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The Honourable Chairperson
Ms J Fubbs
Portfolio Committee on Trade and Industry
Cape Town
8000

By Hand

Dear Madam

RE: LEGAL OPINION: COMPANIES AMENDMENT BILL, 2010

- (1) SECTION 69: WHETHER THE GROUNDS FOR DISQUALIFICATION RELATE TO CRIMINAL OR NON CRIMINAL GROUNDS, OR BOTH; AND
- (2) CLAUSE 83: ANALYSIS OF CLAUSE 83 WITH REGARD TO THE SUSPENSION AND CANCELLATION OF CONTRACTS

1. Introduction

We have been requested by the Portfolio Committee for Trade and Industry ("the Portfolio Committee") on Friday, 11 February 2011 to provide a legal opinion in respect of the following clauses in the Companies Amendment Bill, 2010 ("the Bill"):

- (1) Section 69: Whether the grounds for disqualification relate to criminal or non criminal grounds, or both?
- (2) Clause 83: Analysis of clause 83 with regard to the suspension and cancellation of contracts.

2. Section 69: Whether the grounds for disqualification relate to criminal or non criminal grounds, or both?

2.1.1 In order to address this question we will first consider the previous applicable legislation, namely, the Companies Act, 1973 (Act No. 61 of 1973) ("the previous Act"). Section 218 of the previous Act provides as follows:

"Disqualification of directors and others

218. (1) Any of the following persons shall be disqualified from being appointed or acting as a director of a company or, except for a body corporate, from being concerned or taking part, directly or indirectly, in the management of a company:

- (a) A body corporate;
- (b) a minor or any other person under legal disability;
- (c) any person who is the subject of any order under this Act or the repealed Act disqualifying him from being a director;
- (d) save under authority of the Court—
 - (i) an unrehabilitated insolvent;
 - (ii) any person removed from an office of trust on account of misconduct;

- (iii) any person who has at any time been convicted (whether in the Republic or elsewhere) of theft, fraud, forgery or uttering a forged document, perjury, an offence under the Prevention of Corruption Act, 1958 (Act No. 6 of 1958), the Corruption Act, 1992 (Act No. 94 of 1992), Part 1 to 4, or section 17, 20 or 21 (in so far as it relates to the aforementioned offences) of Chapter 2 of the Prevention and Combating of Corrupt Activities Act, 2004, or any offence involving dishonesty or in connection with the promotion, formation or management of a company, and has been sentenced therefore to imprisonment without the option of a fine or to a fine exceeding one hundred rand.
 - (iv) any person who has, in terms of an Act of Parliament, been removed from office for not being a fit and proper person to serve as a director or in the management or in any other position of trust of the body in question due to theft, fraud, forgery, uttering a forged document, corruption, whether in terms of the common law or not, or any other act involving dishonesty.
- (1A) (a) (i) The Registrar of the Court shall, upon—
- (aa) the issue of a sequestration order;
 - (bb) the issue of an order for the removal of a person from an office of trust on account of misconduct; or
 - (cc) a conviction for an offence referred to in subsection (1) (d) (iii),
- send a copy of the relevant order or particulars of the conviction, as the case may be, to the Registrar.
- (ii) The Registrar shall notify each company which has as a director the person to whom the order or conviction relates, of the order or conviction.
 - (iii) A company notified in terms of subparagraph (ii) shall, within a period of 60 days from notification, inform its shareholders in writing of such notification.
 - (b) The Registrar shall establish and maintain a register of the orders and convictions contemplated in paragraph (a) and such register shall be open to inspection mutatis mutandis as if it were a register contemplated in section 113.
 - (c) (i) If a person's name has been entered on the register contemplated in paragraph (b) because that person was declared insolvent, the Registrar shall remove that person's name from the register as soon as he or she is rehabilitated.
 - (ii) The Registrar shall remove a person's name from the register where a court has granted authority as contemplated in subsection (1) (d).
- (2) Any person disqualified from being appointed or acting as a director of a company and who purports to act as a director or directly or indirectly takes part in or is concerned in the management of any company, or any director or officer of the company in question who knew or who could reasonably be expected to know of the disqualification—
- (a) shall be guilty of an offence;
 - (b) shall be liable, jointly and severally, for all debts incurred by the company for the period during which such person knew or could reasonably be expected to know of the disqualification.
- (3) Nothing in this section shall be construed as preventing a company from providing in its articles for any further disqualifications for the appointment of or the retention of office by any person as a director of such company."

