

THE DRAFTERS' DILEMMA: SOME COMMENTS ON THE
CORPORATE LAWS AMENDMENT BILL, 2006

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INTRODUCTION

The Corporate Laws Amendment Bill (the Bill), published in GG 28765 of 21 April 2006, was introduced in Parliament on 8 May 2006. It heralds a new era in South African company law and comprises the first phase of a sweeping corporate law-reform process initiated by the Department of Trade and Industry (DTI). The impetus for this project apparently originated as far back as November 1997, when the DTI issued a document outlining a broad legislative reform programme that included a review of existing securities regulations, institutions with principal oversight of corporate structure, and current practices and regulations in the area of corporate governance.

As a precursor to the corporate law-reform phase of the broader legislative reform programme, the DTI published a document entitled *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* in GN 1183 GG 26493 of 23 June 2004 (the Proposal). The Proposal sets out, in general terms, those changes which the DTI deems necessary or desirable to its effort to review and modernize South African company law. This is based on a perceived need to bring our law into line with international trends and, according to the DTI, to reflect and accommodate the changing business environment, both nationally and internationally.

It is important to note at the outset that the Proposal envisages that the drafting of, and publication and consultation on, the new company law is to take place in two stages. These are an interim review of the Companies Act 61 of 1973 to deal with problematic provisions which require urgent legislative attention, a process that has now culminated in the Bill; followed by a further, more comprehensive process of drafting, publication and consultation to deal with the remainder of the changes required to bring

company legislation as a whole into line with the DTI's philosophy as set out in the Proposal. (In what follows the first stage is referred to as the Interim Phase, which is to be completed by mid-2006, and the latter as the Final Phase, to be completed by the end of 2006.) This placed the drafters of the Bill in an invidious position. They were required to deal with certain substantive problem areas of company law in sufficient detail to address current difficulties, but could not exceed their mandate in this regard because issues flowing from or tangential to the urgent amendments in the Interim Phase must, in the interests of expediting the legislative procedure, remain reserved for the Final Phase. As is pointed out later in this note, the resulting tightrope act required of the drafters has resulted in some drafting anomalies and ambiguities and, consequently, some uncertainty.

A CLOSER LOOK AT SOME SPECIFIC AMENDMENTS

Definition of 'public interest company' and 'limited interest company'

One of the principal changes to the Companies Act is to be found in the amendment of s 1 by the insertion of two new definitions. A new subsec (6) defines a 'public interest company' and a 'limited interest company' respectively. This definition is the very cornerstone of one of the primary objectives of the corporate law-reform process as expressed by the DTI in the Proposal, since the definitions form the legislative basis for distinguishing between these two types of companies as part of an overarching process of replacing all existing company forms (public and private companies and apparently, in the fullness of time, close corporations) with one simple, flexible choice of business vehicle. The stated philosophy of the DTI in this regard is that it is necessary to move away from the 'largely artificial' separation between the different business forms, to recognize only one form of business vehicle and to provide for a simple, easy company formation process.

In chapter 4 of the Proposal it is suggested that company law should set out mandatory provisions for all companies and provide optional provisions and default provisions in cases where the entity involved does not make an election. The articles and memorandum of the company should provide for mandatory rules and could allow shareholders to create additional optional requirements. Furthermore, the DTI envisages a regime in which shareholders may opt out of certain mandatory rules if a large majority, for example 90 per cent, agree to do so. According to the DTI it is further important to recognize that companies vary in size, turnover and with respect to the number of shareholders, but that the number of shareholders does not provide an adequate basis for differentiation and that the most important distinction is between listed and unlisted entities. A further distinction may apparently be necessary for unlisted companies on the basis of turnover, since the ability of the company to contract and establish relationships with other stakeholders becomes more important and complex as the size and turnover of the company increase. It is further proposed that a company should have a

broad purpose, which would be to do business or to operate ‘not for profit’, and this will be afforded specific attention in the reform process. It appears, therefore, that the distinction between public and limited interest companies has been drawn to facilitate this new approach. In addition, different sets of reporting standards will exist for and apply to public interest companies and limited interest companies, the former being more comprehensive and more onerous than the latter. In the same vein, audit committees are required to be appointed in relation to public interest companies while this is not necessary in the case of a limited interest company. This illustrates the legislative approach to be adopted going forward: public interest companies (given *inter alia* the complexity of the consequences of their interaction with stakeholders other than shareholders) are to be burdened with more onerous standards, requirements and obligations than are limited interest companies, which affect a smaller number of people and affect them to a lesser extent. This being the case, it is obviously essential that the relevant definitions are clear, sufficient and watertight as they underpin the two-tier financial and regulatory regime to be implemented.

