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phasing in the new companies act and its impact on constitutional documents

by vivien chaplin and minal ramnath

The first day of October 2010 is the anticipated general effective date of the new Companies Act 71 of 2008 (the New Act) which makes significant changes to the composition and interaction of constitutional documents regulating the management and administration of company affairs. It is important to understand the immediate impact that the New Act will have on companies' existing constitutional documents as well as the steps that must be taken by companies to gradually bring their constitutional documents in line with the New Act.

Under the current Companies Act 61 of 1973, each company is obliged to keep a twin set of constitutional documents being the memorandum and articles of association which must be filed and registered with the Companies and Intellectual Properties Registration Office (CIPRO).

These constitutional documents are open to public scrutiny and any changes to the documents require adherence with the administrative processes to file and register amendments with CIPRO. In order to overcome this, it is common for the shareholders and the company to enter into a shareholders' agreement which deals with similar matters to those contained in the memorandum and articles of association, but which expressly provide that the shareholders' agreement prevails in the event of any conflict with the memorandum and articles of association. As shareholders' agreements are private agreements and not within the public domain, the confidentiality of provisions contained within them can be protected.

The memorandum and articles of association of pre-existing companies will continue to exist following the general effective date of the New Act in a combined form, being the memorandum of incorporation (MOI), the primary constitutional document envisaged by the New Act. However, the New Act expressly provides that (with effect from the general effective date) any shareholders' agreement must be consistent with the New Act and the company's MOI. Any provision of a shareholders' agreement that is inconsistent with the New Act or the MOI will be void to the extent of the inconsistency. It accordingly follows that even a clause contained in a shareholders' agreement which provides that it prevails over the MOI in the event of conflict, will be void.

As a first step in preparing for the implementation of the New Act, companies are urged to review their constitutional documents and, where appropriate, amend the MOI to ensure that it is consistent with any shareholders' agreements that may be in place. This is particularly of significance with regard to operational matters on the management and administration of the company and ideally such amendments should be put into place by the general effective date.

Shareholders' agreements will still play an important role going forward as provisions contained in them will be valid provided that they are not inconsistent with the MOI. Arrangements between the shareholders that are not necessary to be included in the MOI, may be included in the shareholders' agreement with the assurance that such provisions will be confidential. For example, it may be worthwhile including in the shareholders' agreement special arrangements regarding the management of the company such as financing arrangements, the company's corporate objectives and strategies, any restraints of trade imposed on shareholders and directors as well as the interaction between the company and other entities within its group.

In due course, it will be necessary for the MOI to be amended to ensure that it is consistent with the New Act. However, the New Act recognises that this is a process which may take some time and therefore allows a transition period of 2 years from the general effective date for a pre-existing company to file (without charge) an amendment to its MOI to bring it in harmony with the New Act. During this transition period, if there is a conflict between a provision of the New Act and a provision of the pre-existing company's MOI, the provision of the MOI will prevail. However, it must be noted that Schedule 5 of the New Act contains exceptions to this general rule, being matters where the New Act will prevail over the MOI during the transition period.

The following principles must be borne in mind when putting in place a process to amend the MOI to be consistent with the New Act:

- the MOI may contain provisions dealing with matters that the New Act does not address at all;
- the MOI may regulate "alterable provisions". Alterable provisions are provisions in the New Act which expressly contemplate that their effect on a particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by the MOI. For example, the MOI may, to varying degrees, depart from the New Act and include provisions regulating the powers of the company and the board, notice for company meetings and matters related to such meetings as well as imposing additional duties on board committees;
- the MOI may include any special conditions that will apply to the company;
- the MOI may include additional requirements to those contained in the New Act regarding the amendment of the MOI and any special conditions; and
- the MOI may prohibit the amendment of any provision contained within it.

Pre-existing companies are assured that until they file an amendment as aforesaid, and subject to the exceptions detailed in Schedule 5, the regulatory authorities in charge of companies (being the Companies and Intellectual Properties Commission and the Takeover Regulation Panel, in terms of the New Act) may not issue a compliance notice with respect to the conduct of any company that is inconsistent with the New Act but consistent with the MOI. However, this assurance will fall away after the expiry of the 2 year transition period from the general effective date, and pre-existing companies are therefore urged to ensure that any amendments to the MOI to bring it in line with the New Act are filed before the expiry of this period.

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fractional ownership in south africa: **a legal perspective**

by shelley mackay-davidson

With the current economic climate and slowdown in property growth and value, Fractional Ownership is likely to continue gaining popularity as an affordable, accessible and efficient means of owning leisure accommodation.

