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Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation

Abstract

In the process of company law reform, the official belief was expressed that the regime provided in the new *Companies Act* 71 of 2008 for forming and maintaining a structure that reflects the characteristics of a close corporation had been sufficiently simplified so as to obviate the need to retain the *Close Corporations Act* 69 of 1984 as an avenue for new incorporations. The question arises as to whether such a structure is indeed provided for under the new *Companies Act* and, if so, what its salient features are. This contribution briefly addresses these questions.

Die identifisering van die beoogde struktuur vir beslote ingelyfde ondernemingsvorme in die nuwe statutêre bedeling

In die loop van maatskappyereghervorming is die amptelike oortuiging uitgespreek dat die stelsel wat die nuwe *Maatskappywet* 71 van 2008 voorsien vir die vorming en instandhouding van 'n struktuur wat die eienskappe van 'n beslote korporasie weerspieël, voldoende vereenvoudig is om die behoud van die *Wet op Beslote Korporasies* 69 van 1984 as 'n roete vir nuwe inlywings oorbodig te maak. Die vraag ontstaan of die nuwe *Maatskappywet* inderdaad so 'n struktuur voorsien en, indien wel, wat die belangrikste kenmerke daarvan is. Hierdie bydrae beantwoord dié vrae kortliks.

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1. Introduction

The new statutory dispensation for companies and close corporations was introduced by the *Companies Act* 71 of 2008¹ with effect from 1 May 2011.² The *Companies Act* repealed the *Companies Act* 61 of 1973³ and extensively amended the *Close Corporations Act* 69 of 1984.⁴

The close corporation proved popular among entrepreneurs, as was evident from the large number of close corporations that were registered up until 2011.⁵ It is interesting to note that, even though the impending prohibition on new close corporations was already well known, 183,406 new close corporations were still registered in the past 16 months allowed for this purpose, as opposed to only 27,530 companies. In the main, the *Companies Act* has negative implications⁶ for close corporations. The most significant of these certainly is the prohibition imposed on the incorporation of new close corporations as well as on the conversion of companies to close corporations as from 1 May 2011.

Although it acknowledged the success of close corporations, the Department of Trade and Industry (dti) was convinced that the regime provided in the *Companies Act* for forming and maintaining “small companies”, the characteristics of which largely resembled those of the close corporation, had been sufficiently streamlined and simplified so as to obviate the need to retain the *Close Corporations Act* as an avenue for new incorporations. The dti gave the assurance that a “structure that reflects the characteristics of the close corporation” would be available under the new dispensation.⁷

Since new close corporations are now proscribed, the question arises as to whether the *Companies Act* indeed provides such a structure reflecting the characteristics of the close corporation and, if so, what its salient features are. The remainder of this contribution will seek to explore these questions.

1 Hereinafter, “the *Companies Act*”. The President signed the *Act* into law on 8 April 2009. On 22 December that year, a “rectification” notice was published, listing the errors that were to be addressed. A proposed *Companies Amendment Bill* was published on 27 July 2010, which enumerated and corrected no less than 297 errors. The *Companies Amendment Act* 3/2011 was eventually signed by the President on 20 April 2011.

2 In fact, only from 3 May 2011, as 1 May was a public holiday that fell on a Sunday, which made the first official day 3 May 2011. See Delpont 2011:1.

3 Hereinafter, “the previous *Companies Act*”, of which only chapter XIV remains in force until repealed by a future *Bankruptcy Act*.

4 Hereinafter, “the *Close Corporations Act*”.

5 From 1 January 1985 until the end of 2008, 2,014.122 close corporations were registered. In the period 2009 up until May 2011, an additional 389.357 were registered, adding up to 2,403.479.

6 Cassim *et al.* 2011:68, 100 describe the *Companies Act*’s implications as a “significant impact” and “momentous stance” on close corporations.

7 NEDLAC Trade and Industry Chamber 2005:paragraph 3.5; dti 2004:15-16.

2. The close corporation⁸

2.1 Introduction

The close corporation under the *Close Corporations Act* was conceived as a simple, owner-controlled, deregulated, decriminalised, inexpensive and flexible, free-standing, incorporated, limited-liability vehicle for the single entrepreneur or a small number of participants. The legal requirements, under which the close corporation operated, were basic and far simpler than those prescribed for companies by the previous *Companies Act*.⁹

The term 'close corporation' is derived from the expression 'closely held corporation'. Amongst others, this refers to the limited number of members of the corporation and the closeness of their relationship. Use of this term by company lawyers can be traced back to at least the previous century, and it is a widely accepted concept worldwide.¹⁰

