24 November 2010

ATT: Mr Andre Hermans

The Department of Trade and Industry

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Dear Mr Hermans

IODSA COMMENT ON DRAFT COMPANIES AMENDMENT BILL [B40-2010]

The Institute of Directors in Southern Africa (IoDSA), as the copyright owner of the 'King Report on Governance for South Africa', and the 'King Code of Governance Principles' (King III) and of corporate governance in South Africa, supports the Companies Act 71 of 2008 (the new Act) aim to promote corporate governance. In general we laud the DTI for the effort put into the corporate law reform process.

We believe that certain of the Act's provisions, as proposed to be amended by the Bill, will give rise to problems in the future, if left in its current form, and we request the Minister to consider our concerns listed below.

Companies Act as amended: List of concerns

Audit Committee Duties

The Institute Of Directors in Southern Africa. Association incorporated in terms of Section 21 of the Companies Act 1973 Reg. No. 1985/002734/08 **President** Reuel J Khoza First President Mervyn E King S.C. Patron Basil E Hersov D.M.S. **Directors Non Executive** Herman Mashaba (Chairman) Michelle Cohen (Vice-Chairman) John Kelly (Treasurer) John H Burke Michael J Judin Kwanele Gumbi Ivan R May **Directors Executive** Lindie Engelbrecht (Chief Executive) Angela R Oosthuizen (Chief Operating Officer) Anna F Ramalho **Vice Presidents** Roy C Andersen David C Brink Warren AM Clewlow Pam Golding Peter G Joubert Ronald Lubner Bertram Lubner

The new Act requires audit committees, in s94(7)(i), to perform other functions determined by the board, including the development and implementation of a policy and plan for a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes within the company.

The King Report on Corporate Governance, 2009, (King III) dedicates a substantial portion to the role of the audit committee. King III emphasises that the audit committee's role is that of oversight and not to carry out the functions of management. Section 94(7)(i), however, requires the audit committee to perform certain management functions, which is in direct conflict with the aforementioned principle (Refer to King Committee's submission to the DTI dated March 2010).

The Bill has not amended this. The Minister is requested to remove the provision, and change subsection (i) to read "to perform other functions determined by the board."

Trading under insolvent circumstances

The current Companies Act no 61 of 1973 (current Act), in section 424, and the common law prohibits companies and directors to trade in circumstances where where they do not have a reasonable belief that the debts of the company will be paid as they fall due. This prohibition serves an important objective.

The new Act's provisions, contained in section 22(1)(a), contains a similar prohibition as is currently set out in section 424 of the current Act. The new Act, however contains a further prohibition in section 22(1)(b), the effect and purpose of which is questionable.

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It is not certain whether the intention is for the provisions contained in section 22(1)(b) to limit the application of the provisions contained in section 22(1)(a). If the intention is indeed so, a company would be obliged to cease trading once its liabilities exceed its assets, regardless whether the directors reasonably believe that the company will be able to pay its debts as they fall due. This means that, even though the company's business is not being carried on recklessly, there is no gross negligence, and there is no intention to defraud any person, in terms of section 22(1)(b) the business should cease trading if financial difficulties exist at a point in time (i.e., its liabilities exceed its assets). This result is contrary to the current legal framework and also contradicts the principles that have resulted in the inclusion of business rescue provisions in the Act (Refer to King Committee's submission to the DTI dated March 2010).

The draft Companies Amendment Bill, 2010 (Bill) has not changed these provisions. We request the Minister to provide clarification, alternatively to delete the provision.

Actions for damages

The Act provisions allow 'any person' to claim damages from 'any person who contravenes any provision of this Act' (section 218(2)). This provision could be interpreted widely and if it becomes effective in its current form, could cause a floodgate of litigation against directors and other officers. Although persons will only be successful in their actions if they are able to prove that the contravention of the Act caused damage to them, the wide application of this provision might give rise to vexatious claims and unsubstantiated malicious claims being initiated against directors and officers.

The Bill has not changed these provisions. The Minister is requested to provide clarification, or to limit the ambit of this provision.

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Oral presentation

We do not wish to make oral submissions as our comments above adequately reflect our concerns.

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Chief Executive

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