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Articles and Recent Developments:

1. CONDUCT AND LIABILITY OF DIRECTORS IN TERMS OF THE NEW COMPANIES ACT
2. DEVELOPMENT FACILITATION ACT UNDER SCRUTINY
3. REMINDER: COMPANIES, CC'S AND TRUSTS ARE NO LONGER "LABOUR BROKERS" FOR TAX PURPOSES
4. NEW LEGISLATION FOR SECTIONAL TITLE MANAGEMENT
5. NEW VAT THRESHOLD – THINK TWICE BEFORE DEREGISTERING
6. EXAMINATION OF TENDER DOCUMENTATION
7. THE FUTURE FOR CLOSE CORPORATIONS
8. NEW PROPOSALS FOR RESOLUTION OF SECTIONAL TITLE DISPUTES
9. CORPORATE GOVERNANCE: KING III HAS ARRIVED
10. CONTACTS

We trust that you will find the content of this email flyer to be of interest.

1. **CONDUCT AND LIABILITY OF DIRECTORS IN TERMS OF THE NEW COMPANIES ACT**

The English text of the new Companies Act 71 of 2008 ("the Act") was signed by the President in April 2009 and it is intended that the Act will become operative in July 2010, although this appears to be increasingly unlikely.

Part F of Chapter 2 of the Act deals with the governance of companies and sections 75 to 78 of Part F deal respectively with personal financial interests of directors, standard of directors' conduct, liability of directors and indemnification and directors insurance.

This brief article attempts to summarise the most important points of these extremely far-reaching provisions in terms of which the legislature has attempted to codify directors' conduct and liabilities. At the outset it should be noted that, for the purposes of each of these sections, director includes an alternative, a prescribed officer (still to be defined) and a member of a committee of the board.

Financial Interest

Section 75 of the Act obliges a director to:

- disclose a personal or related party financial interest in respect of a matter to be considered by the board;
- leave the board meeting after making such a disclosure in terms of the Act and the director may not be regarded as present for the purposes of adopting a resolution on the matter;
- also promptly disclose a personal or related party financial interest in any matter where the company has a material interest.

Standards of Conduct

Section 76 sets out the following standards of directors' conduct:

- a director must not use his position or any information obtained to gain advantage for himself or a third party or to cause the company any harm;
- unless the director believes that information is immaterial or in the public domain or that he is precluded legally or ethically from disclosure, that director must communicate to the company at the earliest practical opportunity any material information obtained;
- when acting as such, the director must act in good faith and for a proper purpose, in the best interests of the company and with the degree of care, skill and diligence that can be reasonably expected of someone carrying out the same functions and having the general knowledge, skill and experience of that director;
- the director will be regarded as having acted in the best interests of the company and with the necessary degree of skill, if the director had taken reasonably diligent steps to be informed, if he had disclosed any financial interests and there was a rational basis for believing that the decision was in the best interest of the company;
- in exercising his functions, a director is entitled to rely on employees and professional appointees, who the director reasonably believes to be reliable and competent, as well as committees of the board unless that committee's actions do not merit confidence.

Liability of Directors

Section 77 of the Act spells out the circumstances when a director can be held liable for loss, damages or costs of the company. It does not deal with liabilities to third parties or other stakeholders such as shareholders and employees. (It should however be noted that section 20(6) provides that a shareholder has a claim for damages against any person who acts fraudulently or grossly negligently. Furthermore, section 218(2) provides that any person who contravenes any provision of the Act is liable to any other person for any loss or damage suffered by reason of the contravention.)

A director may be held liable in accordance with the common law for loss, damages or costs sustained by the company as a result of breaches of his fiduciary duties, and in accordance with the principles of the common law relating to delict for loss, damages or costs sustained by the company as a consequence of the director's failure to act with the necessary care, skill and diligence or in accordance with either the Act or the company's Memorandum of Incorporation.

