exercise of their functions within the company
- any other person serving the company as a member of a board committee in exercise of their respective functions of the board within the company.

The last two are new and overrides the long-established principle that the company's constitution is binding on a company and its shareholders only and only in the capacity of shareholders not directors. Owing to this change each party can enforce the MOI or the rules against one another in any lawful manner, this could be by way of an interdict or a damage claim arising from a breach.

The rules create a contract between the abovementioned parties in the abovementioned capacities. Please note that if the director or shareholder act in another capacity to the company then the rules can't be applied.

The rules can be changed or created quite easily without changing the MOI. Remember the rules are ***over and above***, or one can say an ***extension of the MOI***. It should be noted that the ***MOI will always take precedence*** over the rules. Where there are rules inconsistent with the MOI or the Act, these rules will be void to the extent of the inconsistency. The rules are still subject to anti-voidance sections of the Act. Rules cannot be used to alter the ***unalterable provisions*** of the act. One can make unalterable provisions stronger by inserting clauses in the MOI.

The advantage of having rules is that the directors can in fact ***compile*** and ***publish*** the rules and once the rules have been published, they are binding on the company. Regulation 16(1) provides that any rules of a company must be filed on Form Cor 16.1 within 10 business days after being published by the company.

See s15(4)(b), the board may change or append rules in any manner. It is important to know that the rules must be ***ratified*** at the next available shareholders meeting by way of an ordinary resolution. After the rules have been ratified the necessary form has to be filed with the CIPC. Regulation 16.2 is to indicate the rules have been ratified or rejected. It is not necessary to call a shareholders meeting to specifically ratify the rules, the ratification can wait until the next shareholders meeting.

Before the rules have been ratified, they are nevertheless still binding even though they are at an interim stage. What happens when the rules fail to be ratified (I.e. the shareholders vote against the rules or a particular rule) at the next general meeting? The position in this case is that even though they were in an interim stage everyone can rely on them to that point as everyone is bound by them. Once a rule has failed the ratification vote they are therefore no longer binding from that point in time. Once a rule has failed ratification it cannot be reintroduced by the directors for a further 12 months unless approved in advance by an ordinary shareholders resolution.

The advantage of compiling rules is that the directors can do it very easily without going to shareholders and the rules can be binding whilst waiting for ratification. In smaller companies it could be that ratification takes a long time because there are no shareholders meeting to ratify the rules.

Rules would deal with matters of meetings, the maximum number of Directors and potentially anything in relation to the corporate governance not in conflict with the MOI or the Act.

Some examples could be;

- Authority level of chairman of the board and frequency of director's meetings.
- Financial and marketing strategy
- Succession planning

2 EXPLANATION OF THE SHORTFORM MOI

2.1 INTRODUCTION

This document is an attempt to give an explanation of some of the contents of the short form MOI. I believe the standard MOI's are drafted in a very clever way in that

where necessary it refers to the act and does not repeat what is in the Act. It is because of this that as Secretarial Practitioners we have to understand these references to the act. We have modified the short form MOI slightly to improve it.

The benefit of the short form is that it's designed for smaller or owner managed businesses. Once selected it is a simple matter to change the MOI by special resolution.

2.2 TRANSITIONAL ARRANGEMENTS

The commencement of the new companies act on the 1st May 2011 created a transitional period of 2 years whereby the old ***Memorandum of Incorporation*** and ***Articles of Association*** (MOI) took preference over any conflicts with the new act. This meant that on the 1st May 2013 the situation was reversed and the new act took preference. i.e. All articles in the old MOI that conflict with the new act are void. By 1st May 2013 each company should have in fact implemented a new MOI to avoid these conflicts, however it is not essential that this happened by the 1st May 2013 but it is highly recommended. Even now it's not too late it is just going to cost the CIPC fee of R250.

The MOI is in fact the constitution of the company and it sets out the rights, duties and responsibilities of shareholders, directors and others within and in relation to a company. All the parties mentioned above are bound by the articles in the MOI. The MOI will also ***bind new directors*** and shareholders after the company has been formed.

The new companies act is a ***one size fits all*** act that applies to the largest corporations right down to small companies. There is a great deal of flexibility which has been provided by the so-called ***alterable provisions***. Alterable provisions can be modified by the articles in the MOI. It is because of this that each company should have the right MOI for their situation.

