SECOND
PUBLIC
CONSULTATION
PAPER

2. COMPANY LAW AND ONLINE REGISTRY REFORM: STARTING A COMPANY

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GOVERNMENT OF THE KINGDOM OF ESWATINI.

NEW ZEALAND
COMPANIES OFFICE

The Government of New Zealand, through the New Zealand
Companies Office, is assisting with these reforms.

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Executive Summary

This is the second in a series of consultation papers prepared by the Ministry of Commerce, Industry and Trade (the Ministry) regarding reforming the Eswatini Companies Act 2009 and subsequently implementing an electronic, online company registry. While the first consultation paper provided a roadmap on how the reform would progress, this paper begins the substantive discussions on the policies that will inform the drafting of a new law.

The general topic for this paper is "starting a company." It will look at the following issues:

1. What company types are right for Eswatini?
2. How should the concept of a "local" company be implemented?
3. Can Eswatini do away with secondary documents such as the Memorandum?
4. Would Eswatini benefit from having Model Rules set out in the Regulations that can be accepted by simply ticking a box on the application to incorporate?
5. Should the concepts of stated capital and par value be eliminated?
6. What provisions should be included to comply with international anti-money laundering (AML) mandates?

How should the registration of overseas companies be reimagined to ensure that Eswatini receives all pertinent information regarding these entities, while not discouraging foreign investment?

The Ministry welcomes all stakeholder feedback. Comments should be directed to the following email address: ______________________.

1.0 What company types are right for Eswatini?

Older Companies Acts make a distinction between different types of companies. While the main divide is between public and private companies, there are other subtypes as well. There are then technical rules that govern each of these subtypes, relating to prerequisites for formation, liability of shareholders, and the way the entity interacts with the world. Different sections of the legislation pertain to different entities, making it harder for non-lawyers to understand the law under which they operate their businesses.

Eswatini's current 2009 Act recognizes the following four types of local companies[1]:

[1] The 2009 Act also mentions partnerships. As these are not company entity types, they are not addressed in this paper. However, if a new Companies Act is passed then the matters addressed in Section 25 of the current Act related to partnerships will need to be addressed in some manner.

- Private limited liability companies, section 15(1)(a);
- Public limited liability companies, section 15(1)(a);
- Companies limited by guarantee, section 15(1)(b);
- Unlimited liability companies, section 15(1)(c).

This is an outdated traditional British model of corporate structure common in Commonwealth and former commonwealth countries. Other countries that have already undertaken to reform this traditional model of corporate structures have dispensed with the distinction between public and private companies, and with companies that are limited by guarantee. Instead, these countries have created a one-size-fits-all corporate form.[2]

There are significant benefits to this approach, including: i) the law becomes easier for non-lawyers, such as business people, to read as all provisions apply to only the one company type; ii) similarly, this makes it easier for start-ups to incorporate as selecting the proper entity type is not an issue; and, perhaps most importantly, iii) distinctions between private and public companies disadvantage private companies with regard to raising capital. A later consultation paper will examine this issue more closely. Under the 2009 Act, the definition of a "private company" is one that: i) has a restriction on the transferability of its shares, and ii) is prohibited from making any offer to the public for shares or debentures. This closes off two meaningful ways that small companies can obtain capital to grow. Their only alternative under the current law is to become a public company and take on the responsibilities and additional costs to raise capital that come along with this designation. This is one of the main reasons to dispense with the differing company types, as this arrangement discourages growth in small companies.

Since many countries have not reformed their company laws in some time, eliminating the distinction between public and private companies is a minority position at this time. Still, the decision in countries that have reformed was made easier by the fact that there were simply not that many public companies, and virtually no unlimited liability companies, as the vast majority of companies are private. The old Companies Acts, therefore, have pages of provisions of legislation that were practically never used.[3]

[2] America does not have these types of companies. There, a "public" company is one that is listed on a stock exchange. New Zealand dispensed with these distinctions in its 1993 Companies Act. Papua New Guinea, a country similarly situated to Eswatini in terms of development, also dispensed with the public company in its 1997 Act. Other countries in the Pacific have been quick to follow: Samoa, Solomon Islands, Tonga, and Vanuatu have all adopted new legislation that has only one company type. Each of these countries has seen an increase in the rate of company formation—due, at least in part, to the ease with which new companies can now be formed.