A director is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director:

- acting without authority
- acquiescing in reckless trading
- being a party to a fraudulent act or omission
- signing, consenting to or authorising financials or prospectuses which are false or misleading
- failing to vote against various unauthorised acts, despite knowing that such acts are unauthorised

The liability of the directors for such losses is joint and several and a three year prescription period applies from the date of the act or omission which gave rise to the liability.

Finally, except in the case of wilful misconduct or wilful breach of trust, a court in proceedings against a director may relieve a director of liability wholly or partly, if it appears that the director acted honestly and reasonably or it would be fair in the circumstances to excuse the director.

Indemnification and Directors' Insurance

Section 78 of the Act sets out the circumstances in terms of which the company can indemnify the director and where the company purchase insurance to protect the director.

In essence, the company may indemnify the director in all circumstances, except:

- where the liability arises in circumstances where the director failed to act in good faith and for a proper purpose, or failed to act in the best interests of the company, or failed to act with the degree of care, skill and diligence required;
- where the liability arises from wilful misconduct or wilful breach of trust on the part of the director;
- in respect of any fine imposed in terms of any national legislation.

The company may purchase insurance to protect a director against liability or expenses for which the company is permitted to indemnify the director. Therefore, insurance is permitted, except where the director acted in bad faith or not in the best interests of the company or not with the degree of care, skill and diligence required.

Delinquency and Probation

It should also be noted that section 162 of the Act sets out circumstances under which a director can be declared delinquent or under probation. The right to apply to have a director declared delinquent or under probation accrues to the company, a shareholder, another director, the company secretary or prescribed officer, a registered trade union or another representative of the employees of a company. An application must be made to court and section 162 lists a number of circumstances under which a court must make an order declaring a person to be delinquent. For example, if the director grossly abused his position, took personal advantage of information, intentionally or by gross negligence inflicted harm upon the company, or acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust. If a director is declared a delinquent, in most cases, the delinquency subsists for 7 years, whereas an order for probation is for not more than 5 years.

As we have previously commented, being a director of a company is extremely onerous and directors who fail to comply with their various obligations, will run a serious risk of both criminal and civil liability. In the case of criminal liability, provision is made for a fine and/or imprisonment for up to 10 years. In the case of civil liability, the losses sustained by the company, a shareholder or third parties for which the director can be held liable, can be substantial.

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2. DEVELOPMENT FACILITATION ACT UNDER SCRUTINY

A Supreme Court of Appeal judgment delivered recently, has cast serious doubt on the continued use of the Development Facilitation Act ("DFA") by developers for non reconstruction and development type projects.

The DFA was established in 1995 primarily to redress inequalities left by the policy of separate development with the aim that reconstruction and development should occur a lot quicker than that which was able to be accommodated within the framework of various Provincial Planning Ordinances regulating town planning processes. The intention of the Act was to make provision for low cost housing and facilities for those previously impoverished.

The mechanisms available under the DFA were however, and still are, extensively used for non-RDP projects including upmarket commercial and residential developments. One of the main advantages for developers using the DFA is that the DFA Tribunal has the power to suspend and override provisions of certain legislation which usually delays the development process in the normal course of events under the Planning Ordinances. This includes the Subdivision of Agricultural Land Act and the ability of the DFA Tribunal to suspend certain title deed conditions applicable to a property.

In the SCA judgment of City of Johannesburg vs Gauteng Development Tribunal (335/08) [2009] ZASCA 106 on 22 September 2009, Judge Robert Nugent considered an appeal against a judgment in the High Court of Gauteng which concluded that Chapters V and VI of the DFA were constitutionally invalid. These chapters include the

various powers which the development tribunals may exercise as well as those provisions relating to development approval applications.

The judge carefully considered the constitutional powers of national provincial and local government and concluded that the "crisp question that is before us is thus whether the functional area described as 'municipal planning' includes the functions that have been and continue to be performed by municipalities ..." "If so, they are matters that are reserved to the executive authority and administration of municipalities and may not be assigned by legislation to another body (in this case a development tribunal)."

