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Dhana, N.

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University of the Witwatersrand, Johannesburg
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THE ROLE OF BENEFICIAL OWNERSHIP REPORTING OBLIGATIONS AND THE RECKLESS TRADING PROVISION TO PREVENT FRONT COMPANIES IN TERMS OF THE SOUTH AFRICAN COMPANIES ACT 71 OF 2008

by

389554

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ABSTRACT

The corporate form has the potential to be abused by natural persons. A front company is an example of such abuse. A front company is an incorporated company that is used as a vehicle to conduct illegal activities. The natural persons controlling the company and that benefit from proceeds derived from the illicit conduct hide behind the company's separate legal personality to escape civil and criminal liability. Reports indicate that billions of rands are obtained through illegal activities perpetrated against the corporate form. This means that natural persons can successfully misuse the corporate form as a front. For this reason, it is imperative that a legal framework is in place to circumvent the formation and operation of front companies. This type of abuse is a company law issue and ought to be regulated by the Companies Act of 71 of 2008 ("Companies Act"). This research report demonstrates, however, that the Companies Act does not sufficiently guard against the formation and operation of front companies. The Companies Act must therefore be strengthened, by way of legislative amendment, to enhance corporate transparency and accountability. Four main areas in the Companies Act have been identified for possible legislative amendment. The anchoring argument that must be borne in mind with regards to any legislative amendment is that natural persons exert control over the corporate form and ultimately benefit from the company's activities. Further, comparative foreign law and domestic law will be used as a guide for the approach the legislature must adopt when amending the Companies Act. The first area of amendment is to expand the definition of beneficial interest to fully recognise beneficial ownership. The second area of amendment is to impose an obligation on natural persons to disclose their beneficial ownership in a company. The third area of amendment is to broaden the ambit of the reckless trading provision to apply to beneficial ownership. Lastly, the powers of the Companies and Intellectual Property Commission ("Commission"), the regulatory body of the Companies Act, must be enhanced to empower the Commission to institute legal proceedings against natural persons to cease abusing the corporate form as a front.

TABLE OF CONTENTS

1 CHAPTER 1: INTRODUCTION: ANCHORING ARGUMENT AND CASE 5
1.1 INTRODUCTION 5
1.2 THE SPECIAL INVESTIGATING UNIT AND ANOTHER V NDLOVU AND OTHERS: AN EXAMPLE OF FRONT COMPANIES AND A CALL FOR TRANSPARENCY OF BENEFICIAL OWNERSHIP 8
2 CHAPTER 2 BENEFICIAL OWNERSHIP 11
2.1 THE NEED AND PURPOSE TO RECOGNISE THE ANCHORING ARGUMENT 11
2.2 THE DEFINITION OF BENEFICIAL INTEREST IN TERMS OF THE COMPANIES ACT 12
2.3 GUIDELINES FROM THE UNITED STATES OF AMERICA AND KENYA 14
2.4 DISCUSSION 16
3 CHAPTER 3: BENEFICIAL OWNERSHIP REPORTING OBLIGATIONS 17
3.1 THE IMPORTANCE AND AIM OF REPORTING BENEFICIAL OWNERSHIP 17
3.2 REPORTING OBLIGATIONS UNDER THE COMPANIES ACT 17
3.3 REPORTING OBLIGATIONS IMPOSED BY THE LAWS OF THE UNITED STATES OF AMERICA AND THE RECOMMNEDATION BY THE FATF 19
3.4 DISCUSSION 21
4 CHAPTER 4 CORPORATE REMEDIES 22
4.1 THE NEED FOR CORPROATE REMEDIES TO ASSIST IN PREVENTING THE OPERATION OF FRONT COMPANIES 22
4.2 THE CORPORATE REMEDIES UNDER THE COMPANIES ACT 22
4.2.1 RECKLESS TRADING PROVISION 23
4.3 DISCUSSION 24
5 CHAPTER 5: THE POWERS OF THE COMMISION TO STOP THE OPERATION OF FRONT COMPANIES 25
5.1 THE IMPORTANCE OF A WELL EMPOWERED REGULATORY BODY TO ENFORCE THE PROVISIONS OF A STATUTE 25
5.2 THE POWERS AND DUTIES OF THE COMMISSION 26
5.3 ENHANCED POWERS OF ANTICORRUPTION AGENCIES AND FOREIGN COMPANY REGULATORY BODIES 28
5.3.1 THE SPECIAL INVESTIGATING UNIT 28
5.3.2 THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION 29
5.4 DISCUSSION 30
6 CHAPTER 6: PROPOSED REFORM TO THE COMPANIES ACT 32
6.1 PROPOSED AMENDMENT TO THE DEFINTION OF BENENEFICIAL INTEREST 32
6.2 PROPOSED AMENDMENT TO INTRODUCE A REPORTING OBLIGATION ON BENEFICIAL OWNERS 33

6.3 PROPOSED AMENDMENT TO INCLUDE A DUTY ON THE COMPANY TO PERFORM A DUE DILIGENCE AND REPORT THE BENEFICIAL OWNERSHIP OF THE COMPANY TO THE COMMISSION 33
6.4 PROPOSED AMENDMENT TO THE RECKLESS TRADING PROVISION 34
6.5 PROPOSED AMENDMENT TO THE POWERS OF THE COMMISSION 35
7 CHAPTER 7: CONCLUSION 37
8 BIBLIOGRAPHY 38

1 CHAPTER 1: INTRODUCTION: ANCHORING ARGUMENT AND CASE

1.1 INTRODUCTION

The juristic personality of a company renders it an attractive corporate vehicle to conduct business activities, while protecting the shareholders and directors from personal liability of the company's debts.[1] The principle of separate legal personality and limited liability are the foundational principles of company law, which have the potential for abuse by natural persons.[2] An example of such abuse of these principles is a front company.[3]

A front company is an incorporated company that creates the impression of lawful business activities, but, behind this façade the company is committing illegal activities.[4] The disguise of the company also conceals the unlawful proceeds derived from the illegal activities and the natural persons benefiting therefrom.[5] Aside from the concealment, the abuse of the separate legal personality by natural persons is to escape civil and criminal liability for their actions.[6]

A front company can commit various types of illegal activities ranging from tax evasion, money laundering, counterfeiting, piracy, illegal gambling, and drug trafficking to financial fraud.[7] Various methods such as complex company structures and simulated transactions are employed to conceal and move unlawful proceeds.[8] Simulated transactions are the most commonly used instrument to move unlawful proceeds.[9] A simulated transaction is a transaction that disguises the true nature of the agreement and holds no commercial rationale.[10] To determine if an agreement is a simulated transaction, an

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[1] *Salomon v Salomon and Co Ltd* [1897] AC 22 (HL) at 50.
[2] *ADT Security (Pty) Ltd v Botha and Others* [2010] ZAWCHC 563 at 16.
[3] *Die Dros (Pty) Ltd v Telefon Beverages CC* 2003 (4) SA 207 (C) at 215.
[4] Financial Action Task Force 'Concealment of Beneficial Ownership' at 11, available at *www.fatf-gafi.org/publications/methodandtrends/documents/concealment-beneficial-ownership.html*, accessed on 14 October 2022.
[5] Ibid at 16.
[6] Ibid at 20.
[7] J Rocha-Salazar, M Segovia-Vargas, M Camacho-Miñano 'Detection of shell companies in financial institutions using dynamic social network, Expert Systems with Applications' (2022) 207 *Expert Systems with Application* 1 at 2.
[8] Financial Action Task Force 'Guidance on Transparency and Beneficial Ownership' at 7, available at *https://www.fatf-gafi.org/media/fatf/documents/reports/guidance-transparency-beneficial-ownership.pdf*, accessed on 14 October 2022.
[9] Supra note 4 at 42 – 43.
[10] *Commissioner for the South African Revenue Service v NWK Ltd* 2011 (2) SA 67 (SCA) at 55.