It may be useful to point out at this stage that, by virtue of the definitions that have been attached to public and limited interest companies respectively, the Bill has apparently created at least two different types of formal business vehicle as opposed to the single business vehicle originally intended. Furthermore, one may find that as the differentiation between the two forms is fleshed out with respect to mandatory and optional requirements and the different reporting standards and other obligations crystallize, various types of business vehicle will appear within the two distinct forms so that one inevitably ends up with a number of entities, not so very different from those encountered within the system that is currently in place. This illustrates the drafters’ dilemma: the Bill needs to distinguish sufficiently between the different entities to allocate to each the financial reporting obligations set out in it, but the drafters did not have the scope to distinguish between the different entities on all fronts and to address all the consequences of the distinction, as these will presumably be actioned in the Final Phase amendments. The difficulties inherent in this approach become apparent if one considers specific provisions in the Bill.

The definition of ‘public interest company’ contained in the Bill reveals that a company is a public interest company if (a) its articles provide for an unrestricted transfer of its shares; (b) it is permitted by its articles to offer shares to the public; (c) it decides by special resolution to be a public interest company; or (d) it is a subsidiary of any of the companies described in (a) to (c) above. Furthermore, a company with two or more types or classes of shares is a public interest company if its articles provide for the unrestricted transfer of shares in one or more of these types or classes. The new definition goes on to state that, for purposes of the subsection, a transfer of shares will be unrestricted if it is not subject to an effective right of pre-emption. An effective right of pre-emption, in turn, is defined as a right of pre-emption which operates in favour of all shareholders of the company and upon every

proposed sale of shares to a person who is not a shareholder of the company. Finally, the subsection provides a default definition for a limited interest company: a company is a limited interest company if it is not a public interest company.

From this portion of the new definition alone certain questions arise. The methodology adopted in the definition of a public interest company is the mirror image of that currently utilized in the Companies Act to regulate private companies. To illustrate, s 20 of the Companies Act states that a private company means a company which by its articles (a) restricts the right to transfer of its shares; and (b) limits the number of its members to fifty; and (c) prohibits any offer to the public for the subscription of any shares or debentures of the company. Save for the limit on the number of members, it seems that the approach of the DTI envisages that articles of a (new) public interest company should contain provisions which, in relation to the transferability of its shares and offers to the public, provide precisely the opposite of what the articles of an (old) private company must currently contain. However, in its current form the Bill does not necessarily produce this result.

Section 20(3) of the Companies Act clearly enjoins a private company to ensure that its articles continue to contain these provisions by prohibiting it from altering the articles so as to exclude any of them, unless the company is at the same time converted into a public company. Also, in terms of s 20(4) of the Companies Act it is clear what the consequences are should a private company fail to comply with these provisions, as it becomes subject to certain sections of the Act as if it were public company. This is simultaneously the remedy that will address any possible mischief or prejudice should a private company behave like a public company notwithstanding that its articles and legal nature do not permit this.