In the view of the learned judge, the term "municipal planning" as it is used in the DFA, includes the various functions that are assigned to municipalities under the Ordinance, and accordingly they may not be assigned to other bodies by legislation.

In grappling with the appropriate order to be granted, Judge Nugent sought to protect the validity of decisions that have until now been given by development tribunals, secondly to enable development tribunals to continue to perform their legitimate functions until such time as Parliament replaces the offending legislation, and thirdly, to ensure that development tribunals restrict their activities to those "legitimate functions".

While chapters V and VI of the DFA were declared to be invalid, the declaration of invalidity was suspended for 18 months subject to a qualification that no development tribunal may accept for consideration or consider any application for the grant or alteration of land use rights in a municipal area, and secondly that no development tribunal may amend any measure that regulates or controls land use within a municipal area.

The order does not however have effect until it has been confirmed by the Constitutional Court in view of certain provisions of the Constitution which provide that the Constitutional Court has the final decision on whether particular legislation is invalid or not.

The judgment is without doubt, a serious setback for developers who have used the DFA very successfully since it was first brought onto the statute books many years ago.

The difficulty facing developers in the immediate future is whether to proceed with a development application under the DFA or whether to use the planning process provided for under one of the provincial Ordinances. The uncertainty as to when the matter may be heard by the Constitutional Court, and whether the Constitutional Court will agree or not with the decision of the SCA, will concern a number of developers, and potentially put a number of substantial developments in limbo.

DAVID WARMBACK

For a copy of the Judgment or further information, David Warmback can be contacted on 031-3020409 and warmback@wylie.co.za

3. REMINDER: COMPANIES, CC'S AND TRUSTS ARE NO LONGER "LABOUR BROKERS" FOR TAX PURPOSES

Due to the numerous changes SARS has made to the relevant definitions in the Fourth Schedule to the Income Tax Act in recent years, there is much confusion about the status of labour brokers and the concept of personal service providers.

The definition of "labour broker" was amended with effect from 1 March 2009 to exclude all companies, close corporations and other juristic entities. From 1 March 2009, natural persons qualify as "labour brokers" for tax purposes.

This means that labour brokers that are companies, close corporations or trusts now no longer need to apply for exemption (IRP30) certificates and their clients need not withhold PAYE from their fees. That is, unless the labour broking company, cc or trust qualifies as a personal service provider.

Three factors must be met before an entity qualifies as a personal services provider:

- the entity must be a company, cc or trust; and
- the services must be rendered personally by people who are connected to the company, cc or trust; and
- any one of the following must apply:
 - the people performing the services would be regarded as employees if they were providing the service directly to the client; or
 - the duties are performed mainly at the client's premises and the person is under the client's control and supervision; or
 - more than 80% of the company's or trust's income comes from one client.

However, even if these requirements are all met, the company or trust will still escape classification as a personal service provider if it has 3 or more full-time employees who are not members or shareholders of the company or trust and are not connected to the members or shareholders.

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4. NEW LEGISLATION FOR SECTIONAL TITLE MANAGEMENT

A new draft Bill, released by the Department of Human Settlements ("the Department") inviting comments on or before 30 November 2009, seeks to deal specifically with the management of sectional title schemes.

The Cabinet has for some while wanted to bring all housing related legislation, currently administered by other departments, under the administration of the Department and requires that all housing matters "reside under one roof", as stated in the Memorandum on the Objects of the Sectional Title Schemes Management Bill, 2009 ("the Memorandum") published for comment on 30 October 2009.

The current Sectional Titles Act, 1986 ("the Act") deals both with the technical survey and registration issues relating to sectional plans and real rights in sectional title units as well as the management and administration of sectional title schemes. The Act falls within the jurisdiction of the Department of Rural Development and Land Reform.