2.2 Salient features

The following are some of the salient features of close corporations incorporated prior to the commencement of the *Companies Act*.¹¹

- A close corporation is a legal *persona* distinct from its members.¹² It bestows on its members the advantages of legal personality, particularly perpetual succession and limited liability.¹³
- A close corporation is a closely held concern in which all or the majority of its members are actively involved to some extent. Thus, it is owner-managed and, as there is usually no separation between ownership and control, also owner-controlled. It does not have directors or shareholders. In principle, every member is entitled to participate in the management of the corporation¹⁴ and has an equal say in the management of its business.
- It may have a single member, as is presently the case with approximately 75 per cent of all close corporations. In this respect, it displays little or no resemblance to an incorporated partnership.¹⁵

8 See, in general, Naudé 1984:11; Henning & Bleimschein 1990:627; Henning 2003:773; Jaehne 2008:217; Du Plessis 2009:250.

9 The *Close Corporations Act* originally comprised a mere 83 sections, compared to the over 450 sections and three schedules of the previous *Companies Act*.

10 Henning 1996:497; 1999:113-114.

11 See, in general, *Mörsner v Len* 1992 3 SA 626 A; *Philip Business Services CC v De Villiers* 1991 3 SA 552 W; *Van der Merwe v DSSM Boerdery BK* 1991 2 SA 320 T; Henning 1996:497; Du Plessis 2009:250.

12 *Close Corporations Act* 69/1984:section 2(2)-(3).

13 *Close Corporations Act* 69/1984:sections 2(2)-(3).

14 *Close Corporations Act* 69/1984:section 46(a).

15 Henning 1999:113.

- Although membership is limited to ten,¹⁶ there is no restriction on the size or scope of a close corporation's business or undertaking, the number of its employees or creditors, the size of total member contributions, its turnover, the value of its assets, or its type of business.
- In principle, membership is limited to natural persons,¹⁷ and corporate membership of a close corporation is, therefore, excluded.¹⁸ This prevents companies from doing business through the instrumentality of close corporation subsidiaries. One or several persons may have more than one close corporation, but none of these close corporations may be a member of any of the others.
- A member owns an interest in the close corporation, which is expressed as a percentage. The close corporation does not have shares or share capital.
- In principle, a member may only alienate his/her interest with the other members' consent.¹⁹
- To a large extent, the common law principles relating to the fiduciary duties and duties of care and skill in managing the affairs of the corporation were codified in the *Close Corporations Act*.²⁰
- Similar to the *naturalia* of a partnership, many of the rules regulating the internal relations of the close corporation are variable. They apply unless an association agreement or other agreement between the members provides otherwise.²¹ An association agreement is not available for public inspection.²² The vast majority of all close corporations are single-member corporations, in respect of which the option of an association agreement is not available and the legal position provided for in the *Act* is even simpler.
- Solvency and liquidity are substituted for the traditional capital maintenance rules of company law.²³

16 *Close Corporations Act* 69/1984:section 28.

17 *Close Corporations Act* 69/1984:section 29(1).

18 *Close Corporations Act* 69/1984:sections 29(1), 63(d).

19 See *Close Corporations Act* 69/1984:section 37 on the disposal of members' interests in general; *Close Corporations Act* 69/1984:section 35 on the disposal of a deceased member's interest; *Close Corporations Act* 69/1984:section 34 on the disposal of an insolvent member's interest, and *Close Corporations Act* 69/1984:section 34A on the attachment and sale in execution of a member's interest.

20 *Close Corporations Act* 69/1984:sections 42-43.

21 *Close Corporations Act* 69/1984:section 43.

22 *Close Corporations Act* 69/1984:sections 44-45.

23 *Close Corporations Act* 69/1984:sections 39, 40, 51. In essence, section 51 provides that a close corporation may pay a dividend to a member if, after such payment, the corporation's assets, fairly valued, exceed all its liabilities; if the corporation is able to pay its debts as they become due, and if the payment will not render the corporation unable to pay its debts as they become due. Subject to these three requirements as well as every member's previously obtained written consent for a specific transaction, sections 39 and 40,