The new companies act has various provisions which are called ***unalterable provisions***. These are provisions in the act that cannot be changed by the MOI, in other words they can be made stronger, but they can never be made weaker. The ***alterable provisions*** or flexible provisions of the act are subject to any negation, restriction, limitation, qualification, extension or other alteration that is required, but

these changes must be specified in the MOI. It is theses alterable provisions that create flexibility for the one size fits all approach.

An alterable provision normally starts with ***"except to the extent that is otherwise provided in the MOI…."*.** This allows the MOI to modify the contents of the provision.

2.3 MOI SHORT FORM

CoR15.1 A SHORT STANDARD FORM FOR PRIVATE COMPANIES

Article 1 - Incorporation and Nature of the Company

1.1 Incorporation

(1) The Company is incorporated as a private company, as defined in the Companies Act, 2008.

Article 1.1(1). This article specifies that the company is incorporated as a ***private company***. We need to look at s 8(2)(b) which defines a private company as a **profit company** if it is not state owned or its MOI prohibits its securities or shares from being offered to the public and there is also a restriction on the transferability of its securities or shares.

There is a section on securities in the MOI see article 2.1(2) and 2.1(4) which restricts the offering of shares to the public and a restriction on the transferability of securities. It is this article that in fact makes the profit company a private company.

(2) The Company is incorporated in accordance with, and governed by; –

(a) the provisions of the Companies Act, 2008, without any limitation, extension, variation or substitution; and

(b) the provisions of this Memorandum of Incorporation.

Article 1.1(2) - 2(a) says that the company is governed by the ***provisions of the Companies Act*** without any limitations extensions variations or substitutions and; 2 (b) says the company is governed by the provisions of the MOI. This in fact is the constitution of the company and wherever there is a corporate governance issue we need to actually look at the various sections of the act as well as the provisions in the MOI.

1.2 Powers of the Company

(1) The Company is not subject to any provision contemplated in section 15 (2)(b) or (c).

(2) The purposes and powers of the Company are not subject to any restriction, limitation or qualification, as contemplated in section 19 (1)(b)(ii).

Article 1.2 (1) indicates that the powers of the company is not subject to the provisions of s 15(2)(b) or (c). This means that the company does not have any ***ring fencing*** provisions i.e. **RF** between the name and the (Pty) Ltd. A ring-fencing provision is simply something that the company wishes to bring to the attention of an outsider that it deals with as it may affect the transaction with the outsider. A ring-fencing provision or **RF** may also place a restriction on the change of any article in the MOI. The Short Form MOI simply states that there is no restriction in the MOI that an outsider should be concerned with.

Article 1.2 (2) refers to s 19(1)(b)(ii) which allows the powers of the company to have some kind of restriction, limitation or qualification. This may in itself be a ring fence RF if it needs to be brought to the attention of outsiders. An example of this will be that the company can only operate as a furniture retailer and nothing else and this would need to be brought to the attention of anyone that the company deals with. In this article in the short form MOI it is simply saying that there is no restriction on the powers of the company.

Essentially the company is a juristic person and has the capacity of an individual except to the extent that the MOI provides otherwise. This means that if there is no restriction in the MOI the company can do anything that an individual can.

1.3 Memorandum of Incorporation and Company Rules

(1) This Memorandum of Incorporation of the Company may be altered or amended only in the manner set out in section 16, 17 or 152 (6) (b).

(2) The authority of the Company's Board of Directors to make rules for the Company, as contemplated in section 15 (3) to (5), is not limited or restricted in any manner by this Memorandum of Incorporation.

(3) The Board must publish any rules made in terms of section 15 (3) to (5) by delivering a copy of those rules to each shareholder by ordinary mail.

(4) The Company must publish a notice of any alteration of the Memorandum of Incorporation or the Rules, made in terms of section 17 (1), by delivering a copy of the notice to each shareholder by ordinary mail.

Article 1.3 (1) means that the MOI can be altered or amended only in the manner set out in s 16, 17 or 152(6) (b). s 16 deals with changes to the MOI which should be made by special resolution of the shareholders of the company and s 17 allows for the MOI to be modified where there are patent errors or alterations and it deals with the situation where a translation is required. This section also deals where there have been many changes to the MOI and it is necessary for the company to consolidate the MOI. S 152(6)(b) relates to a business rescue plan.