[3] The Ministry acknowledges that Section 17 of the current law provides that associations (non-profit companies) may register as companies limited by guarantee. The new law must account for these existing entities, and further discussions are required to determine the best path forward for them. The associations may be able to reside within a new companies act as "nonprofit companies," or they may necessitate the creation of a standalone nonprofit law.

2.0 What is a "local" company?

Section 15(2) of the current Act sets out a test to determine if a company is local. A company is determined to be local if it:

- has Swazi citizens who hold more than half of its issued share capital;
- has Swazi citizens forming the majority of its shareholders who have control over the election of the Board of Directors; and
- has Swazi citizens forming the majority of its Board.

Many countries have similar tests to determine if a company is local. Companies determined not to be local must then seek some sort of foreign investor certification. Most of these tests look solely to the percentage share of ownership of the company and not to the composition of the Board. The theory behind this is that local owners should not be discouraged from hiring experts to serve as directors, if non-citizen talent is required to run the company. Eswatini must determine if it should also dispense with that part of the test that looks to the composition of the Board when determining if a company is local?

3.0 Simplification of requirements for corporate formation

Under current law, company formation is complicated because it requires the submission of numerous ancillary documents including Memorandum of Association, Articles of Association, and a Declaration of Compliance.

The Memorandum is intended to set out how the company interacts with the world and includes biographical information about the company, such as its name and key addresses. The traditional approach also required that the objectives of the company be listed in the Memorandum. The company was then not permitted to transact any business outside those objectives, creating a substantial burden and risk on a company that might engage in some activity not squarely within its stated objectives. For this reason, this requirement has been somewhat eased in the United Kingdom, but in many other Commonwealth countries it persists, despite there being no economic rationale for limiting a company's activities. The modern approach is to simply allow a company to engage in any lawful business.

The modern approach to company formation also does away with most, if not all, of the ancillary documents. Under this approach a company can be formed by completing a simple online form that collects biographical information about the company, such as its relevant addresses, and the identification of its shareholders and directors. A sample of what such a form could look like is presented together with this consultation paper.[4]

[4] The sample provided is intended only as a sample. Further consultations around filing requirements will be undertaken later in the project.

All the core information about the company, its shareholders, and its directors is collected on this single form without the need for additional documents. This information is important for meeting international AML standards. Additional reforms discussed below will complete Eswatini's AML compliance package.

New Zealand removed the need to submit all these documents in its 1993 legislation.[5] This makes it much easier for entrepreneurs to enter the formal sector as they need not pay a lawyer to draw up these papers. While most Commonwealth countries still require these documents, many of these documents do not serve a vital public purpose and the burden imposed on new companies to prepare these documents outweighs any benefit?

4.0 Would "model rules" be beneficial?

If Eswatini determines that some form of ancillary document supporting incorporation would be beneficial, one approach would be to establish "model rules" in the Regulations. These rules set out the procedures for the internal governance of the company, including such things as setting out how a quorum of directors is to be established, when shareholder meetings occur, and whether super-majority votes are required for corporate action.

The benefit of setting out model rules in the Regulations is that any company may elect to be governed by them by simply ticking a box on the Application to Incorporate. This allows a new company to easily comply with the requirement to have rules in place without incurring the time and expense to have customized rules prepared. It is even possible to have different sets of rules available depending upon the number of shareholders in a company. For example, a sole shareholder company could have limited rules, given that there is little need for formality in things such as shareholder meetings when there is only one person. A different set of rules could be available for 2-9 shareholder companies, and a more complex set of rules available for companies with 10 or more shareholders. However, even though model rules would be available, a company would still be allowed to create its own rules. This approach provides the maximum flexibility to entrepreneurs.

If this approach were followed, then a person forming a company in Eswatini would have the following options:

1. adopt the appropriate model rules;
2. obtain customised model rules written by a third party (such as lawyers); or
3. prepare and supply its own constitution.

[5] Though not a Commonwealth country, none of the American states require these documents to be submitted to form a company. In America, "bylaws" govern the internal workings of a company. America views bylaws as, in essence, a private contract amongst the shareholders as to how the company is to operate internally. As such, it is not deemed a public document.

Establishing model rules makes it easy for new companies to comply with the requirement to have supporting incorporation documents without having to draft their own, saving significant legal fees. However, companies are free to make their own rules if they choose, thus providing the maximum flexibility possible to the business community.