- Members who fail to observe the relatively few basic rules of the system forfeit their protection by incurring a personal and concurrent liability with the close corporation for the debts of the corporation.²⁴
- Not a single administrative duty is imposed that is not meaningful and necessary in view of the characteristics of the form of enterprise. Consequently, only eight administrative forms were prescribed. Apart from having to update the particulars of the registered founding statement as the need arises, no document had to be lodged with the Registrar of Close Corporations on a regular basis.
- A close corporation has the capacity and powers of a natural person of full capacity insofar as a juristic person is capable of having such capacity or exercising such powers.²⁵ For this reason, the *ultra vires* doctrine does not apply to close corporations. There is no constructive notice of any particulars stated in a founding statement.²⁶
- In relation to outsiders dealing with a close corporation, every member is an agent of the corporation. If a member's authority is restricted or excluded, that member's actions will still bind the corporation in respect of an outsider, unless the outsider knows or can be reasonably expected to know of the restriction. Since there is no constructive notice of the provisions of an association agreement,²⁷ knowledge of internal restrictions on members' powers is not imputed to outsiders. Outsiders are entitled to assume that each member has the necessary authority to act on behalf of the corporation. As in the law of partnership, the *bona fide* outsider who does not know of internal restrictions of power is, in principle, not affected by it.²⁸
- A close corporation is not required to appoint an auditor. It must appoint an accounting officer, who must report on the annual financial statements. A formal audit is not required.²⁹

In *Northview Shopping Centre v Revelas Properties*,³⁰ it was stressed that a close corporation is intended to be a simple entity akin to a partnership, but with limited liability. The structure of a close corporation is designed

respectively, permit a corporation to acquire and pay for the interest of one of its members, or to render financial assistance in connection with any acquisition of a member's interest in the corporation.

24 *Close Corporations Act* 69/1984:section 63 provides for such a liability with regard to restrictions or duties imposed in eight different sections in the *Act*. Secondly, the Registrar is empowered, in a few instances, to impose a penalty, which is given the force of a civil judgement. See *Close Corporations Act* 69/1984:section 15(3).

25 *Close Corporations Act* 69/1984:section 2(4).

26 *Close Corporations Act* 69/1984:section 17.

27 *Close Corporations Act* 69/1984:section 45.

28 *Close Corporations Act* 69/1984:section 54.

29 *Close Corporations Act* 69/1984:section 59.

30 *Northview Shopping Centre (Pty) Ltd v Revelas Properties Johannesburg CC* 2010 3 SA 630 SCA.

for individual entrepreneurs or for a limited number of persons to conduct business. There is no board of directors, and each member has the power to bind the close corporation. The complex requirements of company law are not supposed to apply to the close corporation. It may, in fact, be regarded as a fallacy to compare close corporations with companies instead of with partnerships or individuals. After all, it is partnership principles, and not company law principles, that govern the relationship between members.³¹

3. Law reform

In 2004, while the *Companies Act* was being deliberated on, the dti published a policy document on corporate law reform.³² While, in this document, the dti acknowledged that the close corporation offered a viable alternative for smaller businesses,³³ it described the close corporation as still highly formalistic in nature, making it difficult for unsophisticated entrepreneurs to commence business in corporate form and ensure its effective management.³⁴ Restricting membership to natural persons only precluded certain categories of equity financiers from investing in these business entities. In the dti's view, the scope of liability for corporate debt in the event of non-compliance with the *Close Corporations Act* potentially exposed unsophisticated investors to personal liability.³⁵ Of course, this line of reasoning ignored the fact that the *Close Corporations Act* employed this personal civil liability as an alternative for criminal sanctions. Nevertheless, the dti envisaged a need to provide "the best form" of incorporation, especially for those who sought to establish a business for the first time.³⁶

In its working paper of August 2004, Business Unity South Africa (BUSA) disagreed with the dti's proposals concerning close corporations and recommended that the *Close Corporations Act* be retained in its present form.³⁷

31 See also *Man Truck & Bus (SA) (Pty) Ltd v Dusbus Leasing CC* 2004 1 SA 454 W: 472G-I. "Close corporations differ from companies in certain material respects. Unlike companies, it is possible for close corporations to have only one member. Such a member would be both shareholder and director and, unlike shareholders in a company, the shareholder of a close corporation [sic] owes a fiduciary duty to the corporation and to its creditors." This passage calls for some comments. Since the inception of the previous *Companies Act* on 1 January 1974, it has indeed been possible to form and incorporate a private company with only one member. Furthermore, to state that a member of a close corporation, in contradistinction to a shareholder of a company, owes a fiduciary duty to the creditors of the corporation is, it is submitted with respect, unfounded.

32 dti 2004. This document was also tabled at NEDLAC on the date of its release.

33 dti 2004:15.

34 dti 2004:16.

35 dti 2004:16.

36 dti 2004:16.