Primarily a marketing concept, it is borrowed mainly from the United States where it was initially developed to cater for joint ownership of yachts and private jets and where it now also encompasses all aspects of leisure and holiday accommodation. However, as is often the case with marketing concepts, scant consideration is given to the applicable legislative environment within which developers and marketers of fractional ownership products should operate.

Whilst the marketing term "fractional ownership" may appear to be novel, the legal precepts in South Africa upon which it is based, are not.

A simple fractional model envisages one property being owned by 13 owners, each owner being entitled to 4 weeks use of the property per annum on a roster or some other time-sharing basis. More sophisticated models envisage private residence clubs with access to multiple properties and hotel-type facilities and amenities. The underlying legal principles are however, fundamentally the same.

In its simplest form, fractional ownership is no more than joint ownership, with two or more persons owning undivided shares in immovable property, which share in the property can then be registered in the owner's

name in a separate title deed.

Whilst joint ownership structures, close corporations and trusts may be used to house a fractional product, a company is the most commonly-used form, with shares in the company being sold to purchasers as a "fractional share". Ownership of the share entitles the shareholder to use a property or a range of properties for certain determined periods each year.

As straightforward as it may appear, fractional ownership falls within the constraints of a range of legislation which needs to be considered, particularly where a company structure is used. The Companies Act (61 of 1973), the Share Blocks Control Act (59 of 1980), the Property Time-Sharing Control Act (75 of 1983), the Consumer Affairs (Unfair Business Practices) Act (71 of 1988) (Notice 459/2006) as well as the common law may have application.

South African common law provides that no joint owner may appropriate any part of a jointly owned property for his exclusive use, but is entitled to demand partition. Whilst these issues may be dealt with in an appropriate agreement between the parties, difficulties may arise in devising a mechanism that can exist in perpetuity, if necessary, and bind successors-in-title. This is problematic as it is uncertain whether an agreement amongst joint owners to postpone the right to demand partition (which right can only be postponed for a fixed time, not indefinitely) and to regulate their occupancy rights, is capable of registration as a real right against the title deeds to the property, or whether it is merely a personal right, terminating on death and being incapable of alienation or transfer.

The Property Time-Sharing Control Act would also apply to a fractional scheme where the accommodation is allocated on a roster or shared basis. A time-sharing interest is defined very broadly, and in relation to a property time-sharing scheme as *"any right to or interest in exclusive use or occupation, during a determined or determinable period during any year, of accommodation."* Thus, even if use can only be determined on the basis of availability, on a first-come first-serve or roster type system, that use right would be determinable and would fall within the parameters of this Act.

The Companies Act prohibits the sale or issue of shares to members of the public without a prospectus. However, a prospectus is not required for the offer of sale of a shareblock share if the provisions of the Share Blocks Control Act, relating, in particular, to certain minimum disclosure requirements, are met. Whether or not a company is a shareblock company is a matter of fact. The Share Blocks Control Act defines a share block scheme very broadly as being *"any scheme in terms of which a share, in any manner whatsoever, confers a right to, or an interest in the use of immovable property".* The Act furthermore contains a provision that "any company shall be presumed to operate a share block scheme if any share of the company confers a right to or an interest in the use of immovable property or any part of immovable property".

Almost every fractional product in South Africa will fall within the parameters of the Time-Sharing and/or Share Block legislation. With this comes onerous disclosure requirements, mandatory management structures if a shareblock company does not own the property, and civil and criminal sanctions for failure to comply. Both pieces of legislation require certain minimum information to be disclosed in the sale documents and advertisements, and contain restrictions as to when a purchaser's money can be paid to a developer. Importantly, in terms of the Property Time-Sharing Control Act, a developer may not receive any sale consideration unless the accommodation has been completed and a certificate of completion issued by an architect. This would therefore prohibit the sale of a fractional product on a so-called "off-plot" basis where the purchaser pays in instalments and at stated milestones on building progress.

Finally, the provisions of the Unfair Business Practices Act should be considered even though it may have limited application in the fractional industry. A developer who promises the investor a return on investment, may well have to comply with the comprehensive and onerous disclosure requirements.

Whilst much of the legislation discussed is designed to protect the consumer, purchasers of a fractional product should research the product carefully before investing. It is imperative that appropriate shareholders and use agreements are in place, that efficient and competent management structures are established and that the underlying structure of the fractional product is legally sound and compliant.

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