However, the same cannot be said for the new definition. First, while s 20(3) acts as a type of prescriptive device, there is no corresponding section in the new 'mirror-image' definition, i.e. nothing that enjoins a public interest company to include the relevant provisions in its articles, nor any indication of what the consequences are if it does not do so. To illustrate, if one assumes that the articles of a public company are silent in relation to the transferability of its shares and are similarly silent on the offer of its shares to the public as from the date of its incorporation (or that it amends its articles to this effect subsequent to incorporation), does this mean that it does not qualify as a public interest company and is therefore (by default) a limited interest company in terms of the new subsec (6)(d)? If this is the case, it will be relatively simple for a company to avail itself of less onerous reporting requirements and any other less taxing obligations which apply to limited interest companies by omitting any mention of the transfer of shares from its articles. In its present form there is nothing in the Bill to prevent a company which is (in fact, but not by definition) a public interest company from doing

this. In addition, if this is the case, nothing seems to prevent a public company, notwithstanding the fact that its articles are silent on the matter, from then offering its shares to the public, as the sanction utilized in the Companies Act (which treats a company as a public company by virtue of its behaviour) has not been duplicated here. There is also no provision stating that where a company, as contemplated by the new subsec (6)(a)(iii), decides by special resolution to be a public interest company, it has to amend its articles accordingly.

One could, of course, argue that as a matter of interpretation the words 'is permitted by its articles to offer shares to the public' cater for the situation where the articles of a public company are silent on the topic, and the fact that it does not prohibit offers to the public implies that it may offer shares to the public. However, this is a tenuous construction which the drafters could easily have addressed by using an alternative construction such as 'its articles provide that it is permitted offer shares to the public'. It also does not sit well with the 'default' nature of the definition of 'limited interest company'. As there is nothing in the Bill which stipulates that the articles of a limited interest company must prohibit it from offering shares to the public (or indeed any indication of what the articles of a limited interest company must contain), the distinction between the two types of companies becomes blurred and uncertain where the articles are silent on this point. Note further in this regard that, while s 20 of the Companies Act requires a private company to incorporate all three provisions in its articles (ie they are cumulative requirements, separated by the word 'and'), the definition in the Bill envisages that the inclusion of either of the provisions relating to unrestricted transfer or public offers will suffice to establish it as a public interest company: it uses the word 'or' at the end of the list of items and the list also includes the decision of a company to become a public interest company, which is clearly a stand-alone determinant. Presumably this drafting approach is aimed at casting the net as widely as possible so that if, for example, the articles of a company permit it to offer shares to the public but contain no pre-emptive rights provisions, it will still qualify as a public interest company. This may help to provide a rationale for the way in which the new definition is drafted, but does not assist with the ambiguities that arise from that drafting.

Of course, the concerns raised above are based on the assumption that the current s 20, which deals with the requirements of a private company and cessation of its privileges in certain circumstances, will be deleted from the Act in the Final Phase amendment by virtue of the fact that the ultimate intention of the drafters is apparently to replace entirely the existing distinction between public and private companies with one type of statutory vehicle (differing only with respect to its obligations depending on its function, requirements and potential commercial impact). However, this course of action would correspond with the stated intention of the DTI as contained in the Proposal, and it does seem that the new definition is effectively to perform the same function as the existing s 20. Accordingly it

would not make sense to retain both. The problem, however, lies in the fact that the issues raised are currently catered for by the manner in which s 20 is framed as well as by s 20(3) and (4), and that when the section is deleted from the Companies Act the difficulties alluded to may surface. The drafters of the Bill are no doubt alive to these potential problems, but given the structure and timing of the amendment process were unable to address them at this point. The potential confusion seems to have been compounded by the decision to use a mirror-image definition (albeit an amended one) of the existing private company to define the new public interest company. It is unclear why the drafters have adopted this approach, although this may become apparent in due course. It seems, therefore, at the very least, that a provision having a similar effect to that of the current s 20 needs to be enacted in the case of a public interest company in the Final Phase as, until it is enacted, these uncertainties will persist.

As it seems to be a relatively simple exercise to close the loopholes occasioned by the drafting of the new definition in due course by utilizing mechanisms and wording already contained in the current legislation, this raises a further question in relation to the drafting of the new definition: whether there is conceptually any substantial difference between the current public/private company distinction and the public interest/limited interest distinction which the reformers are attempting to create. So far it appears to amount to no more than a change of terminology, and it seems that the differential reporting and audit committee requirements could just as readily have been linked to private and public companies respectively (and achieved the same result) without the uncertainties occasioned by the new definitions. The same principle applies to amendments to the current regime — if the legislature seeks to do away with the statutory minimum membership for private companies, for example, it would have been a matter of simply amending s 20 by deleting s 20(1)(b). However, this perception may once again be a product of the drafters' limited mandate at this point of the reform process, and the rationale for these changes may become apparent as the process unfolds.