37 BUSA 2004:2-3: "BUSA disagrees with the proposal that the *Close Corporations Act* should be abolished. The rationale offered for this proposition is that

NEDLAC³⁸ emphasised in its final report³⁹ that its constituencies eventually agreed that a corporate “structure”, which included the characteristics of the current close corporation, would be one of the available structures under the new dispensation.

According to its *Explanatory Memorandum to the Draft 2007 Companies Bill*,⁴⁰ the dti “convened and engaged with a reference group of South African practitioners, academics and other experts, consulted with NEDLAC, and sought the advice of a small panel of international experts”.⁴¹ The consultation process generated specific goal statements. One of these goals was that, “with a view to simplification, the law should provide for a company structure that reflected the characteristics of close corporations, as one of the available options”.⁴² The strategy envisioned in the draft *Companies Bill* provided for a ten-year experimental period, during which both the *Companies Act* and the *Close Corporations Act* were to be concurrently in force. The dti expressed the belief that the regime in the new *Companies Act* for forming and maintaining “small” companies, which was based on the characteristics of the *Close Corporations Act*, had been sufficiently streamlined and simplified so as to obviate the need to retain the *Close Corporations Act*. However, it recognised that time and experience with the alternative regimes would afford the best indication of which regime best met the needs of the South African economy. Accordingly, the transitional provisions, as set out in schedule 6, required a review of the experience under the concurrent regime before a final decision was to be taken on repealing or retaining the *Close Corporations Act*.⁴³ Consequently, the draft *Companies Bill* of 2007 expressly created the possibility of the *Close Corporations Act* remaining in force indefinitely

these entities struggle to receive funding and exclude juristic persons from membership. However, the distrust that is borne out in the dearth of access to credit for some CC's is not the result of a particular form of legal structuring [which indicates a systemic rather than a functional problem]. Eradicating CC's will not solve the problem of access to credit. Addressing the second concern, the proscription on juristic membership in CC's was specifically designed to ensure that this corporate type remains simple. Allowing juristic persons to become members of CC's will complicate the formation of Group structures, to cite but one example. The elimination of CC's would introduce additional complexities to an existing and successful business form that enables emerging entrepreneurs to create a juristic personality without the necessity for specialist advice. The South African dispensation relating to Close Corporations, which caters particularly for small business ventures, has received international acclaim.”

38 The National Economic Development and Labour Council. A platform where government comes together with organised business, organised labour and organised community groupings on a national level to discuss and try to reach consensus on issues of social and economic policy.

39 NEDLAC Trade and Industry Chamber 2005:paragraph 3.5.5.

40 dti 2007.

41 dti 2007:4.

42 dti 2007:4.

43 dti 2007:6.

and did not envisage an immediate prohibition on the incorporation of new close corporations.⁴⁴ However, this arrangement was not to be.⁴⁵

In its *Explanatory Memorandum to Bill 61D of 2008*⁴⁶ the dti stated that the co-existence of the Companies Act and the Close Corporations Act was provided for, with amendments made to the latter to harmonise the laws as far as practicable in order to avoid regulatory arbitrage. Again, the dti confirmed that, to their mind, the regime provided in the Companies Act for forming and maintaining “small” companies, which was based on the characteristics of the Close Corporations Act, had been sufficiently streamlined and simplified as to render it unnecessary to retain the application of the Close Corporations Act to the formation of new corporations. However, it was recognised that existing close corporations should be free to retain their status until such time as their members determined that it would be in their interest to convert to a company. Therefore, although the Companies Act presently provides for the indefinite continued existence of the Close Corporations Act, it did repeal the Close Corporations Act as an avenue for the incorporation of new entities or the conversion of companies into close corporations with effect from the commencement date of the Companies Act.

The *Companies Act* has made extensive amendments to the *Close Corporations Act*, the main impact of which is twofold,⁴⁷ namely the proscription of new close corporations and of the conversion of companies into close corporations, and a tendency to impose increasingly onerous duties on close corporations. The *Companies Act* prohibited the incorporation of new close corporations and the conversion of companies into close corporations as from 1 May 2011,⁴⁸ while the conversion of close corporations into companies is facilitated. In practice, this translates not only into the gradual phasing out of close corporations, but leaves small entrepreneurs with only one avenue for establishing new incorporations, namely the *Companies Act*. In addition, there is a clear tendency to subject the close corporation to increasing onerous managerial and administrative duties and requirements, which are in direct conflict with the design philosophy of this type of entity. This is done, *inter alia*, by supplanting numerous arrangements in the *Close Corporations Act* by those of the *Companies Act*, repealing the former and incorporating large tracts of the latter by reference.