2.1.2 Section 218 of the previous Act sets out specific grounds for the disqualification of directors of a company. In addition thereto, section 219 of the previous Act provides that the court may also make an order directing that for a specified period a person, director or officer shall not without the leave of the court be a director, whether directly or indirectly, be concerned or take part in the management of the company.

2.1.3 One could argue that the wording of sections 218 and 219 have been enacted to enhance the principle of good corporate governance of companies.

2.1.4 In essence, section 218 deals specifically with those circumstances under which persons are disqualified from being directors of companies. Section 218(1)(a) to (c) refers to both natural persons

and juristic persons who are disqualified from being a director. One may conclude that these grounds relate to non criminal grounds for disqualification of directors.

2.1.5 The grounds for disqualification set out in section 218(1)(d), refer both to criminal and non criminal grounds of disqualification, subject to the condition that such grounds must be endorsed by the court. In terms of section 218(1)(d)(i) and (ii) an unrehabilitated insolvent and any person removed from an office of trust on account of misconduct may not be appointed to serve as a director of a company. Whereas section 218(1)(d)(iii) and (iv) refers specifically to criminal grounds for disqualification of a person to serve as director of a company. In terms of section 218(1)(d)(iii) a person who is convicted of certain criminal offences and sentenced to imprisonment without the option of a fine or to a fine exceeding one hundred rand, is disqualified from serving as a director.

2.1.6 Furthermore section 218(1)(d)(iv) states that any person who has in terms of an Act of Parliament been removed from an office due to theft, fraud, forgery, corruption, whether in terms of the Act or the common law, or any act of dishonesty is also disqualified from being appointed as a director.

2.1.7 In addition to the aforesaid, whenever the court has given an order for the sequestration or the removal of a person from an office of trust on account of misconduct or in the case of a conviction for an offence contemplated in section 218(1)(d)(iii), the Registrar of the Court is obliged to send a copy of the relevant order or particulars of the conviction to the Registrar of Companies. In this regard the Registrar of Companies must notify the relevant company to whom the court order or conviction relates and is authorised to keep a register of persons disqualified as directors. Section 218(1)(2) also provides for an offence where a director or officer of the company who knew or could have reasonably been expected to know of the disqualification will also be guilty of an offence and be jointly and severally, liable for all debts incurred by the company for the relevant period.

2.1.8 Apart from the formal grounds for disqualification of directors set out in the previous Act, a company may in terms of section 218(3) of that Act provide in its articles for any further disqualifications for the appointment of any person as a director of a company¹.

2.1.9 Although section 218 does not expressly impose an obligation on the Minister of Justice and Constitutional Development, but rather the Registrar of the Court, there is an implied statutory obligation on the Minister to ensure that the necessary documentation is sent to the Registrar of Companies as required. In terms of section 218 anybody convicted of the prescribed offences is disqualified from being appointed as a director of a company.

2.2 The new Companies Act, 2008

2.2.1 Section 69 of the Companies Act, 2008 (Act No. 71 of 2008) provides as follows:

¹ Section 218(3) of the Companies Act , 1973 (Act No. 61 of 1973)

"Ineligibility and disqualification of persons to be director or prescribed officer"