The remainder of the provisions contained in the new s 1(6) dealing with unrestricted transfers of shares and effective rights of pre-emption are also not entirely unproblematic. Subsection (6)(e) states that where an effective right of pre-emption (which is one that operates in favour of all shareholders and upon every proposed sale of shares to a non-shareholder) is contained in the articles of a limited interest company, it shall be deemed also to operate, with the necessary changes, upon the disposal of a beneficial interest in a share of the company (i.e. where the beneficial holder of a share disposes of his interest as opposed to the registered member) and an offer by the company of shares created in terms of section 75 (i.e. by the issue of new shares which are offered to a non-shareholder). Presumably this means that the company cannot issue new shares to a future shareholder without first offering them to existing shareholders. It is possible that this may impact unfavourably on black economic empowerment transactions where these are structured to include

the issue of new shares to a BEE partner and where some of the shareholders are more inclined to increase their shareholding than to permit the issue of shares to the new partner. In circumstances where minority shareholders are not in favour of a proposed BEE transaction but are outvoted, it thus affords them a further opportunity to stymie the transaction (provided they have the financial means to do so) by purchasing any new shares in terms of this expanded pre-emptive right. Also, where a beneficial holder disposes of his interest and this is subject to a right of pre-emption, it is not clear how this provision is to be enforced where the company and other shareholders are not aware of or alerted to the change in ownership of the beneficial interest. Whilst this should be ascertainable in terms of the existing s 140A of the Companies Act by virtue of the disclosure requirement in relation to listed securities, it appears that the relevant provision in the Bill relates specifically to limited interest companies (read private, unlisted companies) which are not subject to the disclosure requirements of s 140A.

Amendment of section 38

One of the stated objectives of the Proposal was to investigate the appropriateness of the international model of a United States-style 'solvency-liquidity test' as opposed to a capital maintenance requirement with an initial paid-up capital to which South African company law has to date, at least in part, continued to subscribe. The capital maintenance rule historically justified the prohibition of share buy-backs, distributions to shareholders out of capital and financial assistance for buy-backs which, in terms of the Companies Amendment Act 37 of 1999, were to a large extent repealed and replaced by the American solvency and liquidity tests referred to above which made buy-backs and payments to shareholders possible. The memorandum on the objects of the Corporate Laws Amendment Bill, 2006 states that shareholder diversification is the other primary reason behind the proposed amendment of s 38.

In its current form s 38 prohibits a company from providing financial assistance for the purchase of its own shares or those of its holding company. The rule is aimed at the preservation of the company's capital in the interest of creditors and present shareholders. As pointed out in the explanatory memorandum, the solvency-liquidity test has gained favour over the preservation of capital as an alternative protection for creditors and shareholders because it enables a financially strong company to offer assistance for the purchase of its shares. The proposed amendment to s 38 apparently introduces a further exception (to the limited list already contained in s 38(2)) in order to facilitate shareholder diversification or broad-based black economic empowerment. It is an accepted commercial and legal fact that s 38 has hampered black economic empowerment by preventing even financially strong companies from offering assistance for the purchase of shares to potential BEE partners who do not have the requisite resources to acquire those shares independently. In terms of the proposed

amendment a company will, according to the explanatory memorandum, be able to offer assistance under the new provision if it complies with the solvency test and if its shareholders approve the terms of the transaction by passing a special resolution.

The amendment of s 38 provides for the insertion after the existing subsec (2) of a new subsec (2A), which reads as follows:

‘(2A) Subsection (1) does not prohibit a company from giving financial assistance for the purchase of or subscription for shares of that company or its holding company, if —

- (a) the company’s board is satisfied that —
 - (i) subsequent to the transaction, the consolidated assets of the company fairly valued will be more than its consolidated liabilities; and
 - (ii) subsequent to providing the assistance, and for the duration of the transaction, the company will be able to pay its debts as they become due in the ordinary course of business; and
- (b) the terms upon which the assistance is to be given is sanctioned by a special resolution of its members.