Despite these extensive amendments, however, the *Companies Act* still provides for the continued existence of the *Close Corporations Act*, meaning that existing close corporations continue to exist, although under a more onerous dispensation.

44 Draft Companies Bill 2007:schedule 6 item 2.

45 Henning 2010; Du Plessis 2009:250.

46 The 2008 Companies Bill.

47 Henning 2010:456; Du Plessis 2009:250.

48 Section 2 of the *Close Corporations Act* 69/1984, as amended by schedule 3, item 2, of the *Companies Act* 71/2008; schedule 3, item 2, of the *Companies Act* repealed section 27 of the *Close Corporations Act*.

4. Close company as the structure envisioned

As far as is relevant for present purposes, the *Companies Act* provides for two categories of companies, namely non-profit companies and profit companies. The latter may be a private company,⁴⁹ a personal liability company,⁵⁰ a public company⁵¹ or a state-owned company.⁵²

Rather surprisingly, in view of the official assurances given regarding the availability of a suitable type of company, no such structure, type, subtype or even subspecies of company analogous to a close corporation has since been officially designated in the *Companies Act*. Nonetheless, a perusal of the *Companies Act* leads one to conclude that an important subspecies of company may be identified as the probable alternative to, or even the replacement for the close corporation by teasing the relevant arrangements out of the voluminous provisions of the *Act*.

This analogous structure or subspecies of company is a “close company”, in the sense of a closely held or owner-controlled private company. In essence, it comprises a private company with no distinction between ownership and control. Therefore, the close company is a private-company subspecies in which every person who holds or has a beneficial interest in the securities issued by the company is also a director of the company. A close company seems to be subject to much less complex and onerous regulation under the *Companies Act* than other types of companies. Although some of the provisions governing this relaxed regime are applicable not only to private companies, but also to public companies and some even to non-profit companies, this discussion is limited to closely held *private* companies.

According to the *Explanatory Memorandum to the Bill 61D of 2008*, if all of the company’s shares “are owned by related persons”, this “results in diminished need to protect minority shareholders”, or if “all of the shareholders are directors”, this “results in a diminished need to seek shareholder approval for certain board actions”.⁵³ If the close company is also a one-person company, in the sense that one person is both the only holder of the securities issued by, and the only director of the company, it is subject to an even more relaxed regime.

49 *Companies Act 71/2008*:section 1. A private company “is not a public company, personal liability company or state-owned company” and “satisfies the criteria set out in sec 8(2)(b)”. Therefore, its memorandum of incorporation prohibits it from offering any of its securities to the public and restricts the transferability of its securities.

50 Apparently, the successor of the so-called section 53(b) company under the previous *Companies Act*, which classified it as a particular type of private company.

51 *Companies Act 71/2008*:section 1. A public company is a profit company that “is not a state-owned company, a private company or a personal liability company”.

52 *Companies Act 71/2008*:section 1. A state-owned company is a company that is registered in terms of the *Companies Act* as a company and is either listed as a public entity in schedule 2 or 3 of the *Public Finance Management Act 1/1999* or owned by a municipality as contemplated in the *Municipal Systems Act 32/2000*.

53 dti 2008:4.

4.1 Salient features

The following are some of the salient features of the close company:⁵⁴

- It has all of the legal powers and capacity of an individual, except to the extent that a juristic person is incapable of exercising any such power or having any such capacity, or the company's Memorandum of Incorporation provides otherwise.⁵⁵
- It is a profit company that is not a public or a state-owned company.⁵⁶ The statutory definition also requires it not to be a personal liability company. A personal liability company is apparently the successor of the so-called section 53(b) company under the previous *Companies Act*, which classified it as a particular type of private company.⁵⁷ Although it is treated as a separate type of company in terms of the *Companies Act*, it must comply with all the criteria of a private company.⁵⁸ For purposes of this discussion, it will, as a matter of convenience, be regarded as a private-company subspecies.
- Its Memorandum of Incorporation prohibits it from offering any of its securities to the public.⁵⁹
- Its Memorandum of Incorporation also restricts the transferability of its securities.⁶⁰ Under the previous *Companies Act*, this could be achieved, *inter alia*, by means of pre-emptive rights effectively prohibiting a shareholder from selling his/her shares to an outsider, unless the other shareholders are first afforded the opportunity to purchase the shares.⁶¹
- Its shareholders have pre-emptive rights in respect of new shares to be issued by the company, unless the company opts out of this provision in its Memorandum of Incorporation.⁶² This does not apply to, *inter alia*, shares issued in terms of options or conversion rights, or capitalisation shares issued as contemplated in section 47.⁶³ It seems that this provision protects existing shareholders of a company by enabling them to preserve and prevent dilution of their voting power.
- It may have a single shareholder only. Indeed, only a single person is required for its incorporation.⁶⁴

54 The list is not intended as a *numerus clausus*.

55 *Companies Act 71/2008*:section 19(1)(b).