Article 1.3 (2) and (3) deals with Rules. The Rules are a concept similar to the bylaws of a city council. The rules can be any corporate governance issue not covered by the Companies Act or MOI. The directors publish the rules that they require and all the parties that are bound to the MOI will also be bound to the rules. Article 1.3 (4) deals with the method for publishing an alteration and ratifying rules by delivering a notice to each shareholder. The rules need to be ratified by ordinary resolution at the next shareholders meeting.

1.4 Optional provisions of Companies Act, 2008 do not apply

(1) The Company does not elect, in terms of section 34 (2), to comply voluntarily with the provisions of Chapter 3 of the Companies Act, 2008.

(2) The Companies does not elect, in terms of section 118 (1)(c)(ii), to submit voluntarily to the provisions of Parts B and C of Chapter 5 of the Companies Act, 2008, and to the Takeover Regulations provided for in that Act.

Article 1.4 (1) A private company is not obliged to carry out the extended accountability requirements as set out in chapter 3 of the act except as indicated in the MOI. By having article 1.4 (1) the company does not voluntarily need to comply even though the company is not expected to comply with these requirements, it may however volunteer if it so wishes. The short form MOI just says in this situation that the company will not elect to comply.

Article 1.4(2) deals with s 118(1)(c)(2) which is in relation to the take-over regulations panel and what we call a ***regulated company***. This clause basically says that the company does not elect to comply with the take-over regulations provided in the act. It is extremely unlikely that any small company will voluntarily submit to these sections.

Article 2 - Securities of the Company

2.1 Securities

(1) The Company is authorised to issue no more than the number of shares of a single class of shares with no nominal or par value as shown on the cover sheet, and each such issued share entitles the holder to-

Alternative to the above

The authorised share capital of the Company consists of **ORDINARY SHARES** and the company is authorised to issue no more than 4000 ordinary shares of R1 each, and each such issued share entitles the holder to:-

(a) vote on any matter to be decided by a vote of shareholders of the company;

(b) participate in any distribution of profit to the shareholders: and

(c) participate in the distribution of the residual value of the company upon its dissolution.

Article 2.1 (1) (a) (b) (c) deals with the fundamental ownership of the company and actually refers to the number of shares of a single class of ordinary shares which appears on the first page of the COR 15.1. The alternative in the body is to indicate the type of shares and the authorised number as the MOI document, where there is a change of the MOI from a pre-existing company and not a formation of a new company.

There are basically three fundamental things that the ordinary shares of the company represent and these are reflected in;

(a) the ***voting percentage*** on any matter that needs to be decided by the shareholders of the company; this represents percentage ownership the number of shares held as a percentage of the total;

(b)	***participation*** by the ordinary shareholders in any ***distribution of the profit*** of the company; this represents how the dividend declared will be shared by the shareholders in accordance with their percentage of the shares they hold.
(c)	***participation*** in the ***distribution of the residual value*** of the company upon its dissolution; after the company is liquidated or wound up and all the debts are paid the shareholders will receive the balance in accordance with their shareholding.

(2) The Company must not make an offer to the public of any of its securities *and an issued share must not be transferred to any other person other than-*
(a) the company, or a related person;
(b) a shareholder of the company, or a person related to a shareholder of the company;
(c) a personal representative of the shareholder or the shareholder's estate;
(d) a beneficiary of the shareholder's estate; or
(e) another person approved by the company before the transfer is effected.

Article 2.1 (2) prevents the company from making an offer of securities to the public. This is one of the things that make the company a private company. The underlined italics is what has been amended. In the event of a shareholder dispute there is definitely some contention in the way this has been worded.

(3) The pre-emptive right of the Company's shareholders to be offered and to subscribe for additional shares, as set
(a) out in section 39, is not limited, negated or restricted in any manner contemplated in section 39 (3), or subject to any conditions contemplated in that section.

Article 2.1 (3) deals with the pre-emptive rights contained in s 39 which prevents dilution of shares after a share issue or rights issue to existing shareholders, in other words after the share issue the percentage holdings of shareholders should be exactly the same if all shareholders take up their rights, however there may be situations where some of the shareholders can't take up their rights and in this situation the shareholding percentages would change.

(4) There is a restriction on the transferability of shares and the directors may in their absolute discretion and without assigning any reason, decline to register any transfer of any shares to a person of whom they do not approve.