(2B) For the purposes of paragraph (2A)(a), the directors must consider any contingent liabilities which may arise to the company, including any contingent liability which may result from giving the assistance.’

Whilst the objective of the amendment may be laudable, the wording of the provision is, once again, not devoid of problems. Whether this is attributable to the intention of the drafters or to an oversight in the drafting process is not clear at present. The difficulty lies in the fact that the existing prohibition is far more widely framed than the exception or ‘carve-out’ provided by the new subsection (2A). The general prohibition provides that:

‘No company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person or for any shares of the company, or where the company is a subsidiary company, of its holding company.’

The possibility of permitting a company to give financial assistance subject to adequate safeguards for creditors and minority shareholders is not a novel concept and is especially likely to find favour given the public interest goal of shareholder diversification, which it facilitates in this instance. However, in order to serve its original protective purpose, s 38 was drawn in very wide and general terms. Accordingly, the general prohibition states that financial assistance includes direct or indirect financial assistance and a loan, guarantee, the provision of security or financial assistance otherwise provided. Furthermore, the financial assistance can be made for the purpose of or in connection with a purchase or subscription of shares or shares of the holding company. This terminology has been dealt with in various cases and its application in those instances has not been straightforward. This, together with the fact that the Appellate Division stressed in *Lipschitz NO v UDC Bank* 1979 (1) SA 789 (A) at 798 that ‘there is no latitude for curtailment by the Courts of its scope in respect of conduct which has been clearly prohibited’, has led many practitioners to advise their clients that a contravention of s 38 may very well be less than obvious. Herein lies the rub of the drafting in this instance. On a plain reading of the proposed amendment it appears that the scope of the prohibition is wider than the scope of the permitted exception owing to the fact that different wording

was used in each case. While direct or indirect financial assistance (including loans, guarantees, security or financial assistance otherwise provided) for the purpose of or in connection with a purchase or subscription of shares in a company or its holding company is patently prohibited, it appears, in terms of the amendment in the Bill, that only financial assistance for the purchase of or subscription for shares in a company or its holding company may properly be excused or permitted.

This gives rise to questions such as whether, for example, financial assistance which is prohibited in terms of s 38 by virtue of the fact that it constitutes indirect financial assistance can be cured if, subsequent to the transaction, the company would be liquid and solvent, and if it is sanctioned by special resolution. It is not clear at this stage why the drafters of the Bill opted for different wording or, indeed, whether this was intentional.

If the drafters were desirous of removing the confusion in connection with the very wide and often ambiguous wording of the s 38 prohibition, they should surely have taken this opportunity to prune that wording as well. If not, then the wording in subsec (2A) should logically follow the wording in the general prohibition verbatim if it is intended to provide an exception to all forms of prohibited financial assistance provided that the subsequent requirements of solvency, liquidity and approval by the shareholders by means of a special resolution are met. This puzzling discrepancy, which it seems may not have been intended, may confuse the public and, in addition, have the unintended effect of limiting the potential curative nature of the exception which the legislature has seen fit to provide. If one has regard to the spirit of the *Lipschitz* judgment (supra), it is presumably equally true to say that there should be no latitude for extension by the court of the scope of an exception in respect of conduct which has clearly been accepted as permissible. This anomaly is readily rectifiable if it does not correctly reflect the intention of the drafters, but if this is the case its very existence is troubling. While it may have resulted from the urgency of the drafting process in relation to this particular amendment, it should be clarified or rectified in the Final Phase.

Another feature of the intended amendment of s 38 that merits further consideration, but is not specifically alluded to in the explanatory memorandum, is the requirement that the board of directors of the company should be satisfied that subsequent to the transaction the company will meet the solvency and liquidity tests. The other sections in the Companies Act which operate on the basis of solvency and liquidity principles, namely ss 85 and 90, use the wording '[a] company shall not make any payment in whatever form . . . if there are reasonable grounds for believing that . . . ' (see ss 85(4) and 90(2)). It is not clear why the drafters of the Bill have deviated from the established wording in connection with these tests and what will be made of this in practice. Presumably the interpretation of the phrase 'company's board is satisfied' must recognize some objective component. It would appear that the satisfaction of the board constitutes an inherently subjective element, but (presumably) such satisfaction should be objectively justifiable.