- 69.** (1) In this section, "director" includes an alternate director, and—
- (a) a prescribed officer; or
 - (b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company's board.
- (2) A person who is ineligible or disqualified, as set out in this section, must not—
- (a) be appointed or elected as a director of a company, or consent to being appointed or elected as a director; or
 - (b) act as a director of a company.
- (3) A company must not knowingly permit an ineligible or disqualified person to serve or act as a director.
- (4) A person who becomes ineligible or disqualified while serving as a director of a company ceases to be a director immediately, subject to section 70 (2).
- (5) A person who has been placed under probation by a court in terms of section 162, or in terms of section 47 of the Close Corporations Act, 1984 (Act No. 69 of 1984), must not serve as a director except to the extent permitted by the order of probation.
- (6) In addition to the provisions of this section, the Memorandum of Incorporation of a company may impose—
- (a) additional grounds of ineligibility or disqualification of directors; or
 - (b) minimum qualifications to be met by directors of that company.
- (7) A person is ineligible to be a director of a company if the person—
- (a) is a juristic person;
 - (b) is an unemancipated minor, or is under a similar legal disability; or
 - (c) does not satisfy any qualification set out in the company's Memorandum of Incorporation.
- (8) A person is disqualified to be a director of a company if—
- (a) a court has prohibited that person to be a director, or declared the person to be delinquent in terms of section 162, or in terms of section 47 of the Close Corporations Act, 1984 (Act No. 69 of 1984); or
 - (b) subject to subsections (9) to (12), the person—
 - (i) is an unrehabilitated insolvent;
 - (ii) is prohibited in terms of any public regulation to be a director of the company;
 - (iii) has been removed from an office of trust, on the grounds of misconduct involving dishonesty; or
 - (iv) has been convicted, in the Republic or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence—
 - (aa) involving fraud, misrepresentation or dishonesty;
 - (bb) in connection with the promotion, formation or management of a company, or in connection with any act contemplated in subsection (2) or (5); or
 - (cc) under this Act, the Insolvency Act, 1936 (Act No. 24 of 1936), the Close Corporations Act, 1984, the Competition Act, the Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001), the Securities Services Act, 2004 (Act No. 36 of 2004), or Chapter 2 of the Prevention and Combating of Corruption Activities Act, 2004 (Act No. 12 of 2004).
- (9) A disqualification in terms of subsection (8) (b) (iii) or (iv) ends at the later of—
- (a) five years after the date of removal from office, or the completion of the sentence imposed for the relevant offence, as the case may be; or
 - (b) at the end of one or more extensions, as determined by a court from time to time, on application by the Commission in terms of subsection (10).
- (10) At any time before the expiry of a person's disqualification in terms of subsection (8)(b)(iii) or (iv)—
- (a) the Commission may apply to a court for an extension contemplated in subsection (9)(b); and

- (b) the court may extend the disqualification for no more than five years at a time, if the court is satisfied that an extension is necessary to protect the public, having regard to the conduct of the disqualified person up to the time of the application.

(11) A court may exempt a person from the application of any provision of subsection (8)(b).

(12) Despite being disqualified in terms of subsection (8)(b)(iii) or (iv), a person may act as a director of a private company if all of the shares of that company are held by that disqualified person alone, or by—

- (a) that disqualified person; and
- (b) persons related to that disqualified person, and each such person has consented in writing to that person being a director of the company.

(13) The Commission must establish and maintain in the prescribed manner a public register of persons who are disqualified from serving as a director, or who are subject to an order of probation as a director, in terms of an order of a court pursuant to this Act or any other law.”

2.2.2 The Companies Act sets out qualifications and grounds of disqualification for the appointment of directors². A memorandum of incorporation of a company may impose additional grounds for eligibility and disqualification of directors and minimum qualifications to be met by directors of that company³.

2.2.3 In terms of section 69 a person becomes ineligible to be a director if the person—

- (a) is a juristic person (section 69(7)(a));
- (b) is an unemancipated minor, or is under a similar legal disability (section 69(7)(b));
- (c) does not satisfy any qualification set out in the Memorandum of Incorporation (section 69(7)(c)).

2.2.4 In terms of section 69(8) a person becomes disqualified from being appointed as a director of a company based on the following grounds:

- (a) A court has prohibited that person from being a director or declared such person to be delinquent; (section 69(8)(a))
- (b) An unrehabilitated insolvent (section 69(8)(b)(i));
- (c) A person prohibited from being appointed as a director in terms of any public regulation (section 69(8)(b)(ii));
- (d) A person that has been removed from an office of trust on the ground of misconduct involving dishonesty (section 69(8)(b)(iii)); or
- (e) A person who has been convicted and imprisoned, without the option of a fine, for theft, fraud, forgery, perjury or an offence involving fraud, misrepresentation or dishonesty (section 69(8)(b)(iv)).

2.2.5 The criminal grounds of disqualification set out in section 69(8)(b)(iv) of the Companies Act is a revised version of section 218(1)(d)(iii) and (iv) of the previous Act.