Article 2.1 (4) deals with the restriction on the transferability of shares. The act calls for a restriction on transferability of shares but does not specify what the restriction should be. We have inserted our own restriction which hands over the total control of the transfer to the directors. The directors have the power to block any transfer. Read this together with 2.1 (2).

(5) This Memorandum of Incorporation does not limit or restrict the authority of the Company's Board of Directors to; –

(a) authorise the company to issue secured or unsecured debt instruments, as set out in section 43 (2); or

(b) grant special privileges associated with any debt instruments to be issued by the company, as set out in section 43 (3);

Article 2.1 (5) (a) & (b) deals with the right of the Directors to issue unsecured debt instruments as set out in s 43(2) or to grant any special privileges that are associated with these debt instruments as set out in s 43(3). An example of a debt instrument may be a Debenture.

(c) authorise the Company to provide financial assistance to any person in relation to the subscription of any option or securities of the Company or a related or inter-related company, as set out in section 44;

Article 2.1 (5)(c) deals with the director's authority to grant financial assistance to any person in relation to a subscription of securities of a company or to a ***related or interrelated company*** as set out in s 44. It should be noted that there are a number of conditions required. I.e. a special resolution has to cover the situation within the last two years which must be for a specific recipient or generally for a category of potential recipients, for example like workers. It is also imperative that immediately after providing the financial assistance the company must satisfy the ***solvency and***

liquidity test and the board must satisfy itself that the company does in fact satisfy this test and the terms of the financial assistance must be fair and reasonable to the company.

(d) approve the issuing of any authorised shares of the Company as capitalisation shares, as set out in section 47 (1); or

(e) resolve to permit shareholders to elect to receive a cash payment in lieu of a capitalisation share, as set out in section 47 (1).

Article 2.1.(5) (d) & (e) deals with the Board's authority to issue capitalisation shares as set out in s 47 or to allow the shareholders to receive a cash payment in lieu of capitalising shares. Capitalisation shares are shares that have been created of a book entry from accumulated profits to share capital. In effect a transfer from accumulated profit to share capital. Bear in mind the definition of ***Contributed Tax Capital*** in terms of the income tax act.

2.2 Registration of beneficial interests

The authority of the Company's Board of Directors to allow the Company's issued securities to be held by and registered in the name of one person for the beneficial interest of another person, as set out in section 56 (1), is not limited or restricted by this Memorandum of Incorporation.

Article 2.2 S 56(1) allows the company to register securities in the name of one person for the beneficial interest of another person. There are a whole lot of other conditions which relate to public companies and regulated companies that we are not going to deal with in this explanation.

Article 3 - Shareholders and Meetings

3.1 Shareholders' right to information

Every person who has a beneficial interest in any of the Company's securities has the rights to access information set out in section 26 (1).

Article 3.1 says that any person who owns shares in a company or has a beneficial interest in a company (this will include the so- called nominee) has the right to access information as set out in s 26(1). This will include the companies MOI and rules, records of directors, reports to AGM's and annual financial statements, notices and minutes of AGM's and the security register. They will not be entitled to see the minutes of Directors or to see the books of account.

3.2 Shareholders' authority to act

(1) If, at any time, there is only one shareholder of the company, the authority of that shareholder to act without notice or compliance with any other internal formalities, as set out in section 57 (2), is not limited or restricted by this Memorandum of Incorporation.

(2) If, at any time, every shareholder of the Company is also a director of the Company, as contemplated in section 57 (4), the authority of the shareholders to act without notice or compliance with any other internal formalities, as set out in that section is not limited or restricted by this Memorandum of Incorporation.

Article 3.2 (1) & (2). If there is only one shareholder in a company then in terms of s 57(2) that shareholder may exercise any voting rights on any matter at any time without notice or compliance with any other formalities. This section also says that s 59 - 65 do not apply. These sections deal with the **record date** and ***shareholder meetings***. Subsection (2) deals with the section where every shareholder is also a director of a company that any matter referred to the board may be decided by the shareholders. There are certain formalities that will have to be complied with.

3.3 Shareholder representation by proxies

(1) This Memorandum of Incorporation does not limit, restrict or vary the right of a shareholder of the Company; –

(a) to appoint 2 or more persons concurrently as proxies, as set out in section 58 (3)(a); or

(b) to delegate the proxy's powers to another person, as set out in section 58 (3)(b).