Once again there is no mention of why the drafters have elected to use different wording from that contained in ss 85 and 90, if in fact they elected to deviate at all and it is not merely a drafting oversight. If this is not the case, one would expect the change to be addressed in the memorandum at least to some extent. Perhaps the drafters will take the opportunity in the Final Phase to do so.

Section 228

We are informed by the explanatory memorandum that the changes to s 228 are principally aimed at the protection of minority shareholders. In the past the provisions of s 228 have been misused to the detriment of minority shareholders on two fronts. First, the section has been used as a mechanism for effecting a takeover of a target company as an alternative to the existing section 440K of the Companies Act, which has more stringent requirements. In its current form s 228 allows directors to dispose of the whole or substantially the whole of the business or the whole or the greater part of the assets of a company with the approval of a general meeting of the company, ie in terms of an ordinary resolution. The proposed amendment has the effect that such a disposal will henceforth require a special resolution, resulting in greater protection for minority shareholders. In addition, the words 'the whole or substantially the whole' have in the past been liberally interpreted in relation to the disposal of a business undertaking in order to avoid the application of s 228. For this reason the more objective test already used in respect of assets, namely 'the whole or the greater part', will also apply to the disposal of the business undertaking.

The second instance of misuse relates to the fact that currently, because the Securities Regulation Code on Takeovers and Mergers applies only to public companies and private companies that have more than ten beneficial shareholders, a s 228 disposal which takes place in relation to a wholly-owned subsidiary does not technically fall within the jurisdiction of the Securities Regulation Panel (SRP) no matter how significant the disposal is in terms of value in relation to the group and thus the interest of the minority shareholders in the holding company as a whole. The effect of this is that minority shareholders in the holding company do not enjoy the protection of the SRP in these cases. To cure this defect a further amendment in the new section provides that if, in relation to the consolidated financial statements of a holding company, a disposal by any of its subsidiaries would constitute a disposal by the holding company (in the sense that it constitutes the disposal of the whole or the greater part of the undertaking or assets of the company), such a disposal requires a special resolution by the members of the holding company and subsecs (1) to (4) (ie the provisions requiring a special resolution and the provision stating that the requirements of s 228 are in addition to those of the SRP) will also apply.

I am not convinced that the amendment has achieved its stated objective as regards protection of minority shareholders by the SRP where a s 228

disposal takes place in a company group context. The involvement of the SRP at the subsidiary level requires two things: that an 'affected transaction' as defined in s 440A of the Companies Act (which specifically includes a disposal as contemplated in s 228) will take place and that the entity or entities involved are subject to the jurisdiction of the SRP by virtue of their nature and the number of shareholders. The amendments in the Bill do not, it seems, put paid to the argument that the subsidiary (and thus the transaction) is not subject to SRP jurisdiction or approval where the subsidiary is a private company with less than ten beneficial shareholders, because it does not fall under the SRP's jurisdiction. The amendment does, in these circumstances, give the shareholders of the holding company the additional protection that a special resolution is required at the holding company level if the effect of the disposal in the subsidiary in relation to the consolidated financial statements of the holding company is that it constitutes the disposal of the whole or the greater part of the undertaking or assets of the company. The question that arises is whether this actually means that the disposal is a s 228 disposal at the level of a holding company also. I would argue that this is not the case. There is only one disposal, and that disposal is taking place at the subsidiary level; the fact that the legislature has introduced a group valuation mechanism of the disposal by having regard to the consolidated financial statements and attached legal consequences (namely the special resolution requirement) does not, legally speaking, make it a second s 228 disposal within the group context. If this is so, it means that the minority shareholders of the group company (which may now meet the SRP's jurisdictional requirement of a private company having more than ten beneficial shareholders) still do not enjoy the protection of the SRP because no 'affected transaction' (ie no s 228 disposal) has taken place in that company.