The Bill effectively separates the scheme governance provisions currently contained in the Act and incorporates them into a new Act, as stated in the Memorandum, "in a more user friendly format but without changing the substance of the provisions". The Bill therefore removes the scheme management provisions from the Act, incorporates them in a new statute to be administered by the Minister of Human Settlements, and rearranges the scheme management provisions so as to make them more understandable to the members of the public and those implementing the provisions, without substantially changing their content.

The Act will then remain with all provisions regulating the survey and registration aspects of sectional title schemes, and continue to be operated under the Minister of Rural Development and Land Reform.

DAVID WARMBACK

For a copy of the Bill or further information, David Warmback can be contacted on 031-3020409 and warmback@wylie.co.za

5. NEW VAT THRESHOLD – THINK TWICE BEFORE DEREGISTERING

In March 2009, the threshold at which an entity becomes obliged to register for VAT changed from an annual turnover exceeding R300 000 to an annual turnover exceeding R1 million.

Since the announcement of this change, several articles have appeared in the media advising existing VAT vendors whose current annual turnover is below R1 million to deregister for VAT and "save money".

However, a decision to deregister for VAT should not be taken lightly as deregistration is in itself a VAT event. When a vendor deregisters for VAT it is deemed to dispose of all its assets held and certain rights attaching to the business immediately before deregistration. VAT is payable to SARS on the lower of the cost or the open market value of such assets and rights. This is called "exit VAT" by SARS. VAT also has to be accounted for on the amount of any outstanding trade creditors on the date of deregistration to the extent that input tax deductions have been claimed on the supplies made by the creditor to the vendor.

There is some relief for vendors who deregister due to the increased registration threshold as these vendors may settle their VAT liability resulting from deregistration, excluding any liability resulting from unsettled creditors at the date of deregistration, over a period of 6 months.

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6. EXAMINATION OF TENDER DOCUMENTATION

The recent and as yet unreported, decision of the KwaZulu-Natal High Court in the matter of Ububele Alpha Chemicals (Pty) Ltd ("Applicant") vs Mondi Ltd ("First Respondent") and Silvex ("Second Respondent"), featured a novel attack on a tender process and underlined some important aspects in the preparation of tender documentation.

In his judgment Mr Justice Swain identified the central issue as being whether the Applicant had established the conclusion of a tacit "tender agreement" between it and the First Respondent incorporating conditions under which First Respondent would consider the tenders which it had invited from the Applicant and the Second Respondent among others for the supply of certain chemicals.

The Applicant contended for this "tender agreement" based on the First Respondent's letter inviting tenders in an attempt to demonstrate that the First Respondent was contractually bound to deal with the tenders in a certain way. This would enable the Applicant to contend that the First Respondent had failed to deal with the tenders in accordance with the tender agreement.

Tender documentation is almost invariably drafted in a way which makes it clear that the invitation to submit a tender is not an invitation to contract and reserves particular rights to the party inviting the submission of tenders.

The request for tenders in this case contained the following common but important wording.

1. The request for tenders is not an offer to contract.
2. The First Respondent envisages contract negotiations.
3. The First Respondent reserves the right to reject any and all proposals received.

The request asked tenderers to provide a quotation and indicated that the First Respondent expected to enter into a 1 year agreement.

These provisions made it clear that the First Respondent reserved to itself a significant degree of flexibility in dealing with the tenders submitted. It was not bound to accept the lowest tender and was entitled to negotiate with tenderers before concluding a contract.

It duly negotiated with the Second Respondent and concluded a contract for the supply of the goods which it required. It was this negotiation and the final prices agreed which was the focus of the applicant's attack.

Having considered the wording of the invitation to tender, the court held that no "tender agreement" was concluded obliging the First Respondent to deal with tenders in a particular way, which meant that it was entitled to negotiate with the Second Respondent and to contract with it based on the negotiations.