5.0 Stated capital and par value of shares

The current Eswatini Act contains the concepts of stated capital and par value. Many countries have removed these concepts and Eswatini should consider whether they serve the purpose for which they were originally intended.

Traditionally, "stated capital" refers to the aggregate par value of all a corporation's outstanding shares. In theory, these are to be held by the corporation as cash reserves.[6] These cash reserves are supposed to protect creditors, and those shareholders with preferential rights to company assets, by ensuring there is "money in the bank" if needed. The original purpose of par value as a valuation method has been long lost. It is now just an arbitrary and usually nominal amount set out in the corporate formation documents.

The use of stated capital and par value are an ineffective manner of trying to protect possible future creditors or shareholders of a company. There is nothing to stop a company from issuing shares with an exceptionally low par value, meaning its stated capital is essentially valueless. Second, the par value has absolutely no relation to the market value of a share or to the market value of the company. Thus, requiring companies to track par value, together with such things as "stated capital" and "paid in surplus" are mere accounting rules and do not add anything of value to the company. They also do not add anything to a researcher's understanding of the value of the company. If a person was considering buying a company they would look to financial statements and tax returns, not to the bookkeeping ledger for "stated capital." Finally, these provisions are also confusing to small business owners requiring the expenditure of funds for lawyers and accountants to assist with share transactions.

Eswatini should consider removing the mechanical application of mere accounting rules. Instead, a new Companies Act could place an affirmative duty upon the directors to make appropriate decisions regarding the following specific transactions:

1. For the initial issuance of shares, directors must ensure that fair value is obtained by the company. This means, in part, ensuring that the terms of the subscription agreements are fulfilled before the shares are issued.
2. If the company later issues shares, the directors should be charged with determining a fair value for the shares, which may be paid either in cash, services, or other items of value.
3. No dividend or other distribution should be allowed if the result would be to put the corporation in

[6] This is the basic approach taken in Section 96 of the current Act.

economic jeopardy such that creditors (or preferential shareholders) would be put at risk. In other words, no such payments would be allowed if they rendered the company insolvent.

Eliminating these archaic accounting requirements, and instead placing real-world duties on directors, would represent a much more realistic approach to protecting creditors than reliance on "stated capital" and "paid-in surplus" levels.

6.0 Anti-money laundering issues

International AML efforts continue to permeate all company law reform projects. In some cases, the reform is undertaken primarily to address an adverse finding in a Mutual Evaluation Report[7] issued by an international organization charged with investigating each country for compliance. The standards against which company laws and registries are measured seem to become more stringent every few years. Eswatini would be well served to address four key items in a new law in advance of its next evaluation: beneficial ownership; director residency; shadow directors, and bearer shares.

6.1 Beneficial Ownership

A "beneficial owner" of a company is a person that effectively occupies the position of a shareholder without officially appearing on the register as a shareholder. This secretive arrangement can be used to facilitate money-laundering and can act as a tax avoidance mechanism. International AML and anti-terrorism directives require countries to be able to determine the ultimate beneficial owners of companies. Locally, it also helps a country combat "front" companies, where local persons are named as the owners but the true owners are non-citizens.

Some jurisdictions have committed to obtaining beneficial ownership information by creating a central register just for this information.[8] Other countries only require each company to maintain beneficial ownership information in their internal share register and make that information available to the Registrar and other law enforcement authorities upon request. This formulation strikes a balance between the need to have beneficial ownership information available while not overburdening companies or adding expense to the government to maintain yet another register.

[7] Eswatini's last full Mutual Evaluation Report seems to have been in 2010, with two progress reports issued since then (in 2017 and 2018).

[8] Great Britain and the European Union (EU) are probably the leading proponents of beneficial ownership registries. All EU Member States are to enact laws requiring corporate entities to obtain and hold accurate and current information on their beneficial owner(s) in their own internal share register. The EU also requires that this information be filed in a central register in each member state. However, implementation has been patchy and only a handful of EU countries are fully compliant. Elsewhere in the world such central registries are rare.