interrogation of the substance of the agreement over its form is employed to determine the true nature of the agreement and the parties' true intention.[11] No weight is placed on the performance of an obligation of the agreement since it can be part of the "charade" of the transaction.[12] The most common types of transactions that are used as a simulated transactions are loan agreements, lease agreements, investing moneys and issuing invoices for goods or services.[13]

Front companies are not only a domestic issue but also a foreign one as illicit proceeds can move from domestic companies to foreign companies and vice versa.[14] A report by the Organisation for Economic Co-operation and Development and the National Treasury of South Africa found that between US$ 3.5 to 5 billion of illicit proceeds leave South Africa annually.[15] This means that natural persons are can misuse the corporate form successfully. The increasing number of companies registered per annum is another crucial factor for consideration, rendering the corporate form more suspectable to abuse, if not regulated. In South Africa there has been a sharp increase in the number of companies incorporated over the past few years.[16] The Companies and Intellectual Property Commission ("Commission") reported in 2020 that over 510 000 companies were incorporated under the Companies Act of 71 of 2008 ("Companies Act"), a 32 per cent increase from the previous year.[17] However, how many of these companies could be front companies is unknown.

Nevertheless, the prevalence of front companies deems a proper legislative framework necessary to prevent this form of abuse. This research report demonstrates that the Companies Act does not provide an adequate statutory mechanism necessary to uphold corporate transparency and accountability and

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[11] *Zandberg v Van Zyl* 1910 AD 302 at 309, *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A) at 611, *Michau v Maize Board* 2003 (6) SA 459 (SCA) at 467 and *Sasol Oil v CSARS* (923/2017) [2018] ZASCA 153 at 36.
[12] Supra note 10.
[13] Supra note 4 at 25.
[14] The World Bank 'Illicit Financial Flows: A Global Challenge Underestimated' available at *https://www.worldbank.org/en/news/feature/2014/10/13/illicit-financial-flows-a-global-challenge-underestimated*, accessed on 14 October 2022.
[15] Organisation for Economic Co-operation and Development and the National Treasury of South Africa 'Assessing Tax Compliance and Illicit Financial Flows in South Africa' at 1, available at *https://www.oecd-ilibrary.org/sites/e8c9ff5b-en/index.html?itemId=/content/publication/e8c9ff5b-en*, accessed on 26 September 2022.
[16] C Ryan 'Record number of new company registrations in 2020 is a distress signal' available at *https://www.moneyweb.co.za/news/south-africa/record-number-of-new-company-registrations-in-2020-is-a-distress-signall*, accessed on 10 October 2022.
[17] Ibid.

deter front companies. Furthermore, the scope and object of this research report is aimed at making recommendations to the legislature to strengthen the Companies Act against front companies.

Four main areas have been identified for legislative amendment. These areas are premised on the anchoring argument, as advanced by the Financial Action Task Force ("FATF"), an intergovernmental organisation aimed at combating money laundering, that natural persons exert control over the corporate form and benefit from the proceeds of the company's activities.[18] This argument and its respective principles will be supported by the case *Special Investigating Unit and Another v Ndlovu and Others*.[19] The four main areas are set out below.

First, the importance of introducing an appropriate definition of beneficial ownership in the Companies Act is explained. In this regard, it is suggested that the definition of beneficial interest in the Companies Act must recognise the anchoring argument. Reference to comparable jurisdictions such as the United States of America and Kenya is made.

Secondly, this research report shows that the Companies Act's real weakness is that no obligation exists on natural persons to disclose their beneficial ownership, which contains a serious flaw that calls for legislative amendment.

Thirdly, this research report shows that no real legal remedy is provided for in the Companies Act to stop the operation of a front company. The focus is on the reckless trading provision and its susceptibility to being circumvented by the controlling mind of the front company, which is a natural person.

Fourthly and equally important, a regulatory body should be empowered to enforce the provisions of the Companies Act and prevent the operation of front companies. Recommendations are made on how the Commission's powers can be enhanced for this purpose with reference to the powers of anti-corruption agencies such as the Special Investigating Unit. Further, the Australian Securities and Investment Commission's power, a regulator body overseeing companies

[18] Supra note 4 at 16.
[19] (GP 19/2021) [2022] ZAST 12 (7 June 2022).

incorporated in Australia, to approach a court of law for various types of relief are also considered.

1.2 THE SPECIAL INVESTIGATING UNIT AND ANOTHER V NDLOVU AND OTHERS: AN EXAMPLE OF FRONT COMPANIES AND A CALL FOR TRANSPARENCY OF BENEFICIAL OWNERSHIP

The matter of the *Special Investigating Unit and Another v Ndlovu and Others* ("*Special Investigating Unit v Ndlovu"*) illustrates how front companies operate and the methods that can be used by natural persons to conceal the illegal activities of the company and those that benefit from the illicit conduct.[20]

In this matter, the National Health Laboratory Service embarked on a large-scale emergency procurement of personal protective equipment ("PPE") in response to the COVID-19 pandemic.[21] Officials of the National Health Laboratory Service were approached by an unknown person marketing the companies Hamiltonn Holdings (Pty) Ltd, Mok Pus One (Pty) Ltd ("Mok Plus One"), Abompetha (Pty) Ltd ("Abompetha), Feliham (Pty) Ltd ("Feliham"), Joritans Logistics (Pty) Ltd ("Joritans"), Persto (Pty) Ltd ("Persto"), Kgodumo Mokone Trading Enterprise (Pty) Ltd ("Kgodumo") and Bugatti Security Services and Projects (Pty) Ltd ("Bugatti") (collectively referred to as the "Front Companies") as suppliers of PPE.[22] Pursuant to this, the National Health Laboratory Service concluded agreements with the Front Companies for the supply of PPE in the amount of R172 742 175.00.[23]

A Twitter post by Hamilton Ndlovu displaying seven newly purchased luxury cars caught the eye of the Special Investigating Unit and an investigation began into the source of Hamilton Ndlovu's funds.[24] The investigation revealed five important findings. First, the Front Companies did not operate or have experience in the PPE industry.[25] Secondly, Hamilton Ndlovu was not a director or shareholder of

[20] (GP 19/2021) [2022] ZAST 12 (7 June 2022).
[21] *Special Investigating Unit v Ndlovu* ibid para 11.
[22] *Special Investigating Unit v Ndlovu* ibid para 12.
[23] *Special Investigating Unit v Ndlovu* ibid para 12.
[24] *Special Investigating Unit v Ndlovu* ibid para 30.
[25] *Special Investigating Unit v Ndlovu* ibid.

