THIRD
PUBLIC
CONSULTATION
PAPER

3. COMPANY LAW AND ONLINE REGISTRY REFORM: MAINTAINING A COMPANY IN GOOD STANDING

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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 third 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 implementing an electronic, online company registry. The first consultation paper provided a roadmap on how the reform would progress and the second paper focused on issues around the initial incorporation of a company. This third paper deals with issues regarding how to maintain a company in good standing during its lifetime. The paper will look at the following issues:

1. What duties should be imposed upon directors?
    a. Is some behaviour so bad that it should be criminalized?
    b. Is the current approach to banning certain persons from being directors adequate?
2. Should the Act contain a more modern formulation of a “solvency test” under which corporate actions would be assessed?
3. What protections should be put in place for members, especially minority members?
4. What obligations should there be to update the Registrar when changes occur to the company, such as changes in directors or relevant addresses?
5. What is the best way to leverage the technology of a completely electronic registry to ensure compliance with the requirement to file annual returns?

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

1.0 Company directors

1.1 Director duties

In all countries there is a generalised duty imposed on company directors to act in good faith and in the best interests of the company. The current Companies Act contains language that includes these concepts, but seems to limit claims against directors to the context of a liquidation or winding up. This could disadvantage shareholders attempting to hold directors accountable for actions that, although they do not cause a company to enter liquidation, nonetheless either cause harm to the company or unjustly enrich a director.

The more modern trend is to directly spell out the various duties that a director owes to the company and make actionable any breaches at the time they occur. For example, New Zealand has more directly spelled out various duties of directors in a straightforward manner. Sections 131-138A of the New Zealand Companies Act lists the following specific statutory duties:

1. a duty to act in good faith and in the best interests of the company;

2. a duty for directors to comply with the Act and the company's internal rules;
3. a prohibition on reckless trading, defined as "carrying on business in a manner likely to create a substantial risk of serious loss to the company's creditors";[1]
4. a similar prohibition against allowing the company to take on obligations unless the director "believes at the time on reasonable grounds that the company will be able to perform the obligation";
5. a prohibition against directors taking part in any transaction in which the director has self-interest without disclosing the interest to the other directors;
6. a protection for directors, by specifically allowing them to rely on reports from outside experts when making decisions; and
7. a definition of "duty of care" as the care, diligence, and skill that a reasonable director would exercise in the same circumstances considering, but without limitation —
    a. the nature of the company; and
    b. the nature of the decision; and
    c. the position of the director and the nature of the responsibilities undertaken by him or her.

Chapter 8 of the Eswatini Companies Act contains provisions which govern director behaviour [2] and, philosophically, is not that different from the modern standards set out above. However, the Act does not set out the duties above in as straightforward or clear a manner as in modern legislation, and sometimes lacks the nuance that is found in current laws. For example:

- sections 360 and 361 indicate that a director can be accountable for "a breach of faith or trust" or for reckless trading, but seem limited to the context of winding up a company; and
- sections 207–208 deal with director self-interest. These sections properly seek to prohibit directors from causing a company to enter into transactions in which they have a "material interest in a material contract or a potential material contract being considered by the company." However, the prohibition only covers the director himself/herself, it does not extend to family members such as a parent, child, spouse, or sibling who would derive a financial benefit from the transaction.

1 Section 362 of the current Companies Act addresses "wrongful" trading. However, the section reads as if it only allows for a cause of action in the context of a liquidation proceeding.

2 Section 213 also touches on these issues. There are other provisions which impose specific administrative duties on directors as well, such as section 247 which requires directors to prepare annual financial statements.

Section 228 of the Act confers a right on shareholders to bring an action against directors "where a company has suffered damages or loss or has been deprived of any benefit as a result of any wrong, breach of trust or breach of faith committed by any director or officer of that company…". This is an appropriate remedy. The Ministry believes Eswatini could benefit from enhancing the current language governing director duties by setting out with specificity the types of actions that can give rise to a shareholder suit.

1.2 Director liabilities: offences

Some countries, following numerous financial scandals involving egregious director behaviour towards their own company, have criminalized the worst of these financial transgressions. An example of this can be seen in a 2014 Amendment to the New Zealand Companies Act, which established a criminal offence where a director exercises powers or performs duties in bad faith towards the company, knows that the conduct is not in the best interests of the company, and knows that the conduct will cause serious loss to the company. The text provides:[3]

1. A director of a company commits an offence if the director exercises powers or performs duties as a director of the company—
    a. in bad faith towards the company and believing that the conduct is not in the best interests of the company; and
    b. knowing that the conduct will cause serious loss to the company.
2. However, a director does not commit an offence under subsection (1) if the power or duty in question is exercised or performed under any of section 131(2) to (4) or is a power exercised under section 132.
3. A person who commits an offence under this section is liable on conviction to the penalties set out in section 373(4).