56 *Companies Act 71/2008*:section 1.

57 *Companies Act 61/1973*:section 53(b), which provided for a private company that regulated directors' unlimited liability for company debts.

58 *Companies Act 71/2008*:sections 1 and 8(2)(c)(i).

59 *Companies Act 71/2008*:section 8(2)(b)(ii)(a).

60 *Companies Act 71/2008*:section 8(2)(b)(ii)(b).

61 For further discussion in this regard, see Cassim *et al.* 2011:75-76.

62 *Companies Act 71/2008*:section 39.

63 *Companies Act 71/2008*:section 39(1)(b). "... other than (i) shares issued - (aa) in terms of options or conversion rights; or (bb) as contemplated in section 40(5)-(7); or (ii) capitalisation shares issued as contemplated in section 47".

64 As a profit company. See *Companies Act 71/2008*:section 13(1).

- In principle, its shareholders are not limited to natural persons.⁶⁵
- There is no statutory limitation on the maximum number of shareholders. The restriction to a maximum of 50 shareholders under the previous *Companies Act* has been abolished.⁶⁶
- It may have a single director. More than one director will, however, be required where a private company is expected to appoint an audit committee or a social and ethics committee, whether in terms of the *Companies Act* or in terms of its Memorandum of Incorporation.⁶⁷
- It is generally exempt from the requirements in section 30 to have its annual financial statements audited or independently reviewed.⁶⁸ This exemption, however, does not apply if it falls into a class of company that is required to have its annual financial statements audited in terms of the regulations,⁶⁹ and does not relieve the company of the requirement to have its financial statements audited or reviewed in terms of another law or any agreement to which the company is a party.⁷⁰ Under regulation 28(2), a private company must have its annual financial statements for that financial year audited if, in the ordinary course of its primary activities, it holds assets in a fiduciary capacity for persons who are not related to the company, and the aggregate value of these assets held at any time during the financial year exceeds R5 million; if its public interest score⁷¹ in that financial year, calculated in accordance with the regulations, is 350 points or more, or if its annual

65 *Companies Act 71/2008*:section 69(7)(a). See below for further discussion.

66 See below for further discussion.

67 See *Companies Act 71/2008*:section 66(2)-(3).

68 *Companies Act 71/2008*:section 30(2A) and regulation 28(1).

69 Contemplated in *Companies Act 71/2008*:section 30(7)(a).

70 *Companies Act 71/2008*:section 30(2A)(i)-(ii).

71 Regulation 26(2) provides that for the purposes of regulations 27-30, 43, 127-128, every company must calculate its "public interest score" at the end of each financial year, calculated as the sum of the following – (a) a number of points equal to the average number of employees of the company during the financial year; (b) one point for every R1 million (or portion thereof) in third-party liability of the company at the financial year end; (c) one point for every R1 million (or portion thereof) in turnover during the financial year, and (d) one point for every individual who, at the end of the financial year, is known by the company (i) in the case of a profit company, to directly or indirectly have a beneficial interest in any of the company's issued securities; or (ii) in the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company. The formula to determine the public interest score is as follows:

PI score = <E> + D + TO + BI, where:

PI score = Public interest score

E = Average number of employees per year (1 point per employee)

D = Third-party liabilities of the close company at year-end (1 point for every R1 million or portion thereof)

TO = Turnover for the year (1 point for every R1 million or portion thereof)

BI = Number of individuals holding a direct or indirect financial interest in the close company at year-end (1 point per individual).

financial statements for that year were internally compiled, its public interest score is at least 100 points. However, regulation 28(1), in turn, provides that regulation 28 does not apply to a company if, in terms of section 30(2A), it is exempt from having its annual financial statements either audited or independently reviewed. The end result of this elaborate referencing seems to be that a close company is exempt from both the independent review and the audit of its annual financial statements.⁷² Other aspects of the exemption in section 30(2A) are equally unclear. The requirement is that every person who has a beneficial interest must be a director of the company. Therefore, the holding of a debenture by a third party would exclude the exemption as well as the holding of any of the beneficial interests in a security by a third “person”, such as a trust, and that third “person” is not a director. If the holder of the beneficial interest is a director of the company, but the trust is the holder of the securities, the exemption will not apply either.⁷³