Abompetha, Feliham, Joritans, Persto, Kgodumo and Bugatti at the time the transactions were concluded.[26] Thirdly, Hamilton Ndlovu was the controlling mind of the Front Companies when the agreements were concluded and he concealed this information from the National Health Laboratory Service.[27] Fourthly, the delivery notes submitted by the Front Companies were inaccurate and incomprehensible.[28] Hamilton Ndlovu's bank account statements revealed that he only purchased R13 891 253.87 worth of PPE to supply the National Health Laboratory Service.[29] As such, it could not be ascertained if the Front Companies did indeed deliver the full quantity of PPE to the National Health Laboratory Service.[30] Fifthly, 90 per cent of the money paid into the Front Companies' bank accounts were transferred to Hamilton Ndlovu's personal bank account through various companies.[31] Hamilton Ndlovu spent the money on assets and luxuries such as houses valued at R 38 million, décor purchased at R 5.8 million, investments worth R 40 million and cars worth R 18 million. [32]

The Special Investigating Unit and the National Health Laboratory Service instituted legal proceedings before the Special Tribunal to set aside the agreements on the basis that Hamilton Ndlovu exploited the emergency procurement process of the National Health Laboratory Service and failed to deliver the full quantity of PPE.[33] The Special Tribunal found that Hamilton Ndlovu used the Front Companies as a front.[34] The directors of Bugatti, Mok Plus One, Persto and Kgodumo did not approach the National Health Laboratory Service to supply PPE and were unaware of the transactions concluded with the National Health Laboratory Service.[35] Further, the Special Tribunal found that Hamilton Ndlovu could not prove that the PPE was delivered in full as per the delivery notes submitted to the National Health Laboratory Service.[36] An inference of corruption was attributed to Hamilton Ndlovu and the manner in which he spent the moneys

[26] *Special Investigating Unit v Ndlovu* ibid.
[27] *Special Investigating Unit v Ndlovu* ibid para 31.
[28] *Special Investigating Unit v Ndlovu* ibid para 36.
[29] *Special Investigating Unit v Ndlovu* ibid para 38
[30] *Special Investigating Unit v Ndlovu* ibid.
[31] *Special Investigating Unit v Ndlovu* ibid para 35.
[32] *Special Investigating Unit v Ndlovu* ibid.
[33] *Special Investigating Unit v Ndlovu* ibid para 19.
[34] *Special Investigating Unit v Ndlovu* ibid para 55.
[35] *Special Investigating Unit v Ndlovu* ibid para 30.
[36] *Special Investigating Unit v Ndlovu* ibid para 38.

was consistent with such corruption.[37] The Special Tribunal consequently set aside the agreements concluded between the Front Companies and the National Health Laboratory Service.[38]

Special Investigating Unit v Ndlovu confirms the anchoring argument that natural persons exert control over the corporate form and ultimately benefit from the activities of a company.[39] This is seen from the control exerted by Hamilton Ndlovu over the Front Companies and the benefit he received from the transactions of the Front Companies. *Special Investigating Unit v Ndlovu* also evinces that the separate legal personality of a company obfuscates the natural persons that control the company, making it difficult to ascertain those responsible for the company's actions.[40] It only came to light that Hamilton Ndlovu was the controlling mind of the Front Companies when the Special Investigating Unit interrogated his personal bank account.

It can be argued that Hamilton Ndlovu would not have used the Front Companies to do business with the National Health Laboratory Service if it was revealed that he was the controlling mind of the Front Companies and the ultimate beneficiary of the transactions concluded with the National Health Laboratory Service.

It is for the above reasons that a mechanism should be in place which reveals the controlling mind of the company and ultimate beneficiary of the company's activities so as to deter the operation of front companies and hold natural persons that abuse the corporate form accountable for their actions.[41]

[37] *Special Investigating Unit v Ndlovu* ibid.
[38] *Special Investigating Unit v Ndlovu* ibid para 40.
[39] Supra note 18.
[40] Supra note 6.
[41] Supra note 8 at 4.

2 CHAPTER 2 BENEFICIAL OWNERSHIP

2.1 THE NEED AND PURPOSE TO RECOGNISE THE ANCHORING ARGUMENT

South African law does not contain a strict definition of legal ownership.[42] However, based on case law, *ownership* can be described as unrestricted and unconditional control over a thing.[43] The owner of the thing can ultimately do with it as they wish including transferring control of the thing to another person, to using and enjoying the thing, alienating the thing, granting limited real rights against the thing and claiming the thing from a third party, as long as it is within the ambit of the law.[44]

The definition of ownership in terms of company law differs from the definition of ownership in terms of case law.[45] Under company law, corporate ownership vests in the shareholders of a company and a shareholder holds a "proprietary interest" in the company.[46] Unlike the case law definition of ownership, corporate ownership does not denote complete control over the company.[47] The shareholders have control in the decision-making of the company and exercise this control at the shareholders meeting acting upon the votes of the shareholders.[48] However, executive control of the company is vested in the board of directors who are responsible for the company's day-to-day management of the company.[49] A distribution of dividends, which is any payment made by the company to a shareholder as a result of the shareholder holding a share in the company, lies with the board of directors as part of the day-day decision management of the company.[50] A right of a shareholder to receive a distribution also exists in terms of a court order or an existing legal obligation of the company

[42] Andries Johannes Van der Walt and Gerrit Pienaar *Introduction to the Law of Property* 6th Ed (2009) at 40.
[43] *Johannesburg Municipal Council v Rand Townships Registrar* 1910 TS 1314 at 1319.
[44] Andries Johannes Van der Walt and Gerrit Pienaar op cit note 42 at 41.
[45] V Julian 'Shareholder Ownership and Primacy' 2010 *University of Illinois Law Review* 897 at 905
[46] *Standard Bank of SA Ltd v Ocean Commodities Inc* 183 (1) SA 276 (A) at 288.
[47] V Julian op cit 45.
[48] Section 57(1) of the Companies Act.
[49] Section 66(1) of the Companies Act.
[50] Section 46(c) of the Companies Act read with section 1 of the Companies Act.

to make payment of a distribution.[51] Apart from these three instances, a shareholder is not entitled to a dividend.

The separation between corporate ownership and corporate control is relevant when discussing front companies as this separation is disregarded when a company is operated as a front.[52] This is seen in *Special Investigating Unit v Ndlovu* were Hamilton Ndlovu was not a director or shareholder of the Front Companies at the time that the transactions were concluded with the National Health Laboratory Service but nevertheless concluded agreements on behalf of the Front Companies, issued fraudulent delivery notes to the National Health Laboratory Service, and received payment in the amount of R172 742 175.00 from the Front Companies. Because natural persons can disregard the separation between corporate ownership and corporate control, the anchoring argument, natural persons exert control over a company and benefit from the company's activities, should be legally recognised by company law.

2.2 THE DEFINITION OF BENEFICIAL INTEREST IN TERMS OF THE COMPANIES ACT

The Companies Act recognises that a person can hold a beneficial interest in securities issued by a company. Securities is defined under the Companies Act as a share, debenture or instrument (irrespective of its form or title) issued by a profit company.[53] A person holds a beneficial interest in securities when that person is entitled to exercise a legal right in relation to the securities either alone or with another person, including a nominee appointed by the owner of the securities.[54] A person can exercise three types of legal rights can be exercised by a person with a beneficial interest in securities. First, the legal right to receive or participate in any distribution of the securities.[55] Secondly, the legal right to exercise or cause to be exercised any right attached to the securities.[56] Thirdly,

[51] Section 46(1)(i) – 46(1)(ii) of the Companies Act.
[52] See *Ebrahim and Another v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 where a member of a close corporation used the close corporation to serve his own interests. Although the case dealt with a close corporation, the same principles apply to companies.
[53] Section 1 of the Companies Act.
[54] Ibid.
[55] Ibid.
[56] Ibid.

the legal right to dispose or direct the disposition of the securities, or any part of a distribution received from the securities.[57] The definition of beneficial interest expressly excludes any interest held by a person in a unit trust of a collective investment scheme in terms of the Collective Investment Schemes Act 45 of 2002.[58]

The definition of beneficial interest recognises a nominee appointed by an owner of securities because the Companies Act permits a nominated person to appear on the company's securities register.[59] The relationship between an owner of securities and a nominee was explained in O*akland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* ("*Oakland Nominees v Gelria Mining*").[60] The then Appellate Division held that a principal-agent relationship exists between the owner of the securities and the nominee.[61] The nominee acts upon the instructions of the principal, 'whose name does not appear on the register'.[62] A nominee essentially carries out the wishes of the owner of the securities.