The Respondents successfully resisted the application because of the wording of the invitation to tender and the contract documentation. This emphasises the fact that care must be taken in the wording of every document forming part of the tender process so as to ensure that the party inviting tenders retains the flexibility which it requires in its best interests. It is also important to ensure that all of the documents forming part of the tender process are consistent and properly reflect what it is intended to achieve.

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7. THE FUTURE FOR CLOSE CORPORATIONS

The new Companies Act, which is expected to come into operation during 2010, will have a profound effect on the way that business is done in South Africa, and in particular, on the future of close corporations or "CC's".

A close corporation is an inexpensive and simple method to establish and maintain a business which was introduced into South Africa for the specific purpose of encouraging small business development. One of the main aims of the new Companies Act is to promote the development of the South African economy by making the formation and maintenance of a company more flexible and simple, and by doing so, facilitating the formation of a small private company comparable to a close corporation. For this reason, from the time that the new Companies Act comes into operation, the formation of close corporations will no longer be necessary. No new close corporations will be registered, and existing companies will not be permitted to convert to close corporations. The Companies and Intellectual Property Registration Office (CIPRO) will continue to process and implement any applications for incorporation or conversion which it has received, but not processed, by the date when the new Companies Act takes effect.

Under the new Companies Act, close corporations will continue to exist indefinitely until they are deregistered or dissolved under the current Close Corporations Act, or converted to a company under the new Companies Act. The current Close Corporations Act (with slight amendments) and the new Companies Act will exist concurrently and CC's will be required to comply with the provisions of both Acts.

Although a CC is currently cheaper and easier to incorporate and maintain than a company, it is not yet known what it will cost to incorporate and maintain a small scale company comparable to a CC under the new Companies Act. The practicalities of such

a company have not yet been tested and only time will tell how it compares to a close corporation.

One of the obvious advantages of incorporating a CC before the new Companies Act comes into operation is that one will have the choice of continuing business as a CC for the foreseeable future (and to a large extent according to the current familiar legislation), or converting to a company once the new simpler and more flexible concept of a company provided for in the new Act has been tried and tested.

The new Companies Act contains an easy and fairly seamless process for converting a close corporation to a company. All that is required is a notice of conversion, a special resolution of the members approving the conversion, a new memorandum of association or an amended founding statement which complies with the provisions of the new Act, and payment of the prescribed filing fee. Following the conversion, the assets and liabilities of the CC will vest in the company and each member of the CC will be entitled to become a shareholder of the company.

If you are considering incorporating a business within the next few months, registering a CC before the date when the new Companies Act takes effect will enable you to establish your business in accordance with familiar legislative requirements and will give you the added benefit of continuing business as a CC or converting to a company once we have entered the new dispensation.

CLAIRE McGEE

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8. NEW PROPOSALS FOR RESOLUTION OF SECTIONAL TITLE DISPUTES

Many owners and occupants of residential sectional titles schemes have been frustrated by the lack of an effective dispute resolution mechanism for resolving disputes in sectional titles schemes. The prescribed management rule which introduced the compulsory arbitration of sectional title disputes has in many instances proved problematic from a practical point of view.

On 30 October 2009, the Minister of Human Settlements published the long awaited Community Scheme Ombud Service Bill, 2009 ("the Bill"), requesting comment by interested parties by 30 November 2009.

The Bill establishes a dispute resolution service for all "community schemes", being those property developments, including sectional title and share block schemes, home owners associations and housing schemes for retired persons in which there is governance by the community, shared financial responsibility and land and facilities used in common, irrespective of the particular title or tenure arrangements.

The memorandum on the objects of the Bill acknowledges that disputes amongst participants require effective resolution in community schemes as they involve control and administration of finances, facilities and behaviour, and that there is no effective and affordable dispute resolution mechanism available to parties in those schemes. Currently the custody and administration of sectional title governance documentation is the responsibility of the Department of Rural Development and Land Reform, which is

principally involved with the land survey and deeds registration functions. The Bill provides that the Community Scheme Ombud Service will take over the governance of schemes which falls outside the mandate of the Department of Rural Development and Land Reform.