Similarly, the New Zealand 2014 Amendment also makes it a criminal offence for a director to dishonestly fail to prevent the company from incurring a debt when the director knows that the company is insolvent or will become insolvent by incurring the debt. The new text provides:[4]

> Every director of a company commits an offence and is liable on conviction to the penalties set out in section 373(4) if—
>
> 1. the company incurs a debt (the debt); and
> 2. the company—

3 This text is to be added as new section 138A to the New Zealand Companies Act.

4 This language amends section 380 of the New Zealand Companies Act.

a. is insolvent at the time that it incurs the debt; or

b. becomes insolvent by incurring the debt; or

c. is insolvent at the time that it incurs debts that include the debt; or

d. becomes insolvent by incurring debts that include the debt; and

3. the director knows, at the time when the company incurs the debt, that the company is insolvent or will become insolvent as a result of incurring the debt or other debts that include the debt; and

4. the director's failure to prevent the company incurring the debt is dishonest.

There are provisions in the current Eswatini Act that call for the application of criminal liability in certain situations. Sections 360-364 follow the traditional approach where a director (or officer) can be held criminally liable for acts that disadvantage a company, but these sections appear to be limited to only cases where a winding up order has been granted.[5] As such, they are not as expansive as the approach outlined above. The Eswatini provisions are also drafted in an unusual manner and thus do not contain the direct, clear application of criminal liability for bad acts as seen in modern language.

The Ministry seeks input on whether it is appropriate to extend potential criminal liability to directors that engage in serious bad acts such as those outlined above.

1.3 "Wrongful trading" vs solvency test

One aspect of possible director liability deserves special discussion. Section 362 of the current Act makes it possible for a director to incur personal financial liability if that director engaged in wrongful trading. However, subsection 362(2) states:

(2) This subsection applies in relation to a person if—

a. the company has gone into insolvent liquidation;

b. at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and

5 The full text of section 364 provides: "If any person who is or was a director or officer of a company in respect of which a winding up order has been granted, whether or not such order has been discharged or confirmed under this Act, and which is or was unable to pay its debts, has committed any act or made any omission in relation to any assets, books records, documents, business or the affairs of such company, which act or omission, if such act has been committed or such omission had been made by a person whose estate was sequestrated on the date upon which the winding-up of such company commenced, in relation to his assets, books documents business or affairs, or those of his estate, would have constituted an offence under the law relating to insolvency, such past or present director or officer shall be guilty of such offence and liable on conviction to the penalties provided by law insolvency, and all the provisions of the law of insolvency shall, mutatis mutandis, apply in respect of such act or omission, the method of establishing it, and such past or present director, officer charged with it."

c. that person was a director of the company at that time.

Other countries take a slightly different approach, with the standard being whether, after a given corporate transaction, the company can pass a "solvency test." For example, New Zealand has adopted a very detailed provision pertaining to whether a company satisfies what is called "the solvency test." It provides, in pertinent part:[6]

1. For the purposes of this Act, a company satisfies the solvency test if—
    a. the company is able to pay its debts as they become due in the normal course of business; and
    b. the value of the company's assets is greater than the value of its liabilities, <u>including contingent liabilities</u>. [Emphasis added.]

This test requires directors to contemplate contingent liabilities when assessing the financial standing of the company.[7]

A properly crafted solvency test provides further guidance on how to determine whether a company is solvent:

2. …[i]n determining for the purposes of this Act…whether the value of a company's assets is greater than the value of its liabilities, including contingent liabilities, the directors—
    a. must have regard to—
        i. the most recent financial statements of the company that are prepared under this Act or any other enactment (if any); and
        ii. the accounting records of the company; and
        iii. all other circumstances that the directors know or ought to know affect, or may affect, the value of the company's assets and the value of the company's liabilities, including its contingent liabilities:
    b. may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances.

The Ministry believes there may be value in implementing a more robust solvency test for Eswatini, under

6 New Zealand Companies Act, section 4.

7 There is also guidance on how to assess contingent liabilities:
In determining, for the purposes of this section, the value of a contingent liability, account may be taken of—
(a) the likelihood of the contingency occurring; and
(b) any claim the company is entitled to make and can reasonably expect to be met to reduce or extinguish the contingent liability.

which director actions would be judged, and seeks input on this question.

2.0 Member protections

All Companies Acts provide some level of protection for members (shareholders). Eswatini is no exception. Section 214 of the current Act is the primary provision which provides protections for members. This section allows a member to bring a court action where the member alleges that an act or omission of the "company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable to him" or the other members.