The Companies Act expressly recognises six types of relationships that constitute a relationship between a nominee and owner of securities for purposes of a public company. The six types of relationships are as follows: a person married in community of property to an owner of the securities, a parent of a child that is the owner of the securities, a person that acts on behalf of an owner of the securities to acquire, dispose of and any other matter relating to the beneficial interest, the holding company of a company that has a beneficial interest in the securities, a person entitled to exercise votes on behalf of the owner at general meetings of a juristic person that has a beneficial interest in that security, and a person that gives directions or instructions to a juristic person that has a beneficial interest in the securities.[63] These relationships simply recognise the different types of relationships that can exist between an owner of securities and a nominee.

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[57] Ibid.
[58] Section 1 of the Companies Act.
[59] Section 56 of the Companies Act.
[60] 1976(1) SA 441 (A).
[61] *Oakland Nominees v Gelria Mining* ibid at 453.
[62] *Oakland Nominees v Gelria Mining* Ibid.
[63] Section 56(1)(a) – (f) of the Companies Act.

The definition of beneficial interest thus recognises persons that exercise a legal right attached to securities issued by company, the receipt of a distribution as a result of holding securities and nominated persons that act on the instructions of the owner of securities. However, the definition of beneficial interest does not recognise that persons who do not hold a beneficial interest in securities can exert control over the company and/or benefit from the company's activities and assets. The effect of the limited definition of beneficial interest is the Companies Act does not recognise natural persons that abuse the corporate form as a front.

2.3 GUIDELINES FROM THE UNITED STATES OF AMERICA AND KENYA

The Senate of the United States recently passed the Corporate Transparency Act of 2019, H.R 2513 ("CTA"). The CTA is aimed at discouraging the misuse of the corporate form to conceal criminal conduct, the illegal proceeds that arise from the criminal conduct, and the natural persons that exert control over the company and benefit from the illegal proceeds.[64] The CTA endorses a concept call beneficial ownership. A natural person is a beneficial owner under the CTA in three instances. First, when a natural person exercises direct or indirect "substantial control" over the company.[65] Secondly, a "natural person owns or controls 25% or more of the company".[66] Thirdly, a natural person receives a substantial benefit from the company.[67] The first and third category employs broad wording to ensure that persons that are not directors and shareholders of a company but nevertheless exert significant control over the company and benefit from the company's activities fall within the ambit of beneficial ownership.

Kenya is another jurisdiction that has introduced the definition of beneficial ownership. The Kenyan Companies Act 17 of 2015 ("Kenyan Companies Act") provides a similar definition of beneficial ownership to that of the CTA, but more simplistic and in line with the anchoring argument confirmed by *Special*

[64] Section 2 of the CTA. The Corporate Transparency Act will come into effect when the Financial Crimes Enforcement Network issues its final ruling.
[65] Section 3(A) of the CTA.
[66] Section 3(A) of the CTA.
[67] Section 3(A) of the CTA.

Investigating Unit v Ndlovu .[68] The Kenyan Companies Act defines beneficial ownership as "a natural person who ultimately owns or controls a legal person or arrangement or a natural person whose behalf a transaction is concluded and includes those persons who exercise ultimate effective control over a legal person or arrangement".[69]

Importantly, the Companies (Beneficial Ownership Information) Regulations 2020 promulgated under the Kenyan Companies Act ("Beneficial Ownership Information Regulations") sets out four instances when a natural person will fall within the definition of beneficial ownership for purposes of control.[70] First, a natural person holds directly or indirectly ten per cent of the issued shares in the company.[71] Secondly, a natural person directly or indirectly exercises ten per cent of the voting rights in the company.[72] Thirdly, a natural person directly or indirectly has the authority to appoint or remove a director of the company.[73] Fourthly, a natural person exerts 'significant influence or control' over the company.[74] 'Significant influence or control' is defined as a person that 'participates in the finances and financial policies of the company without necessarily having full control over them'.[75] The fourth category is broad to ensure, like the CTA, that persons who do not exercise a legal right over the company but nevertheless exert control over the corporate form and/or receive a benefit from the company's activities fall within the ambit of the definition of beneficial ownership.

The CTA and the Kenyan Companies Act both recognise that a natural person who is not a director or shareholder of a company can exert control over the corporate form and/or benefit from the company's activities. The CTA and Kenyan Companies Act recognise different ways that a natural person can exert control over the corporate form such as exercising voting rights, exerting substantive control over the company, and materially influencing the company's activities. The CTA and the Kenyan's Companies Act further recognises that natural

[68] The Kenyan Companies Act of 2015.
[69] Section 3 of the Kenyan Companies Act.
[70] Kenya Gazette Supplement 22 dated 24 February 2022.
[71] Section 3(2)(a) of the Beneficial Ownership Information Regulations.
[72] Section 3(2)(b) of the Beneficial Ownership Information Regulations.
[73] Section 3(2)(c) of the Beneficial Ownership Information Regulations.
[74] Section 3(2)(d) of the Beneficial Ownership Information Regulations.
[75] Sect 2 of the Beneficial Ownership Information Regulations.

persons that do not hold a beneficial interest in securities issued by the company can receive a benefit from the assets of the company and the transactions concluded by the company. Consequently, the definition of beneficial ownership under the CTA and the Kenyan Companies Act recognises that the separation between corporate control and corporate ownership can be disregarded. More importantly, the CTA and Kenyan Companies Act are in line with the anchoring argument presented above.

2.4 DISCUSSION

Special Investigating Unit v Ndlovu demonstrates that the definition of beneficial interest under the Companies Act is not wide enough to recognise that natural persons that are not shareholders and/or directors of a company can exert control over the corporate form and benefit from the proceeds of the company. This means that the perpetrators of front companies are not recognised by the Companies Act. A wide definition of beneficial ownership must respectfully be introduced into the Companies Act to cure this deficiency. Otherwise, perpetrators of a front company will continue to fall outside the ambit of the Companies Act.

3 CHAPTER 3: BENEFICIAL OWNERSHIP REPORTING OBLIGATIONS

3.1 THE IMPORTANCE AND AIM OF REPORTING BENEFICIAL OWNERSHIP

An empirical study of unethical and illegal conduct explained the importance of imposing legal obligations on natural persons to prevent crimes.[76] The study found that people are less likely to commit corporate crimes when clear laws exist.[77] The report argues that laws can affect the decision-making process of natural persons and facilitate the weighing up of the benefits of committing a crime against the consequence of violating the law.[78]

With this in mind, imposing a law that reveals the identity of beneficial owners can prevent the formation of font companies.[79] This is because beneficial owners will be unable to conceal their identity from the public and consequently unable to hide behind the separate legal personality of the company.[80] Furthermore, the concealment of beneficial ownership will be viewed as a violation of the law – a natural preventative measure. A clear and detailed statutory obligation is thus vital.