Amending s 228 also presented the legislature with an ideal opportunity to put paid to the problems arising out of the interaction between the protection provided to shareholders by the section and the *Turquand* rule. This dichotomy came to the fore in *Levy & others v Zalrut Investments (Pty) Ltd* 1986 (4) SA 479 (W) and in *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* 2004 (2) SA 146 (C). In the *Levy* case the defendant company had granted to the plaintiffs an option to purchase property. The defendant ultimately refused to grant transfer and, in an action instituted by the plaintiffs to compel it to do so, pleaded that the granting of the option amounted to a disposal of the whole or substantially the whole of the defendant's undertaking, alternatively, of the whole or the greater part of it assets as contemplated by s 228, and that the requisite consent of the majority of the shareholders had not been obtained. The plaintiffs replicated, alleging that the defendant, on the facts, was estopped from relying on the absence of the approval. The defendant applied for the striking out of, alternatively excepted to, this replication on the basis that it did not found an estoppel. Examining the question whether unanimous consent of the members of the company to the granting of the option was sufficient to avoid the provisions

of s 228, the court held that the intention of the legislature in enacting the provision was to limit the powers of the directors; that it was clearly designed for the benefit of shareholders; and that the unanimous consent had the same effect and validity as the approval of such transactions by a general meeting (at 485F). The court held further that there was no question that the disposal was in fact *intra vires* the company and could not be considered illegal, void and unenforceable (at 486–7). Accordingly, the plaintiffs were entitled to raise estoppel in the circumstances.

Similarly, in the *Farren* case (*supra*) the applicant and the respondent concluded a written agreement of sale in respect of the respondent's immovable property. Two weeks later the respondent purportedly cancelled the agreement. The applicant brought an application for specific performance in order to pass transfer of the property. The respondent raised various defences to the application, *inter alia*, that the agreement did not bind the respondent and was not a valid agreement because the approval of the respondent's shareholders to the deed of sale had not been obtained in accordance with the provisions of s 228 of the Companies Act. It was common cause that the property in question was the only asset of the company, and the transaction therefore qualified as a disposal which fell within the parameters of s 228. The *Turquand* rule, generally expressed by saying that a person dealing with the company in good faith is entitled to assume that all internal formalities or acts of management have been duly performed and carried out by the company, would normally protect the third party contracting with the company. The question in this case was whether the respondent could be ordered to pass transfer of the property in the absence of the resolution prescribed by s 228. Cleaver J found that it was common cause that the approval of the shareholders of the respondent in general meeting had not been obtained as required, and that it was clear that the mere fact that the agreement had not been authorized or approved by the shareholders did not make it invalid or void (para 11). This had to be so because s 228(2) made provision for the subsequent ratification of an agreement by the shareholders. It was held further that the agreement had no legal effect but that it could be cured by subsequent ratification by the shareholders in general meeting, and if it were accepted that the objective of the legislature was to protect the shareholders then that intention should be given effect to (para 14). The judge opined that it could not have been the intention of the legislature to curb the authority of directors well knowing that the *Turquand* rule would effectively neutralize the provisions of s 228 and that, for reasons which the legislature considered sound, it was decided that the provisions in question should be embodied in the statute thus giving them far more weight (paras 14–15). Accordingly the court held that the *Turquand* rule does not apply in these circumstances, and dismissed the application for specific performance.

Given that both of these judgments were based on, amongst other things, an interpretation of the intention of the legislature in drafting the original version of s 228, and that the decision ultimately reached by the court in

