Lapsing two-year "grace period" under the Companies Act, 2008

By Yaniv Kleitman

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The so-called two-year "grace period" under the Companies Act 71 of 2008 in respect of companies' memoranda of incorporation ("MOI") and shareholders' agreements, lapsed on 1 May 2013. What does this mean and what are the risks for companies who have not undergone the exercise of updating their constitutional documents and aligning them with the Companies Act?

Firstly, a company is free to file a new MOI at any time, i.e. 1 May, 2013, was not a "cut-off" date in that regard. A company must, however, now pay a small filing fee at the Companies and Intellectual Property Commission, being R250.

The significance of the grace period, which commenced on 1 May, 2011, (when the Companies Act came into force) was that, subject to certain exceptions, a pre-existing MOI (being the old memorandum and articles of association of a company) prevailed over the Companies Act in the case of any inconsistency between the two and, furthermore, (and perhaps more importantly in most instances) a pre-existing shareholders agreement prevailed over both the Companies Act and the pre-existing MOI. This is all set out in the transitional arrangements in schedule 5 to the Companies Act, particularly item 4 thereof. Now that the grace period has lapsed, the ranking now is: first the Companies Act, second the MOI and last the shareholders' agreement. The reason that the Act and MOI now trump the shareholders agreement is because the default position in section 15(7) of the Companies Act will now apply to pre-existing constitutional documents, and that section provides that a shareholders' agreement is invalid to the extent that it conflicts with the MOI or the Companies Act.

Another relevant principle in this whole question is the following: the Companies Act provides that its alterable provisions may be amended, modified or otherwise altered in the MOI of a company, and that its unalterable provisions may be made more onerous in the MOI. It is probably debatable whether this means that the MOI is the only document (as opposed to the shareholders agreement) that can competently deal with these matters, given that section 15(7) of the Companies Act provides that a shareholders agreement may deal with any matter in relation to the company as long as it is consistent with the MOI. The conservative view held by many for the time being, however, is that such aspects must indeed be dealt with in the MOI in order to be effective.

Private arrangements amongst the shareholders

What then are some concrete examples of problems that may arise in this regard?

What should be borne in mind at the outset is that a lot of aspects dealt with in companies' shareholders agreements are matters on which both the Companies Act and, in many instances, the old MOI are silent. This is then left to private

arrangements amongst the shareholders and other parties, which they are free to deal with in a shareholders agreement. In that case, there is no overlap between what the shareholders agreement is saying and what the Companies Act and/or the MOI is saying, and, consequentially, no concern should arise of an "inconsistency" that causes the relevant provisions in the shareholders' agreement to be void. Typical examples that can be gleaned from many shareholders' agreements are clauses relating to loan funding, come-along and tag-along provisions, restraints of trade and non-competition, confidentiality, forced sales/deemed offers, dispute resolution, and BEE arrangements and undertakings.

On the other hand, where there is an overlap, one has to consider whether the relevant provisions in the shareholders' agreement may be at risk. Also, consider whether your shareholders' agreement is altering an alterable provision or toughening up an unalterable provision of the Companies Act - if that clause is not contained in the MOI, there is a risk that the default position in the Companies Act or MOI will instead apply. Examples that are often found are clauses relating to pre-emptive rights/rights of first refusal on share disposals or fresh share issues, equity finance, governance aspects pertaining to meetings, quorums and thresholds for the passing of resolutions, and the mechanics for the appointment or election of directors (note that under section 66(4)(b) of the Companies Act, at least 50% of the directors and alternate directors of a profit company must be elected by shareholders as opposed to being directly appointed by a shareholder or third party - shareholders agreements often provide for direct appointment of all directors). A major aspect that could potentially be at risk is minority protection, the so-called "reserved matters", "restricted matters" or "specially protected matters". Call them what you will, many of these clauses typically contain limitations (by, for instance, requiring minority shareholders to consent to the transaction) on the board's ordinary powers to manage the company and to carry out all its functions, as empowered by section 66(1) of the Companies Act. Section 66(1) of the Companies Act states that either the Act itself or the MOI may limit the board's powers - does this then create the risk that if you do not have the minority protections in the MOI, they are overridden by the position in the MOI and Companies Act? That concern aside, however, many items listed in minority protection clauses require, as a matter of law under the Companies Act, a special resolution of shareholders in any event, which may or may not to some extent mitigate the risk for minority shareholders.

Therefore, the upshot is that the potential risk has to be assessed from company to company, based on its own constitutional documents.

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