3.2 REPORTING OBLIGATIONS UNDER THE COMPANIES ACT

The Companies Act imposes various reporting obligations on persons. The first reporting obligation is in terms of section 56(4) of the Companies Act. Section 56(4) places a reporting obligation on a nominee of securities held in a public company to make a twofold disclosure to the public company. The nominee is required to provide the public company with the name of the owner of the securities and each person that holds a beneficial interest in the securities, the class held by each person with a beneficial interest, and the extent of the beneficial interest.[81] The purpose of placing a disclosure obligation on a nominee

[76] N Smith, S Simpson and C Huang 'Why Managers Fail to do the Right Thing: An Empirical Study of Unethical and Illegal Conduct' (2015) 17 *Business Ethics Quarterly* 633.
[77] Ibid at 634.
[78] Ibid.
[79] Supra note 5.
[80] Supra note 8 at 4.
[81] Section 56(3) (a) - (b) of the Companies Act.

is to keep the board of directors of the public company appraised of the owners of the company.[82]

To ensure that the public company's records are accurate and up to date, the nominee must make the disclosure to the public company in writing and within five days after the end of every month when a change in beneficial interest occurs.[83]

The second reporting obligation is placed on a 'regulated company'. This reporting obligation is more onerous than the reporting obligation placed on a public company. A regulated company must keep and maintain a register of disclosures made in terms of section 56(4) of the Companies Act and publish the disclosures in its annual financial statements.[84] Companies that fall within the ambit of what is considered a regulated company is a public company are a state-owned enterprise (unless exempt), and a private company if its memorandum of incorporation states that obligations of a regulated company are imposed on the company or 'the percentage of the issued securities of that company that have been transferred, other than by transfer between or among related or inter-related persons, within the period of 24 months immediately before the date of a particular affected transaction or offer exceeds' 10 percent.[85]

The statutory reporting obligation under the Companies Act is narrow as it places an obligation on only a nominee to make a disclosure to a public company or a private company that falls within the definition of a 'regulated company'. The Companies Act does not place a further obligation on either the nominee or the company to report the disclosure to the Commission, and neither is the information obtained from the nominee placed in a central repository system to be accessed by the public or the Commission. The disclosure simply remains with the public company and regulated company, except when the regulated company discloses the information in its annual financial statements.

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[82] S M Luiz 'The Companies Act 71 of 2008 and the disclosure of and Rights of Access to information about securities' (2014) 26 *SA Mercantile Law Journal* 167 at 176.
[83] Section 56(4)(a) of the Companies Act.
[84] Section 56(7)(a) – (b) of the Companies Act.
[85] Section 118(1)(a) to (c) of the Companies Act.

As the nominee makes the disclosure to the public company, the Companies Act empowers the public company (and any other company incorporated in terms of the Companies Act that wishes to ascertain the beneficial owners of the company) to issue a notice to any person that the company has reason to believe is a nominee of an owner of securities issued by the Company.[86] The notice may require the person to confirm if it is a nominee, provide information on the extent of the beneficial ownership during the three years preceding the notice or disclose the identity of the owner(s) of the beneficial interest.[87] Apart from this notice, the public company does not have any further powers to obtain the name of the owners of the securities held in the company as well as any investigative powers to confirm the veracity of the information provided to it.

In the matter *Special Investigating Unit v Ndlovu*, Hamilton Ndlovu abused the corporate personality of private companies (the Front Companies). The Front Companies do not fall within the ambit of the definition of a regulated company or a public company. Ndlovu hide behind the corporate vehicles' separate legal personalities to conduct illegal activities and benefitted from the illicit conduct. This illustrates that all companies incorporated under the Companies Act, especially those that are dormant, are suspectable to being abused by natural persons as a front.[88] Reporting obligations should thus apply to all companies incorporated under the Companies Act.

3.3 REPORTING OBLIGATIONS IMPOSED BY THE LAWS OF THE UNITED STATES OF AMERICA AND THE RECOMMNEDATION BY THE FATF

The United States of America is a jurisdiction that has implemented mandatory statutory reporting obligations on natural persons to disclose their beneficial ownership. The CTA has identified that the lack of available information about

[86] Section 56(5) of the Companies Act.
[87] Section 56(5)(a) to (c) of the Companies Act.
[88] The Companies Act recognises profit companies, private companies, public companies, personal liability companies, state-owned companies and non-profit companies. See Section 8(2) of the Companies Act.

beneficial ownership has spurred the abuse of the corporate form.[89] The stated purpose of imposing reporting obligations is to curtail such abuse.[90]

The CTA places a reporting obligation on a wide range of corporate vehicles such as corporations, limited liability companies and foreign entities registered to do business within the United States to submit to the Financial Crimes Enforcement Network ("FinCen"), the regulator body of the CTA, a beneficial ownership report.[91] The beneficial ownership report is a form setting out key information about the beneficial owner. The report requires the beneficial owner to disclose his/her full name, date of birth, residential address, government identity number and a government document reflecting a photograph of the beneficial owner.[92] The information that a reporting company will provide to FinCen is sufficient to ensure that beneficial owners are easily identifiable and reachable by FinCen. Importantly, the information received by FinCen is required to be placed in a central repository system for a period of five years to ensure that the information received can be readily accessible.[93]

To safeguard accurate and up to date information about the beneficial owner of a company, the FinCen has issued rules regulating when the beneficial owner and the reporting company must make the disclosure to FinCen ("the Final Rules").[94] The Final Rules require the beneficial ownership report to be submitted to FinCen within 30 calendar days of formation of a company and places an ongoing disclosure obligation that every 30 calendar days when a change in beneficial ownership has taken place to report the change in beneficial ownership to FinCen.[95] When the company has reported incorrect information to FinCen, then the reporting company has 30 calendar days from the date it becomes aware of the incorrect information to provide FinCen with the correct information.[96]

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[89] Section 2(4) of the CTA.
[90] Section 2(9) of the CTA.
[91] Section 3(a)(i) of the CTA.
[92] Section 5333 of the CTA.
[93] Section 5333 of the CTA.
[94] Regulations promulgated under section 6403 of the CTA ("'Final Rule").
[95] Ibid.
[96] Ibid.

Importantly, the FATF recommends that a reporting company adopt a verification process to ensure that the information provided by the beneficial owner to the reporting company is true and correct.[97] A verification step thus guards against natural persons circumventing the disclosure obligation by providing false information to the reporting company. The Isle of Man's Beneficial Ownership Act 3 of 2017 ("the Beneficial Ownership Act") is an example of this approach. The Beneficial Ownership Act places an obligation on the reporting company to take reasonable steps to ensure the information provided by the beneficial owner is accurate and reliable.[98] In doing so, the reporting company must nominate an officer to verify the information supplied by the beneficial owner.[99]

3.4 DISCUSSION

The South Africa economy is divested of money on an annual basis in the form of unlawful proceeds. This is part due to the fact that beneficial ownership is concealed. Thus, beneficial ownership reporting obligations can play a significant role in enhancing corporate transparency and accountability. The net of reporting obligations of beneficial ownership must be cast wider than regulated companies and public companies to include all companies incorporated under the Companies Act, to be effective. This will deter the concealment of beneficial ownership. Such disclosure must be made to the regulatory body, in this instance the Commission, and a repository maintained to allow the Commission to access the information from time to time as necessary. Without a reporting obligation on beneficial owners, natural persons will continue to hide behind the corporate form.

[97] Financial Action Task Force 'Best Practices of Beneficial Ownership Legal Persons', at 5, available at *https://www.fatf-gafi.org/publications/methodsandtrends/documents/best-practices-beneficial-ownership-legal-persons.html*, accessed on 14 October 2022.
[98] Section 9(1) of the Beneficial Ownership Act.
[99] Section 13(1) of the Beneficial Ownership Act.

4 CHAPTER 4 CORPORATE REMEDIES

4.1 THE NEED FOR CORPROATE REMEDIES TO ASSIST IN PREVENTING THE OPERATION OF FRONT COMPANIES

Reporting beneficial ownership will place an obligation on both the beneficial owner and the company to disclose the particulars of the beneficial owner to the Commission. This reporting obligation relies heavily on both the beneficial owner and the reporting company to be honest and transparent with the Commission. This can provide as an opportunity for the beneficial owner and/or the reporting company to misrepresent the beneficial owner's identity to perpetuate the beneficial owner's concealment.[100] This is an inherent limitation of a beneficial ownership reporting obligation.

This means that a statutory disclosure obligation is insufficient to alone prevent the formation and operation of a front company. The Companies Act must, therefore, do more to curtail front companies.