- It is generally not subject to the enhanced accountability and transparency provisions of chapter 3 of the *Companies Act*,⁷⁴ since, in terms of section 84, chapter 3 applies to a private company only if it is required by the *Companies Act* or the regulations to have its annual financial statements audited every year,⁷⁵ or only to the extent that the company’s Memorandum of Incorporation so requires.
- It need not appoint a company secretary.⁷⁶
- It need not appoint an audit committee.⁷⁷
- It need not appoint a social and ethics committee, unless its public interest score during any two of the previous five years exceeded 500 points.⁷⁸
- Any matter that the board is required to refer to the shareholders for decision may be decided by the shareholders at any time after having been referred by the board, without notice or compliance with any other internal formalities, except to the extent that the company’s

72 Delpont *et al.* 2011:143; Cassim *et al.* 2011:81; Davis *et al.* 2010:150-151. Note that the exemption in *Companies Act* 71/2008:section 30(2A) does not apply to close corporations.

73 Delpont *et al.* 2011:143.

74 According to *Companies Act* 71/2008:section 84, chapter 3 applies to a private company only if the company is required by the *Companies Act* or the regulations to have its annual financial statements audited every year, provided that the provisions of parts B and D of that chapter will not apply to any such company, or otherwise, only to the extent that the company’s Memorandum of Incorporation so requires, as contemplated in section 34(2).

75 Provided that the provisions of parts B and D of chapter 3 do not apply to such a company.

76 *Companies Act* 71/2008:section 86(1), read with the *Companies Act* 71/2008:section 84(1)(c) proviso.

77 *Companies Act* 71/2008:section 84(1)(c) proviso.

78 *Companies Act* 71/2008:section 72(4)(a)(i)-(iii), read with regulation 43(1)(c).

Memorandum of Incorporation provides otherwise.⁷⁹ The proviso is that every shareholder/director needs to have been present at the board meeting where the matter was referred to them in their capacity as shareholders; that sufficient persons need to be present in their capacity as shareholders to satisfy the quorum requirements set out in section 64, and that a resolution adopted by those persons in their capacity as shareholders needs to have at least the support that would have been required for it to be adopted as an ordinary or special resolution at a properly constituted shareholder meeting. When acting in their capacity as shareholders, the shareholders/directors are not subject to the provisions of sections 73 to 78 relating to the duties, obligations, liabilities and indemnification of directors. This provision recognises the unique nature of the shareholder/director position in a close company and, therefore, dispenses with the formalities of shareholder meetings and resolutions to the extent allowed by the Memorandum of Incorporation. These formalities are thus relaxed to allow for expedient decision-making by shareholders who are already aware of the matter to be decided.

- Where the close company has only one shareholder, the shareholder may exercise any or all of the voting rights pertaining to that company on any matter, at any time, without notice or compliance with any other internal formalities, except to the extent that its Memorandum of Incorporation provides otherwise.⁸⁰ In addition, its governance is exempt from the detailed requirements of sections 59 to 65 of the *Companies Act*, *inter alia*, relating to resolutions, shareholder meetings, notices of meetings, the conduct of meetings, quorum and adjournment, and shareholder resolutions.⁸¹ In such a close company, the shareholder is afforded wide powers to exercise his/her voting rights in any manner and at any time s/he deems fit, subject only to limitations provided for in the Memorandum of Incorporation, and is exempt from having to comply with governance formalities in doing so.
- Where the close company has only one director, that director may exercise any power or perform any function of the board at any time, without notice or compliance with any other internal formalities, except to the extent that the company's Memorandum of Incorporation provides otherwise. In addition, sections 71(3) to 71(7), 73 and 74 of the *Companies Act* do not apply to its governance.⁸² These provisions relate to, *inter alia*, the removal of a director, board meetings, and decisions of the board adopted by written consent of a majority of directors. The sole director of a close company, who necessarily is also the only holder of its securities, has unfettered discretion in the performance of the board's functions, subject only to constraint by the

79 *Companies Act 71/2008*:section 57(4). If every shareholder of the company is also a director of that company.

80 *Companies Act 71/2008*:section 57(2)(a)-(b).

81 *Companies Act 71/2008*:section 57(2).

82 *Companies Act 71/2008*:section 57(3)(a)-(b).