2.2.6 In terms of section 69(9), a disqualification as referred to herein, ends at the later of 5 years

² In terms of section 69(1), “director” includes an alternate director, and a prescribed officer or a person who is a member of a committee of a board of a company, or the audit committee of a company, irrespective of whether or not the person is also member of the company’s board.

³ Section 69(6) of the Companies Act, 2008 (Act No. 71 of 2008)

after the date of removal from office, or the completion of any sentence imposed for the relevant offence, as the case may be, or at the end of one or more extensions as determined by a court.

2.2.7 Similar to section 218(1A)(b) of the previous Act, section 69(13) requires the Commission to establish and maintain in the prescribed manner a public register of persons who are disqualified from serving as a director or who is subject to an order of probation as a director. However, this provision does not expressly provide for an obligation on the Registrar of the Court to send a copy of the relevant sequestration order, order for the removal of a person from an office of trust on account of misconduct or conviction of the prescribed offences to the Commission. In this regard section 69(13) could be interpreted to mean that this particular function will be prescribed in the regulations.

2.2.8 It appears from the relevant sections in the Companies Act that it is envisaged that both criminal and non criminal grounds for disqualification is contemplated under the Act.

2.2.9 In view of our comments relating to section 218(1A) of the previous Act, we recommend that a similar substantive provision be inserted in the Bill, to impose a statutory obligation on the Registrar of the Court to send particulars of the conviction or relevant court order to the Commissioner.

2.2.10 Currently section 69(13) of the Companies Act only refers to an obligation on the Commission, by way of regulations, to establish and maintain a public register of persons who are disqualified from serving as a director, but is silent on the role of the Registrar of the Court. In this regard, we recommend that a substantive provision be inserted in the Bill specifying the role of the Registrar of the Court to facilitate the transmission of information and documentation relating to particulars of convictions and court orders pertaining to persons who are disqualified from serving as a director.

2.2.11 We propose the following amendment in this regard:

"Amendment of section 69 of Act 71 of 2008

Section 69 of the principal Act is hereby amended by—

(a) by the insertion after subsection (12) of the following subsections:

- "(12A) The Registrar of the Court must, upon—
- (a) the issue of a sequestration order;
 - (b) the issue of an order for the removal of person from any office of trust on the grounds of misconduct involving dishonesty; or
 - (c) a conviction for an offence referred in subsection (8)(b)(iv),
send a copy of the relevant order or particulars of the conviction, as the case may be, to the Commission.

(12B) The Registrar of the Court must notify each company which has as a director to whom the order or conviction relates, of the order or conviction."

3. Analysis of clause 83 of the Bill (section 136 of the Companies Act, 2008)

3.1 Chapter 6 of the Companies Act introduces the concept of business rescue. The main purpose of this Chapter is to ensure the efficient rescue and recovery of financial distressed companies. The Act makes provision for the appointment of a qualified business rescue practitioner to oversee the business of a company during the business rescue process and to balance the rights of all the stakeholders involved. In addition thereto the business rescue proceedings prescribed under the Act will also benefit the economy and ensure that the rights of employees are protected as well.

3.2 Clause 83 of the Bill reads as follows⁴:

“Amendment of section 136 of Act 71 of 2008

83. Section 136 of the principal Act is hereby amended—
- (a) by the substitution for subsection (2) of the following subsection:
- '(2) Subject to **[sections 35A and 35B of the Insolvency Act, 1936 (Act No. 24 of 1936)]** subsection (2A), and despite any provision of an agreement to the contrary, during business rescue proceedings, the practitioner may **[cancel or]—**
- (a) ~~entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, [entirely, partially or conditionally any provision of] any obligation of the company that—~~
- (i) ~~arises under an agreement to which the company [is] was a party at the commencement of the business rescue [period, other than an agreement of employment] proceedings; and~~
- (ii) ~~would otherwise become due during those proceedings; or~~
- (b) ~~apply urgently to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any agreement to which the company is a party;'~~ and
- (b) by the insertion after subsection (2) of the following subsection:
- '(2A) When acting in terms of subsection (2)—
- (a) ~~a business rescue practitioner must not suspend any provision of—~~
- (i) ~~an employment contract; or~~
- (ii) ~~an agreement to which section 35A or 35B of the Insolvency Act, 1936 (Act No. 24 of 1936), would have applied if the company was liquidated;'~~."