4.2 THE CORPORATE REMEDIES UNDER THE COMPANIES ACT

The Companies Act provides various corporate remedies that are aimed at preventing the misuse of corporate control exercised by directors and shareholders of the company.[101] These corporate remedies include an application to declare a director delinquent or under probation, relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of a company, dissenting shareholder's appraisal rights and the derivative action.[102]

The Companies Act recognises that directors and shareholders can unconscionably abuse the separate legal personality of a company as a "sham".[103] Aggrieved persons can bring an application to pierce the veil of incorporation and hold these shareholders and directors liable for damages

[100] Supra note 97 at 44.
[101] Chapter 6 Part B of the Companies Act and section 20(9) of the Companies Act.
[102] Ibid.
[103] *Knoop NO and Others v Birkenstock Properties (Pty) Ltd and Others* (7095/2008) [2009] ZAFSHC 67 (4 June 2009) at 11.

suffered as a result of their actions.[104] Veil piercing, however, does not stop the abuse of the corporate form. On the other hand, the reckless trading provision provides a remedy to cease a company from carrying on its business or trade in certain circumstances. This research report focusus on this provision.

4.2.1 RECKLESS TRADING PROVISION

Section 22(1) of the Companies Act prohibits a company from "carrying on its business recklessly, with gross negligence, with the intent to defraud any person or for any fraudulent purpose".[105] Phungula argues that the aim of section 22 is to deter a company from trading when it is insolvent.[106] Case law to date supports Phungula's argument as creditors have used section 22(1) as a means to restore their loses from directors that have elected to continue the company's trade when insolvent.[107]

Notwithstanding the aforesaid, the ambit of section 22 is broad enough to recognise that the corporate form can be abused for a fraudulent purpose. In *Metro Minds (Pty) Ltd v Pienaar*, a company was unable to pay its debts but nevertheless concluded an agreement for services.[108] Thereafter, a new company was established to avoid paying the service provider in terms of the agreement.[109] The court held that the directors abused the juristic personality of the contracting company and the newly established company to defraud the service provider.[110] It is submitted that the abuse of the corporate form as a front is to use a company for a fraudulent purpose and falls with the ambit of the reckless trading provision.

To uphold the prohibition of reckless trading, the Commission is empowered to call upon a company by way of notice to show on good cause why the company should continue trading and if reasonable grounds exist that the company is in

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[104] *Ex parte application of Gore NO and Others* 2013 (3) SA 382 (WCC) at 34.
[105] Section 22(1) of the Companies Act.
[106] S Phungula 'Lessons to be learned from reckless and fraudulent trading by a company: Section 424(1) of the Companies Act 61 of 1973 and sections 22 and 77(3)(b) of the Companies Act 71 of 2008' (2016) 28 *South Africa Mercantile Law Journal* 238 at 244
[107] See *Philotex (Pty) Ltd and Others v Snyman and Others; Braitex (Pty) Ltd and Others v Snyman and Others 1998 (2) SA 138* (SCA).
[108] *Metro Minds (Pty) Ltd v Pienaar* 2021 JDR 0123 (GP) at 29.
[109] *Metro Minds (Pty) Ltd v Pienaar* ibid.
[110] *Metro Minds (Pty) Ltd v Pienaar* ibid.

violation of section 22(1).[111] The company is provided with 20 business days to respond to the Commission.[112] If the Commission is not satisfied that the company has shown good cause, then the Commission can issue a compliance notice to the company to cease carrying on business or trading.[113]

The reckless trading provision can play an important role in preventing the operation of front companies. A compliance notice can assist in ensuring that the company immediately stops its fraudulent conduct. However, the reckless trading provision is concerned with the conduct of the company and not the conduct of the natural persons that exert control over the company. This means that the reckless trading provision does not recognise the anchoring argument, natural persons exert control over a company and benefit from the company's activities. This can lead to natural persons ceasing control of the front company to comply with the notice but only to control another company as a front, allowing natural persons to continue their commercial crimes and benefit from the illicit conduct.

4.3 DISCUSSION

The Companies Act provides a remedy that ceases the operation of front companies via the reckless trading provision. This can be used as a safety mechanism should the reporting obligation placed on beneficial owners fail to prevent the operation of front companies. Whilst the reckless trading provision prohibits the corporate form from being abused as a front company, it does not prohibit a natural person form exerting control over another company as a front. Natural persons can easily circumvent the reckless trading provision, particularly when dormant companies are being used as front companies. For this reason, the ambit of the reckless trading provision requires expansion to apply to beneficial owners, ensuring that fraudulent conduct committed by a beneficial owner ceases.

[111] Section 22(2) of the Companies Act.
[112] Section 22(3) of the Companies Act.
[113] Ibid.

5 CHAPTER 5: THE POWERS OF THE COMMISION TO STOP THE OPERATION OF FRONT COMPANIES

5.1 THE IMPORTANCE OF A WELL EMPOWERED REGULATORY BODY TO ENFORCE THE PROVISIONS OF A STATUTE

The law of general application ensures that the rule of law is applied equally and not arbitrary or capriciously.[114] Statutory regulation plays an important role in upholding general application. Regulatory bodies established in terms of a statue are tasked to uphold the provisions of the statute.[115] This is achieved by assigning the regulatory body with rights and duties. Rights and duties will be dependent on the legislative mandate of the regulatory body but may include the right to issue licenses, grant exemptions, conduct inspections and regulate compliance of the provisions of the statute.[116] Regulatory compliance is carried out by employing tools of enforcement such as license revocation, license suspension, issuing compliance notices and issuing warning notices.[117]

Enforcement of the provisions of a statute can be said to be the most important power of a regulatory body since enforcement prevents the violation of the provisions of the statute.[118] Without the exact and appropriate tools of enforcement, provisions of the statute are rendered ineffective.[119]

A regulator body must therefore command the necessary tools to ensure that it can guard against the contravention of a statute and related powers must be expressly stated in the statute.[120] Failing which, any decision taken by the regulatory body not provided for in the statute is suspectable to being reviewed

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[114] M Tenza 'An evaluation of the limitation of the right to strike in terms of the law of general application in South Africa' (2018) 29 *Stellenbosch Law Review* 471 at 480.
[115] Various regulatory bodies' founding legislation state that their purpose is to uphold the provisions of the statute. For example, the Financial Intelligence Center is established to enforce the provisions of the Financial Intelligence Act 38 of 2001 in terms of section 3(2)(C).
[116] See the Film Publication Board established in terms of the Film Publications Act 65 of 1966 and the Gauteng Gambling Board established in terms of the Gauteng Gambling Act 4 of 1995 for examples of rights and duties that statutes can grant a regulatory body.
[117] S Abay 'Designing the Regulatory Roles of Government in Business: The Lessons from Theory, International Practice and Ethiopia's Policy Path' (2009) 23 *Journal of Ethiopian law* 66 at 83.
[118] D Farisani 'The potency of co-ordination of enforcement functions by the new and revamped regulatory authorities under the new Companies Act' 2010 *Acta Juridica* 433 at 434.
[119]Maleka Cassim Rehanna Cassim, Richard Jooste et al *Contemporary Company Law* 2ed (2012) at 26.
[120] *Masethla v President of the Republic of South Africa* 2008 1 BCLR 1 (CC) at 173.

and set aside by a court of law on the ground that the regulator acted *ultra vires*, exceeding its powers during the enforcement process.[121]

5.2 THE POWERS AND DUTIES OF THE COMMISSION

The Commission is a statutory body established in terms of the Companies Act.[122] The Commission is tasked with the objective of incorporating domestic and external companies, educating the public about company and intellectual property laws, encouraging compliance with the provisions of the Companies Act and enforcing the provisions of the Companies Act.[123]