Farren (supra) is still a controversial one which has been criticized by various academic writers, this was an opportune time for the drafters of the Bill to settle the uncertainty once and for all, and it is a pity that they did not make use of this opportunity. However, I would point out that the aforesaid problem will be ameliorated (or further compounded, depending on one's view) by the fact that the amended s 228 now requires a special resolution by the company to effect a transaction which will qualify as a s 228 disposal. By way of explanation, in circumstances where the special resolution is passed prior to the entering into of the agreement regulating the s 228 disposal, a copy of that special resolution must in terms of s 200(3) of the Companies Act be embodied in or annexed to every copy of the articles issued after the registration of the resolution. Section 9 of the Act provides that any person may, on payment of the prescribed fee, inspect the documents lodged under the Act with the Registrar of Companies. It appears, then, that this public access to a special resolution authorizing a disposal in terms of s 228 will, in terms of the doctrine of constructive notice, mean that a prospective purchaser will be deemed to have knowledge of the special resolution where it has been passed; but of course this would then present no problem, as the disposal will have been properly authorized. If, however, there is no special resolution on file, the question arises whether the third party would be deemed to have knowledge of this fact (in terms of the doctrine of constructive notice) and, if so, whether this would mean that he is no longer bona fide and that the possible application of the *Turquand* rule therefore falls away altogether. One could possibly argue not, because the Bill permits a company to ratify a disposal as provided in s 228(2) and thus it may, in due course, pass a ratifying resolution; but the further question which then arises is whether the absence of a resolution at the time of the transaction places some obligation on a bona fide third party to make enquiries from the company in this regard, failing which he will no longer be regarded as bona fide. Alternatively, given the public nature of a special resolution, does the act of passing that resolution (or not, as the case may be) as opposed to an ordinary resolution cease to be an internal formality and accordingly negate the possible application of the *Turquand* rule entirely? If one does not apply the reasoning set out above, in circumstances where a ratifying special resolution is to be passed (but this never takes place) the problem with the *Turquand* rule evidenced by the judgment in *Farren* (supra) will, of course, persist. The upshot of the matter is that, at the very least, the amendment does not satisfactorily resolve the current legal uncertainty and may yet create even more problems in its application.

Other assorted issues

The Bill contains a host of other amendments relating inter alia to financial reporting, the appointment of auditors and audit committees (which drew much media attention owing to public and professional uncertainty caused by imprecise drafting, but which should be clarified in the Corporate Laws

Amendment Act), the limitation of liability of various office-bearers, making provision for the use of electronic aids in furnishing company and close corporation information, extending the Minister's powers of delegation, providing for methods of giving notice in relation to companies and close corporations, the elimination of certain formalities regarding the memorandum and articles, the restoration of a company or close corporation which has been deregistered in certain circumstances, matters to be stated in a prospectus and the disclosure of information. However the effects of most of these amendments are less far-reaching and less complex than the specific provisions discussed above, and it is not clear in all instances why these specific amendments qualified as deserving of urgent interim legislative attention and why other pivotal amendments contained in the Bill (such as the definitions of the different types of companies) were not afforded more comprehensive drafting consideration.

CONCLUSION

On a closer analysis of some of the fundamental and significant amendments contained in the Bill it becomes apparent that the constraints imposed upon the drafters and the drafting process by dividing the reform of company law into two distinct phases, whilst it may have been unavoidable, has caused certain problems. Some amendments, such as the distinction between public interest and limited interest companies, have not been carried out in sufficient detail, thereby creating uncertainty, or do not disclose enough of the underlying rationale at this stage of the drafting process to convince that they are required at all. Where the same results could have been achieved without the concomitant uncertainty which stems from such a substantial redrafting (and the inevitable omission of aspects which can only be properly addressed in the Final Phase), this would obviously have been the more desirable route to follow. Other amendments which are conceptually sound and beneficial, such as those contained in ss 38 and 228, appear to have been loosely drafted. Either this, or the drafters' intentions are more far-reaching and complex than appears from their stated intentions in the Proposal and the explanatory memorandum to the Bill, in which case they could have avoided any uncertainty by explaining their reasoning and motives more thoroughly. Perhaps the need for some of the sweeping changes (such as the new definitions) and their unavoidable nature will be revealed as the reform process unfolds, and puzzling aspects of certain amendments (such as the wording of s 38) may turn out to be attributable to considered policies which will also be revealed in due course. The Proposal frequently makes mention of the fact that comprehensive corporate law reform is long overdue. While this may be true, the reform process should obviously not be unduly hastened by public or political pressure to the ultimate detriment of legal certainty and the making of good law.