IN BAD FORM
Why the short-form Memorandum of Incorporation should not be used
By
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Private companies who score less than 100 public benefit points and whose shareholders also serve on the board of directors do not need to have their annual financial statements audited or subjected to independent review. This is in terms of section 30(2A) of the Companies Act 71 of 2008 (the new act). However at present this boon is only available to existing private companies who have converted their Memorandum and Articles of Association to the Memorandum of Incorporation (MOI) required in terms of the new act before their financial year end. The considerable savings flowing from not undergoing an audit resulted in a large number of applications for conversion being lodged just before the end of February this year. The volume of those applications has overwhelmed the Companies and Intellectual Properties Commission (the CIPC) with the result it now takes 50 working days for the CIPC to process these applications instead of the 25 days promised in its service delivery standards.

It is likely that the vast majority of these companies converted using the short-form Memorandum of Incorporation – COR15.1A . This form contains the injunction "*This form may only be used to incorporate a private company*" but does not contain any provision that either restricts transferability of its securities or prohibits the offering of its securities to the public. These are essential prerequisites of a private company prescribed in terms of section 8 (2) of the new act. A company that is incorporated without both these restrictions is by definition a public company.

Companies that were incorporated or who converted using the short form MOI are in fact public companies. Section 8(2) (d) of the new act states that a profit company is a public company if it does not qualify as a state-owned company, a private company or a personal liability company. This is irrespective of what its notice of incorporation or other official company documents say.

The fact that this problem exists is not unknown. Some shelf company businesses sell short-form companies whose MOIs are amended to include words to the effect that the company is a private company and that the transferability of its shares is restricted and sales of shares to the public prohibited. I don't think this assists at least insofar as the transferability of shares is concerned. The MOI must detail the nature and extent of the restriction otherwise the stipulation is void for vagueness.

An incorrect registration does not invalidate the existence or acts of a profit company. A company is a juristic person from the date of its incorporation. As such it is entitled to enjoy all the powers of a human being excepting those powers that it cannot exercise by virtue of

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its nature. This is regardless of the defects that may exist in its registration.

The registration of a public company as a private company is nonetheless a contravention of the new act. It is a contravention by all those persons who are responsible for its incorrect incorporation or conversion. This would include the subscribers in the case of a new company, the shareholders and directors in the case of a conversion as well as the CIPC, and the person at the CIPC who issues the notice of incorporation or conversion. It will also extend to those advisors or agents who undertook the registration or conversion on behalf of the subscribers or directors.

The incorrect registration of a company is not an offence in terms of the new act. There is also nothing in the act that specifically imposes liability on a person for incorrectly incorporating or converting a company. However section 218(2) states:

> "*Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.*"

That at the very least creates a very considerable risk of liability for those responsible for the incorrect incorporation or conversion of a company.

So where does that risk of liability arise? Again it's not that clear. A public company may be incorporated with a single shareholder though it must have three directors. No penalties are visited on a company or its directors for carrying on business without the requisite number of directors.

Public companies are subject to much stricter accounting standards. All public companies irrespective of their size must prepare annual financial statements that comply with either IFRS or IFRS for SMEs. They are also subject to the enhanced accounting standards set out in chapter three of the new act and as such must appoint a company secretary, an audit committee and also, notwithstanding the sloppy drafting of section 30 (2A), an auditor.

The risk of loss or damage arising from a failure to do this is considerable.

One must not forget that one of the stated objectives of the new act is to promote transparency and good corporate governance. The incorporation of so-called private companies using the short form fails to meet this standard. It is disgraceful that the CIPC will nonetheless register and convert companies using the short-form MOI.

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