The functions of the Commission is enforcement centric to ensure that the Commission is able to act as a watchdog for the Companies Act.[124] The functions of the Commission includes encouraging the resolution of disputes between the company and shareholder or director, overseeing that persons whom the Companies Act applies are not in violation of the provisions of the Companies Act, considering complaints received by members of the public, initiating complaints over alleged violations of the Companies Act, considering and evaluating complaints, launching investigations into to the veracity of complaints, receiving direction from the Minister of Trade and Industry to investigate alleged contraventions of the Companies Act, issuing and enforcing compliance notices, proposing that the complainant and affected persons meet with the Commission in an effort to resolve a complaint by way of a consent order, referring alleged offences committed in terms of the Companies Act to the National Prosecuting Authority and referring matters to a court of law or Companies Tribunal as permitted in terms of the Companies Act.[125]

The power to issue a compliance notice can be regarded as the Commission's most important power as it gives effect to enforcing the provisions of the Companies Act.[126] A compliance notice can direct the recipient of the notice to

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[121] *Municipal Employees Pension Fund v Natal Joint Municipal Pension Fund and others [2018] 1 BPLR 1 (CC)* at 54.
[122] Section 185(1) of the Companies Act.
[123] Section 186(1)(a) – (e) of the Companies Act.
[124] Maleka Cassim *New Derivative Action under the Companies Act: guidelines for judicial discretion* Juta 2016 at 16.
[125] Section 176(2)(a) to (i) of the Companies Act.
[126] Supra note 118 at 437.

do five things. First, the compliance notice can direct a person to 'cease, correct or reverse any action in contravention of' the Companies Act.[127] Secondly, a compliance notice can direct a person to 'take any action required' by the Companies Act.[128] Thirdly, a compliance notice can direct the retransfer of assets to any person or the payment of the value of an asset to a company or any person.[129] Fourthly, a compliance notice can give effect to the rehabilitation of a person by directing the person perform community service.[130] Fifthly, a compliance notice can direct a person to 'take any other steps reasonably related to the contravention and designed to rectify its effect'.[131] Non-compliance with the notice allows the Commission to either apply to court for an order to impose an administrative fine on the non-complier or refer the matter to the National Prosecuting Authority for prosecution.[132]

The Commission must ensure that its decision to invoke its powers of enforcement must be structured to give effect to the provisions of the Companies Act.[133] During the investigation of a complaint, the Commission has intrusive powers and includes issuing summons to compel a person to produce information, a book, document or object that relates to the investigation.[134] To protect evidence that could potentially be destroyed and collect evidence, the Commission can apply to the high court for a warrant to enter and search any premises if the Commission has reasonable grounds to believe that a contravention has taken place, or a person is in possession of anything in connection with an investigation.[135]

The ambit of the Commission's powers is wide, however, it is not empowered to institute legal proceedings in its own name to ensure compliance with the provisions of the Companies Act, except where an administrative fine is being sought. The only instance when the Commission can institute legal proceedings

[127] Section 171(2)(a) of the Companies Act.
[128] Section 171(2)(b) of the Companies Act.
[129] Section 171(2)(c) of the Companies Act.
[130] Section 171(2)(d) of the Companies Act.
[131] Section 171(2)(e) of the Companies Act.
[132] Section 171(7)(a) – (b) of the Companies Act.
[133] *Singh & others v the Companies and Intellectual Property Commission & others* (822/2018) [2019] ZASCA 69 (30 May 2019) at 25.
[134] Section 176(1)(b) of the Companies Act.
[135] Section 177(1)(a) - (b) of the Companies Act.

before a court of law is when a complainant, with legal standing to apply a remedy provided for in terms of the Companies Act, has consented to the Commission instituting legal proceedings on its behalf.[136] This can severely limit the enforcement of the Companies Act when complainants refuse to provide their consent.

5.3 ENHANCED POWERS OF ANTICORRUPTION AGENCIES AND FOREIGN COMPANY REGULATORY BODIES

When a beneficial owner violates the Companies Act or commits a crime using the corporate form, the powers of the Commission must be wide enough to stop the natural persons from such misuse. The Commission's power to enforce the provisions of the Companies Act must be directly proportional to the tools available to prevent the contravention of the Companies Act. The Commission's strongest enforcement power is to issue a compliance notice, but this can be toothless when any contravention of the Companies Act persists in the face of an imposed administrative fine, or a compliance notice has been circumvented. This is particularly concerning as the reckless trading provision can be rendered nugatory as a result of the aforesaid.

The powers of the anticorruption agency, the Special Investigating Unit can provide guidance for the tools that the Commission needs to prevent front companies as the Special Investigating Unit is mandated to stop commercial crimes committed by juristic and natural persons. A comparison of the powers held by the Australian Securities and Investments Commission ("ASIC"), the regulator body of companies incorporated in Australia, can also provide guidance.

5.3.1 THE SPECIAL INVESTIGATING UNIT

The Special Investigating Unit is a statutory body established in terms of the Special Investigating Units and Special Tribunal Act 74 1996 ("Special Tribunal Act").[137] The Special Investigating Unit is mandated to investigate, at the behest

[136] Section 170(1)(e)(i) - 170(1)(e)(ii) of the Companies Act.
[137] Section 2(1)(a)(i) of the Special Tribunal Act.

of the President of South Africa, concerns over the administration of State institutions, State assets, State moneys and any serious harm to the interest of the public.[138]

The Special Investigating Unit has wide ranging powers when investigating matters directed by the President of South Africa. These power are similar to that of the Commission and include seizing evidence relating to an investigation.[139] Importantly and when the investigation of the Special Tribunal has found evidence of unlawful conduct, the Special Investigating Unit has the power to institute civil proceedings in the Special Tribunal or any court of law.[140] The relief that the Special Investigating Unit can seek is vast and includes any relief that the organ of state would be able to approach a court for, "any relief relevant to any investigation" and "any relief relevant to the interests of the Special Investigating Unit". [141] This wide-ranging relief ensures that the rule of law is upheld, and perpetrators are held accountable for their actions.

5.3.2 THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

The ASIC is the regulatory body established in terms of the Australian Securities and Investments Commission Act 51 of 2001 ("ASIC Act").[142] The ASIC oversees the enforcement of the Australian Corporations Act 50 of 2001 ("Australian Corporations Act").[143] The ASIC Act empowers ASIC to, amongst other things, instituted civil proceedings in its own name (without the permission of a complainant) when the provisions of the Australian Corporations Act have been contravened.[144] The ASIC can approach a court of law for several types of relief.

ASIC can approach a court of law for an relinquishment order to remove the financial benefit obtained by a wrongdoer, disqualification orders to disqualify a wrongdoer from managing corporations for a period of time and compensation

[138] Section 2(2)(a), (c), (e) and (g) of the Special Tribunals Act.
[139] Section 4(1)(b) of the Special Tribunals Act.
[140] Section 4(1)(c) of the Special Tribunals Act.
[141] Section 4(1)c(i) - (iii) of the Special Tribunals Act.
[142] Section 8 of the ASIC Act.
[143] Section 5B of the Australian Corporations Act.
[144] Section 12GBA(1) of the ASIC Act.

order to compensate an investor for any loss suffered as a result of the wrongdoers actions.[145] The ASIC can also request a court to declare a wrongdoer to pay the Australian Commonwealth a civil pecuniary penalty for contravening the Australian Corporations Act.[146] The enforcement power held by ASIC to institute legal proceedings ensures that egregious violations of the Australian Companies Act are stopped, and natural persons are held accountable for their actions.

For example, the ASIC's power to approach a court of law can provide grave consequences for beneficial owners. A relinquishment order can ensure that any illegal proceeds obtained by a beneficial owner is forfeited to the State. Notably, the Australian Corporations Act provides a wide definition of directors and recognises a director that is validity appointed and not validity appointed.[147] The effect of this recognition is that natural person who exerts control over the corporate form, in the capacity as a shadow director, will fall within the definition of a director. This in turn allows the ASIC to approach a court to declare a shadow director from being disqualified from managing a company for a defined period.