Modern companies law affords more specific protections to members than older laws. Although some of these protections are afforded by the common law, it is better practice to expressly set them out in law. For example, there are typically provisions that:

- require the buy-out of minority members in certain circumstances so that these persons are not unfairly treated by the majority members;[8]
- give all members (of the same class) equal rights to dividends;
- confer pre-emptive rights on all members (of the same class);
- disallow adverse corporate actions against a class of shares unless that class has voted in favour of the action;
- allow for resolutions at the general meeting that are binding on management if the constitution allows for such;
- authorize members to speak at the annual general meeting;
- provide a means for members to make specific inquiries of management for information about the company and to obtain relevant documents[9];
- sometimes require "large" companies to prepare a more complete annual report with financial data and make it available it to members. This is the case in Eswatini. The current Act contains provisions that speak to this in Sections 247-248. Financial reports are to be provided 21 days prior to the annual general meeting under 263. A nice reform would be to allow members to opt to receive financial reports via email, or for large companies to allow publication to a company website, thereby allowing the company to save significant funds in the printing and mailing of these reports.

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8 Section 268 provides that a minority can be compelled to sell their shares in the context of a takeover. This is appropriate. However, the opposite should also be available to members: those that dissent to a takeover should be allowed to force the purchase of their shares.

9 To protect companies from harassment by minority shareholders, the language should provide the opportunity for the company to resist "frivolous" inquiries. A court would sort out any disputes and the loser would pay the costs of the winning side.

The Ministry seeks input on whether the Companies Act should contain the additional member protections outlined above.

3.0 Ongoing maintenance of a company

Proper policy dictates that once a company has been formed, the ongoing obligations that it must satisfy should be easy-to-understand and not overly burdensome. However, there should be a balance between ease of compliance and proper oversight. Fortunately, modern electronic, online registries offer significant advantages both to companies to stay in compliance with reporting requirements and to Registrar Offices to enforce compliance.

3.1 Compliance: annual returns

To maximize the use of technology solutions, in those countries that have implemented online registries there is a trend to streamline the entire annual return process. For companies, annual filings are easy to submit. The system should present the information currently held in the registry about the company, and if any changes are needed then the company is automatically directed to the proper online form to make the change.[10] This approach ensures that at least once a year information is provided to the registry so that information stays current.

From the registry perspective, most reformed laws make it easier for the Registrar to de-register a company for failing to file the return. Usually, the grace period is set at only a few months. Additionally, the need to publish de-listing for failure to file an annual return in a national gazette is eliminated. This publication requirement is costly to the registry office, often ends up being a hindrance to any compliance, and can result in numerous defunct companies showing as active and registered.

The annual return compliance regime is set out in section 62 of current law. Under 62(3), compliance can only begin if a company fails to file an annual return for 2 years. The Registrar must send a physical letter by registered post to the company and publish a notice of intent to delist in the gazette. No actual enforcement can be taken until 2 months after the notice by post.

In a world where information is readily available in an online registry, the value of publication in a national gazette is greatly diminished. All notices from the Registrar can be sent to email accounts associated with the company (all directors, lawyers, etc.). In addition, modern registry systems can include a “watch list” feature that allows interested persons to receive email alerts when any item is filed against a company or else a company undergoes a status change. This allows creditors, for example, to easily keep up with their borrowers’ actions.

10 For example, if a director had resigned 2 months earlier but this had not been reported to the registry, then the filer would be pushed to the “change of director” form to enter the updated information.

When de-registration is made easier, compliance is greatly enhanced and the information provided in the online registry is far more accurate. It is poor practice to allow for a grace period of 2 years or more as the net effect is potentially having outdated data in the registry. To make the overall regime far more accurate, the modern approach is to make it much easier for a company to be restored to the register after de-registration. All a company need do is simply file the back-due returns together with paying the fees and late penalties. This is far easier than Section 62(6) of the current law, which requires a company to seek a court order for reinstatement.

Under this streamlined regime, enforcement becomes self-regulating. If a company seeks a loan or desires to take some other corporate action while deregistered it will find that its inability to gain a current certificate of good standing prevents the corporate action from being taken. It will have to reinstate in order to proceed. The modern approach also makes it much easier for the Registrar to administer the process and requires less staff time to manage strike-offs.

The Ministry believes a streamlined enforcement regime that is easily administered is the proper approach for Eswatini and seeks comment on this.

3.2 Compliance: updating the registry

Companies should be required to update all information that is held in the registry whenever a change is made. This would be in keeping with current law regarding changes to directors (section 196) and changes in the registered office (section 149). The failure to update the registry within a short time after an event should give rise to a late filing fee/penalty.

As noted above, if a company fails to update the registry it will be discovered when it is time to file the annual return, as there will be a mismatch between what the registry shows and reality. In this case, the company would be directed to the relevant service (such as a change of director filing) to file the proper form that collects the applicable data. It also allows the late filing penalty to be applied. Otherwise, companies would have no incentive to keep changes updated if they could simply fix up any discrepancies for free during the filing of the annual return.

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