(2) The requirement that a shareholder must deliver to the Company a copy of the instrument appointing a proxy before that proxy may exercise the shareholder's rights at a shareholders meeting, as set out in section 58 (3)(c) is not varied by this Memorandum of Incorporation.

(3) The authority of a shareholder's proxy to decide without direction from the shareholder whether to exercise, or abstain from exercising, any voting right of the shareholder, as set out in section 58 (7) is not limited or restricted by this Memorandum of Incorporation.

3.4 Record date for exercise of shareholder rights

If, at any time, the Company's Board of Directors fails to determine a record date, as contemplated in section 59, the record date for the relevant matter is as determined in accordance with section 59 (3).

Article 3.4. The record date is the date that the board decides to determine which shareholders are entitled to receive notices or get paid out a dividend etc. This is very unlikely to happen in a smaller company, however if no record date is determined by the directors it is the latest date by which the shareholders are required to give notice or the date of the action or event in any other case.

3.5 Shareholders meetings

(1) The Company is not required to hold any shareholders meetings other than those specifically required by the Companies Act, 2008.

(2) The right of shareholders to requisition a meeting, as set out in section 61 (3), may be exercised by the holders of at least 10% of the voting rights entitled to be exercised in relation to the matter to be considered at the meeting.

(3) The authority of the Company's Board of Directors to determine the location of any shareholders meeting, and the authority of the Company to hold any such meeting in the Republic or in any foreign country, as set out in section 61 (9) is not limited or restricted by this Memorandum of Incorporation.

(4) The minimum number of days for the Company to deliver a notice of a shareholders meeting to the shareholders, is as provided for in section 62 (1).

(5) The authority of the Company to conduct a meeting entirely by electronic communication, or to provide for participation in a meeting by electronic communication, as set out in section 63 is not limited or restricted by this Memorandum of Incorporation.

(6) The quorum requirement for a shareholders meeting to begin, or for a matter to be considered is as set out in section 64 (1) without variation.

(7) The time periods allowed in section 64 (4) and (5) apply to the Company without variation.

(8) The authority of a meeting to continue to consider a matter, as set out in section 64 (9) is not limited or restricted by this Memorandum of Incorporation.

(9) The maximum period allowable for an adjournment of a shareholders meeting is as set out in section 64 (13), without variation.

3.6 Shareholders resolutions

(1) For an ordinary resolution to be adopted at a shareholders meeting, it must be supported by the holders of greater than 50% of the voting rights exercised on the resolution, as provided in section 65 (7).

(2) For a special resolution to be adopted at a shareholders meeting, it must be supported by the holders of at least 75% of the voting rights exercised on the resolution, as provided in section 65 (9).

(3) A special resolution adopted at a shareholders meeting is not required for a matter to be determined by the Company, except those matters set out in section 65 (11), or elsewhere in the Act.

Article 4 - Directors and Officers

4.1 Composition of the Board of Directors

(1) The Board of Directors of the Company comprises the number of directors and alternate directors as reflected in the Companies Register of Directors and reflected on file at the CIPC. All directors are to be elected by the holders of the company's securities as contemplated in section 68.

(2) The manner of electing directors of the Company is as set out in section 68 (2), and each elected director of the Company serves for an indefinite term, as contemplated in section 68 (1).

4.2 Authority of the Board of Directors

(1) The authority of the Company's Board of Directors to manage and direct the business and affairs of the Company, as set out in section 66 (1) is not limited or restricted by this Memorandum of Incorporation.

(2) If, at any time, the Company has only one director, as contemplated in section 57 (3), the authority of that director to act without notice or compliance with any other internal formalities, as set out in that section is not limited or restricted by this Memorandum of Incorporation.

4.3 Directors' Meetings

(1) The right of the Company's directors to requisition a meeting of the Board, as set out in section 73 (1), may be exercised by at least 25% of the directors.

(2) This memorandum of Incorporation does not limit or restrict the authority of the Company's Board of Directors to; –

(a) conduct a meeting entirely by electronic communication, or to provide for participation in a meeting by electronic communication, as set out in section 73 (3); or

(b) determine the manner and form of providing notice of its meetings, as set out in section 73 (4); or

(c) proceed with a meeting despite a failure or defect in giving notice of the meeting, as set out in section 73 (5); or

(d) consider a matter other than at a meeting as set out in section 74.