As mentioned, Hamilton Ndlovu was not a director of the Front Companies but influenced the day-to-day decision making of the Front Companies at the time that the agreements were concluded between the National Health Laboratory Service and the Front Companies. In short, he was a shadow director. In these circumstances, the ASIC would be able to apply to court to declare Hamilton Ndlovu disqualified from exerting control over a corporate form for a defined period and any benefits received from controlling the Front Companies be paid to the State.

5.4 DISCUSSION

For the Commission to prevent the operation of front companies, it must be armed with the appropriate enforcement tools. It is for this reason that the Commission's powers need to be enhanced in the fight against corruption and malfeasance

[145] Section 12GBCC, 12GBB and 12GBA of the ASIC Act.
[146] Section 12GBCA of the ASIC Act.
[147] Section 9 of the Australian Corporations Act.

associated with front companies. Regulatory bodies such as the Special Investigating Unit and ASIC are tasked with powers to combat commercial crimes. They are empowered by way of their founding legislation to institute proceedings in their own name to stop illegal activities. It is submitted that for the Commission to follow suite, it must be equally empowered in terms of the Companies Act to institute proceedings, without limitations, to deter front companies, the controlling mind of front companies, and natural persons that benefit from the illegal activities.

6 CHAPTER 6: PROPOSED REFORM TO THE COMPANIES ACT

The Companies Act does not sufficiently guard against the prevention and operation of front companies. Many loopholes exist for natural persons to abuse the corporate form as a front company. The Companies Act must therefore be strengthened by legislative amendment to close these loopholes. Four main areas of the Companies Act are in dire need of amendment. As articulated above, any legislative amendment must be premised on the anchoring argument that natural persons exert control over a company and benefit from the company's activities.[148] The proposed amendments to the respective provisions of the Companies Act are italicised below.

6.1 PROPOSED AMENDMENT TO THE DEFINTION OF BENENEFICIAL INTEREST

The first proposed legislative amendment is to the definition of beneficial interest in section 1 of the Companies Act. This amendment will widen the definition of beneficial interest to expressly recognise the anchoring argument. In other words, the amendment will replace the definition of beneficial interest with the definition of beneficial ownership. The proposed amendment can be guided by the definition of beneficial ownership found in the Kenyan Companies Act.

The following amendment is proposed to the definition of beneficial interest in section 1 –

"Beneficial *owner*", means a persons that -

(a) exerts substantial control over the company; or

(b) receives a substantial economic benefit from the assets of the company/or any transaction that the company is a party to.

[148] Supra note 5.

but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act No. 45 of 2002).

6.2 PROPOSED AMENDMENT TO INTRODUCE A REPORTING OBLIGATION ON BENEFICIAL OWNERS

The second proposed legislative amendment should be made to section 56 of the Companies Act to introduce a reporting obligation on all beneficial owners to reveal himself/herself to the company and provide the company with his/her personal information. The personal information must be sufficient to allow either the Commission or the reporting company to identify the beneficial owner and locate him/her if necessary. The proposed amendment will seek guidance from the particulars requested in the beneficial ownership report under the CTA.

The following amendment is proposed to section 56(1A) -

56(1A) Every beneficial owner of a company and must disclose in the prescribe form and manner to the reporting company –

(a) The full legal name of the beneficial owner.

(b) date of birth of the beneficial owner.

(c) the residential or business address of the beneficial owner.

(d) the identity document number if the beneficial owner is a South African national or permanent residence. In the instance when the beneficial owner is a foreigner then the passport number of the beneficial owner.

6.3 PROPOSED AMENDMENT TO INCLUDE A DUTY ON THE COMPANY TO PERFORM A DUE DILIGENCE AND REPORT THE BENEFICIAL OWNERSHIP OF THE COMPANY TO THE COMMISSION

The third proposed legislative amendment to the Companies Act is the introduction of an obligation on the reporting company to submit the information received from the beneficial owner to the Commission. In addition, a further obligation must be placed on the reporting company to take reasonable steps to ensure that this information is accurate and correct. This will prevent the circumvention of the reporting obligations by natural persons and the reporting company. The amendment can be introduced to section 56 of the Companies Act and after the introduction of Section 56(1A). The following amendment is proposed to section 56(1)(B) -

> *56(1)(B)(a) The reporting company must take reasonable steps to verify that the information provided by the beneficial owner is true and correct.*
>
> *(b) The reporting company must submit the particulars of beneficial owner to the Commission.*

6.4 PROPOSED AMENDMENT TO THE RECKLESS TRADING PROVISION

The fourth proposed legislative amendment is to section 22 of the Companies Act. This amendment will widen the application of the reckless trading provision to apply to beneficial owners. This amendment will ensure that any natural persons that exert control over the company are precluded/prevented from abusing the corporate form as a front company. This proposed amendment act as a safety net should the beneficial ownership reporting obligation fail to deter the operation of front companies. The following amendment is proposed to section 22 -

> "22 Reckless Trading Provision
>
> (1) A company *and/or beneficial owner* must not carry on *the* business *of any company* recklessly, with gross negligence, with intent to defraud any person or for any fraudulent propose.

(2) If the Commission has reasonable grounds to believe that a company is engaging in conduct prohibited by subsection (1) or is unable to pay its debts as they become due and payable in the normal course of business, the Commission may issue a notice to the company *and/or beneficial owner* to show cause why the company and/or beneficial owner be permitted to continue carrying on its business, or trade *or the business of another company* as the case may be.

(3) If a company *and/or beneficial owner* to whom a notice has been issued in terms of subsection (2) fails within 20 business days to satisfy that Commission that it is not engaging in conduct prohibited by subsection (1), or that it is able to pay its debts as they become due and payable in the normal course of business, the Commission may issue a compliance notice to the company *and/or beneficial owner* requiring it to cease carrying on its business or trading *or the business of another company*, as the case may be."

6.5 PROPOSED AMENDMENT TO THE POWERS OF THE COMMISSION

The final proposed amendment to the Companies Act seeks to broaden the Commission's power to institute legal proceedings in its own name to enforce section 22(1) of the Companies Act. This will ensure that natural persons that exert control over the front company are prevented from abusing the corporate form in the event that a compliance notice issued in terms of section 22(3) of the Companies Act is ineffective. The following amendment is proposed to section 187 of the Companies Act –

187. Functions of Commission

(1)……..

(2) Other than with respect to matters within the jurisdiction of the Takeover Regulation Panel, the Commission must enforce this Act, among other things, -

(aA) institute legal proceedings in its own name to cease a beneficial owner from engaging in prohibited conduct referred to in section 22(1).

7 CHAPTER 7: CONCLUSION

Considering some of the provisions of the Companies Act, this research report has demonstrated some of the loopholes accessible to natural persons for the operation of a company in South Africa as a front. Comparative law such as the United States of America, Kenya, and Australia have demonstrated similar areas of the Companies Act that ought to be amended to prevent front companies. The anchoring argument, as confirmed by the *Special Investigating Unit v Hamilton Ndlovu*, will be the foundation of any legislative amendment. Namely, (i) the amendment of the definition of beneficial interest to recognise beneficial ownership, (ii) a mandatory reporting obligation placed on beneficial owners to reveal themselves to the company and the Commission, (iii) the expansion of the reckless trading provision to apply to beneficial ownership and (iv) enhanced powers of the Commission to institute legal proceedings against beneficial owners to stop the abuse of the corporate form as a front. It must be borne in mind that the proposed legislative amendments work in tandem to ensure the present loopholes under the Companies Act are barred.

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