3.3 Section 136 makes provision for the effect of business rescue proceedings on employees and other contracts to which the company is a party. It is important to note the meaning and application of business rescue proceedings as contemplated in the Act. In this regard the section 128(1)(b) defines "business rescue" as follows:

- "(b) **'business rescue'** means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for—
- (i) the temporary supervision of the company, and of the management of its affairs, business and property;
- (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
- (iii) the development and implementation, if approved, of a plan to rescue the

⁴ The current version of this clause incorporates the amendment proposed by the Department of Trade and Industry on 9 February 2010.

company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company;" (our underlining)

3.4 In terms of the aforesaid definition, business rescue as contemplated in the Act must be understood as a means to rehabilitate a company that is in financial distress. For this purpose the business rescue practitioner is authorised to suspend entirely, partially or conditionally, any provision of an agreement⁵ to which the company is a party when the proceedings commence. In terms of clause (2)(a) the suspension of the obligation of the company is for the duration of the business rescue proceedings, which may not last for more than three months⁶. However, if the business rescue proceedings have not ended within three months, or such longer period as determined by the court, the business rescue practitioner must prepare a report on the progress of the proceedings, with updates each subsequent month. The reports must be delivered to the court or the Commission, as the case may be.

3.5 Furthermore, clause 2(b) only permits cancellation of an agreement by a court on any terms that are just and reasonable in the circumstances. In this regard the court will have regard to the facts of each case before making an order as required under this clause. Subject to subclause (2A), the court may exercise its inherent discretion to consider any urgent application for the cancellation (entirely, partially or conditionally) of any agreement to which the company is a party and any creditor or interested party to the court application will have an opportunity to join such proceedings. In terms of section 145 of the Act the creditors, as in the case of employees and employee representatives, may participate in the business rescue proceedings⁷.

3.6 However section 136(2) also states certain exceptions in this regard. In terms of the recommendation, the business practitioner may not cancel employment contracts. This serves to

⁵ Section 1 of the Companies Act, 2008 defines "agreement" as follows: "agreement" includes a contract, or an arrangement or understanding between or among two or more parties that purports to create rights and obligations between or amongst those parties;" .

⁶ Section 132(3) of the Companies Act, 2008

⁷ Section 145(1) of the Companies Act, 2008 provides as follows:

"Each creditor is entitled to—

- (a) notice of each court proceeding, decision, meeting or other relevant event concerning the business rescue proceedings;
- (b) participate in any court proceedings arising during the business rescue proceedings;
- (c) formally participate in a company's business rescue proceedings to the extent provided for in this Chapter; and
- (d) informally participate in those proceedings by making proposals for a business rescue plan to the practitioner.

(2) In addition to the rights set out in subsection (1), each creditor has—

- (a) the right to vote to amend, approve or reject a proposed business rescue plan, in the manner contemplated in section 152; and
- (b) if the proposed business rescue plan is rejected, a further right to—
 - (i) propose the development of an alternative plan, in the manner contemplated in section 153; or
 - (ii) present an offer to acquire the interests of any or all of the other creditors in the manner contemplated in section 153."

protect the rights of employees as required in terms of the relevant labour legislation. The business rescue practitioner must not suspend any provision of an agreement to which section 35A or section 35B of the Insolvency Act, 1936 (Act No. 24 of 1936) would have applied if the company was liquidated.

3.7 In terms of section 136(3) of the Companies Act any party affected by such cancellation or suspension of an agreement may assert a claim for damages for its loss as a result of such action taken by the business rescue practitioner. Section 136(4) provides that, if liquidation proceedings are converted into business rescue proceedings, the liquidator will be the creditor of the company to the extent of any outstanding claim for his or her remuneration and expenses incurred before the proceedings began.

We trust that we have addressed the concerns raised by the Portfolio Committee and should further clarification be required in respect thereof, we will avail ourselves to do so.

Yours faithfully

A handwritten signature in black ink, appearing to be 'M. M. M.', is written over a horizontal line.

CHIEF STATE LAW ADVISER