4.4 Directors' compensation and financial assistance

This Memorandum of Incorporation does not limit the authority of the Company to; –

(a) pay remuneration to the Company's directors, in accordance with a special resolution approved by the Company's shareholders within the previous two years, as set out in section 66 (9) and (10);

(b) advance expenses to a director, or indemnify a director, in respect of the defense of legal proceedings, as set out in section 78 (3);

(c) Indemnify a director in respect of liability, as set out in section 78 (5); or

(d) purchase insurance to protect the company, or a director, as set out in section 78 (6).

3 SHAREHOLDERS AGREEMENT

3.1 GENERAL POINTS

The New Company's Act recognises a shareholder's agreement. We would need to look at s 15(7) which basically says that shareholders may enter into agreement with one another. The shareholders agreement may cover any matters ***"relating to the company"***, however this is a little vague and can cover a very wide area.

It is important to note that the ***company is not party to a shareholder's agreement*** in terms of s 15(7), but there is nothing to prevent the company from being a party to the agreement,

There are some **advantages** to shareholder's agreements and these are that they are ***private***, therefore the public cannot inspect the contents of a shareholder's agreement, and therefore they are secret.

The shareholders agreement is also binding in terms of the normal law of contract. S 15(6) governs only the legal status of the MOI and the rules and this does not extend to the shareholders agreement.

There are also some **disadvantages**; those shareholders who are party to the agreement are bound by the terms. In many situations new shareholders coming into the company who have not signed to the effect that they are bound by the agreement are not bound. There is no

facility in the act to alter a shareholder's agreement; the individual parties have got to all agree with any change to the shareholders agreement. In other words, if a shareholder's agreement is amended, all the parties, that is all the shareholders have to agree with it if they are to be bound. Could some rules be created forcing all shareholders to sign the shareholders agreement?

A shareholder's agreement is useful in practice but must be consistent with the companies act and the MOI. Where there are provisions in the shareholders' agreement which are not consistent with the MOI or with the act, these are void and therefor unenforceable. It is also important to understand that the ***Act and the MOI takes preference over the shareholder's agreement.***

In the past, there were clauses in the shareholder's agreement that made the shareholders ***agreement prevail in the event of an inconsistency***. This does not apply anymore. There is a major difference between a shareholder's agreement under the old act and that of the new act. Under the old act the shareholders agreement added to the various provisions of the articles, in other words the terms of the shareholders agreements could enhance what the articles said.

The company was also a party to the shareholder agreement which could contain provisions contrary to the articles and these contrary provisions would prevail.

Under the new act there is a policy shift in the way shareholders agreements work which could have an adverse effect on the impact and value of a shareholder's agreement.

In the past shareholder's agreements dealt with minority protection and various voting rights were built into shareholder's agreement but this no longer applies.

S 65(11) defines all the special resolutions that a company has to pass but the MOI can add other situations where a special resolution is required.

A shareholder's agreement ***cannot alter the effect of the alterable provisions*** in a MOI. Where an alterable provision has been changed by a MOI the shareholder's agreement must be consistent with those provisions. This in fact makes the constitutional documents more complex.

The anti-avoidance provisions of the act may have an effect on shareholders' agreements. The shareholders agreement cannot defeat or reduce the effect of a prohibition by an unalterable provision of the act.

Voting agreements may also be supported if they are not used to change the effect of alterable or any unalterable provisions but may very well prevail in most instances.

3.2 TRANSITIONAL ARRANGEMENTS

The transitional arrangements are set out in s 15(7) and basically for 2 years from inception of the act the shareholders agreements will take preference over the act even if there are provisions that are inconsistent with the act. After the two years the inconsistent provisions of a shareholder's agreement will be void.

3.3 POINTS TO BE TAKEN INTO ACCOUNT WHEN DRAFTING SHAREHOLDERS AGREEMENTS

Carl Stein in his book ***The New Companies Act Unlocked*** talks about what the drafter of shareholder's agreements should consider on page 76. It's important to go through these points some of which are ***S46 - distributions***, ***anti-dilution clauses*** and ***pre-emptive rights***. Many corporate governance issues that used to be in the shareholders agreement must now be handled in the MOI.