The actual language required in a Companies Act to address this issue is quite straightforward and could be as simple as the following:

1. No notice of a trust, whether express, implied, or constructive, may be entered on the share register.
2. However, a company must—
   a. obtain and maintain sufficient information to identify the beneficial owner of a share issued by the company; and
   b. disclose that information in a written notice to the Registrar on the written request of the Registrar without the necessity for a Court order requiring disclosure.
3. For the purposes of subsection (2), beneficial owner means a natural person or persons who ultimately owns or controls a share or other membership interest in a company, respectfully, or who exercises ultimate effective control directly or indirectly over a legal person or arrangement affecting shares or membership interests or decisions in a company, and "beneficial ownership" is to be construed accordingly.
4. If a company fails to comply with subsection (2)¾
   a. the company commits an offence and is liable on conviction to the penalty [to be determined]; and
   b. every director commits an offence and is liable on conviction to the penalty [to be determined].

6.2 Residency requirement for company directors

AML dictates do not yet require at least one director of a company to live in-country, but it seems that this is the direction that the mandates are heading. Eswatini should consider whether there should be a requirement that at least one director of an Eswatini company reside in the country. While this requirement is similar to the current test to determine if a company is "local" or not, that test is dependent upon "citizenship" and not "residency." If all directors are citizens but living abroad then there would be no person present in Eswatini to hold to account for corporate malfeasance.

6.3 Shadow directors

A "shadow director" is a person who exercises the powers of a director over a company but who is not officially named as a director in the company registry. This management structure can allow bad actors to hide their involvement in the management of a company, which causes AML issues. It can also allow foreign citizens to exercise control over a local company, without the foreign control being apparent. It is suggested that language be included in the new Act which would bring transparency to this arrangement. The actual text can be quite straightforward:

a. The term “shadow director” means a natural person or persons in accordance with whose directions or instructions a director is required or is accustomed to act.

b. A shadow director is liable under this Act to the same extent as a director.

c. A company incorporated under this Act shall maintain information related to any nominee director and make that information accessible to the Registrar upon request free of charge and without the need for a court order.

6.4 Bearer shares

A “bearer share” is an equity security that is owned by the person that physically possesses the actual share certificate—thus the name “bearer” share. The company that issues the bearer share does not keep track of the owner of the share, and it is not reported to any government registry. The company is usually obligated to pay dividends to the holder of a bearer share when a physical coupon from the share is presented to the company. Because the share is not registered anywhere it is easily used for money laundering purposes.

Usually, bearer shares are used in companies created in “offshore” or tax haven registries and are not used in regular domestic companies. However, it makes sense to include a one-line provision in a new Companies Act simply stating that bearer shares are a nullity. This will be viewed favourably in Eswatini’s next Mutual Evaluation Report.

7.0 Transition from current to new requirements: re-registration

The information currently maintained by the Office of the Registrar for each company will be out-of-sync with the new Companies Act requirements.[9] Additionally, there is no electronic database within the Ministry that can serve as a comprehensive source for the type of information that will be maintained in the new registry. Thus, the issue is how to migrate companies into the new electronic register.

To address this situation, the Ministry is strongly considering that all companies be required to re-register as a company under the new Act.[10] All those companies that did not re-register would be removed from the register, just as if they did not file an annual return. This will allow Eswatini to catch up on any outstanding compliance that has been delayed in the past.

[9] Many data points will be the same, but the filing forms to be promulgated under the new law will be different. The filing forms have not yet been created pending adoption of the new legislation. The sample Application for Incorporation presents only a preliminary draft of the data fields that may be required.

[10] New Zealand passed a separate Companies Reregistration Act 1993 to address various issues presented by this approach. Other jurisdictions near New Zealand have also undertaken this process including Cook Islands, Samoa, Solomon Islands, and Tonga. Papua New Guinea also has a Bill before Parliament to require re-registration as part of a significant registry upgrade project.

The re-registration form will contain the same data elements that would be required for a new company formed under the new law. In this way, all existing companies will provide information into the registry that is up to date. This process also has the positive effect of clearing the registry of companies that are no longer active, as the failure to re-register within the grace period (usually one year) results in the company being struck off.

There is one significant additional practical justification for re-registration: it significantly reduces the need for the government to undertake laborious data migration work and digitization of old records. This work is both time-consuming and expensive. Instead, after re-registration, each company will simply start afresh under the new law. If historical information is ever needed about a particular company, it can always be retrieved via the paper records, but with time the need to reference these old records diminishes.

If re-registration is put in place, then the actual re-registration process will commence when the new registry is activated. Thus, the re-registration provisions will require the new Act to have a delayed commencement date until a new registry is deployed.

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