The Bill proposes to establish the Community Scheme Ombud Service as a national public entity with executive authority vested in the Minister of Human Settlements and provide a framework for the avoidance and resolution of disputes in community schemes.

DAVID WARMBACK

For a copy of the Bill or further information, David Warmback can be contacted on 031-3020409 and warmback@wylie.co.za

9. CORPORATE GOVERNANCE: KING III HAS ARRIVED

Following hot on the heels of the new Companies Act 71 of 2008 is the revised King Code of Governance for South Africa, 2009, popularly known as "the King III Report" or just "King III". On 1 September 2009 the King III Report was formally launched by the Institute of Directors in Southern Africa which commissioned all three King Reports.

King III is based on an "apply or explain" approach in preference to the potentially mindless "comply or explain" or the more general "adopt or explain" of the UN code. King III is written for application by all types of entities regardless of manner of incorporation and whether public, private or non-profit, and will come into effect on 1 March 2010.

Due to the new legislative climate introduced by the Companies Act 2008 and changes in governance standards worldwide, King III has become necessary. Some of the recommendations contained in King II have now been legislated per the Companies Act 2008 and will no longer be voluntary but compulsory for companies when that Act comes into effect some time in 2010.

King III emphasises the fundamental principles of effective leadership, good corporate governance and especially sustainability. For the first time in history mankind is consuming natural resources faster than they can be replenished and climate change has become a major threat to our survival. Companies are urged to operate in a sustainable manner and to implement reporting that integrates sustainability reporting with conventional financial reporting.

Management pay schemes should be structured to promote long term performance in all these key areas and must not create incentives that maximise only short-term results.

A "stakeholder inclusive" approach is preferred over an "enlightened shareholder" approach when directors analyse which decisions are or are not in the best interests of the company. This means that directors should take into account the broader long-term

interests of stakeholders and not just the narrow transient financial interests of its present shareholders.

Social transformation and redress from apartheid remain as relevant today as they did in the last decade and benefits both the company and society.

New areas for governance include alternative dispute resolution. Directors must ensure that disputes are resolved as effectively, efficiently and expeditiously as possible. This means the board must formulate and adopt a formal dispute resolution policy and designate appropriate individuals to represent the company.

Other new areas in the report cover risk based internal audit processes and an annual assessment of internal financial controls by internal auditors to the board and the audit committee.

Also new are recommendations around information technology governance given the pervasiveness of IT in business strategy, the initiation of business rescue procedures as soon as a company is in financial distress and directors' responsibilities during mergers, acquisitions and amalgamations.

Some of the recommendations include:

- the chairman of the board should be an independent non-executive director;
- a retired CEO should not be the chairman of the board within 3 years after ceasing to act as CEO;
- the majority of the board of directors should non-executive directors of which a majority should be independent;
- the CEO and the financial director should serve as directors on the board;
- the criteria that should be used for determining the independence of a non-executive director;
- every company should have a remuneration policy which is subject to a non-binding advisory vote of shareholders at the AGM;
- non-executive directors should not receive share options or corporate performance based remuneration;
- the salaries of individual directors and the 3 highest paid non-board executives should be disclosed;
- every company should have standing risk, nomination, audit and remuneration committees;
- companies should also have a company secretary and a chief information officer responsible for IT governance.

King III recognises the importance of active institutional investors with vested interests for ensuring market success and the role that they can play in holding boards accountable for the consistent application of good corporate governance principles. In the light of this the drafting of an investor code has become highly desirable.

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10. CONTACTS

Should you require additional information on any of the above issues or with regard to any other issues of a commercial and corporate law nature, please contact any one of our following team members:

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