Memorandum of Incorporation, and is not restricted by governance formalities. A sole director of a close company, who remains subject to the duties imposed upon him/her in such capacity, is, therefore, generally unfettered in the board's direction of the company's business.

- If one person holds all of the beneficial interests of all of the issued securities of a company and that person is also the only director of the company, section 75 on the disclosure of personal financial interests does not apply to the company or its director.⁸³

It is trite that the close company is not a new concept and that it has been recognised in jurisprudence for quite some time. Equitable considerations may apply to the relationship between shareholders and directors as participants in close companies. In appropriate circumstances, the courts apply principles analogous to those of partnership law, for instance in the event of the winding up by the court of a solvent company on just and equitable grounds.⁸⁴ As this is not a new principle introduced by the *Companies Act*, this important aspect need not be further explored for present purposes.

4.2 Further considerations

Some of the criticism levelled at the close corporation by the dti was its restriction of members to natural persons up to a maximum of ten, as well as its perceived formalism.

As far as membership is concerned, there is, in principle, no statutory limit on the number or type of shareholders of a close company. However, closer inspection reveals that this perceived benefit may be more ostensible than real. As one of the requirements for a close company is that every shareholder must be a director, companies and other juristic persons will not be suitable shareholders, since they are not eligible for appointment as directors.⁸⁵ This "every shareholder a director" requirement will inevitably also affect the practicality of a large number of shareholders/directors engaged as active participants in a close company. Notably, the maximum number of members of a close company permitted in Botswana is five.⁸⁶

83 *Companies Act 71/2008*:section 75(2)(b)(i)-(ii).

84 For example, *Re Yenide Tobacco Co Ltd* [1916] 2 Chy 426; *Brahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL) ([1972] 2 All ER 492); *Rand Air (Pty) Ltd v Ray Bester Investments (Pty) Ltd* 1985 2 SA 345 W: 349-350; *Hulett v Hulett* 1992 4 SA 291 A: 307; *APCO Africa (Pty) Ltd v APCO Worldwide Inc* 2008 5 SA 615 SCA ([2008] 4 All SA 1); *Emphy v Pacer Properties (Pty) Ltd* 1979 3 SA 363 D: 365; *Erasmus v Pentamed Investments (Pty) Ltd* 1982 1 SA 178 W: 181; *Hughes v Ridley* 2010 1 SA 381 KZP; *Budge NNO v Midnight Storm Investments 256 (Pty) Ltd* 2012 2 SA 28 GSJ: 31; *Paarwater v South Shara Investments (Pty) Ltd* 2005 4 All SA 185 SCA; *Knipe v Kameelhoek (Pty) Ltd* 2014 1 SA 52 FB: 61-62.

85 *Companies Act 71/2008*:section 69(7)(a).

86 *Botswana Companies Act 32/2003*:chapter 19, section 248.

As far as formalism is concerned, it should be obvious that, in contrast to the close corporation, which was designed to be free-standing, the close company is locked into a voluminous and complex *Companies Act* along with public and numerous other types of companies. For the most part, the *Companies Act* clearly remains faithful to the traditional school of thought, namely that company law developed mainly with the public company in mind. The provisions of the *Companies Act* that apply to private companies, and even more so in the case of close companies, are more often than not expressed as an exception to the provisions applicable to public companies, in effect making them more rather than less complicated. Examples include the provisions on meetings and resolutions, which are largely structured based on the needs of public companies, with private, and thus also close, companies covered by way of additional provisions or exceptions.

This very approach adds to the complexity of the legal position of the close company. To determine precisely what the scope and consequences of the exemption afforded to a close company entail, one must first ascertain the exact scope and consequences of the regulatory provisions of the *Companies Act*, from which the close company is then exempted to a greater or lesser extent. In particular instances, this may very well render the legal position of a close company more complex than that of, for example, a public company. If the extensive negative regulatory impact of the *Companies Act* on the *Close Corporations Act* was intended to level the proverbial playing field and streamline the regime for small companies, it may have missed the mark to some extent, possibly having created a more complex legal position for the close company compared to that of the close corporation in its original format.

5. Conclusion

The legal position of the close company cannot be described as less complex than that of the close corporation as originally conceived, and some of its perceived benefits may prove to be more ostensible than demonstrably real. A careful and detailed analysis of the ambit, delineation and consequences of the various applicable exemptions, as well as a comparison with all the relevant features of the close corporation, is advised before it can be concluded whether the close company will satisfy the reasonable legal requirements and expectations of small businesses equally efficiently as the original close corporation.

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