VARIOUS SECTIONS OF THE COMPANIE ACT AND RAMIFICATIONS

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By Mark Silberman

Contents

1. OFFICERS OF A COMPANY

What is in fact a Company? A company is referred to as a ***juristic person***. It is an entity created by company law. It can do anything or almost anything. It cannot get married; it cannot fall pregnant. It can conduct business; it can buy and sell and employ people. It can sue and be sued. The various laws that we have mentioned and what we are still going to go through make the functioning of this company as efficient and as smooth as is possible. There are the officers of a company that we need to know about, the most important being the directors.

1.1 DIRECTORS

Every company must have at least one director to manage the company. In the case of one person running a business the person who starts the business will be the sole director. He would probably also hold a 100 percent of the shares in a company. As the company grows and raises more capital and issues more shares more directors will be added to the Board and therefore there would be whole lot of rules in the way that these directors would govern the company. A lot of these rules would be found in the MOI and rules as well as in the act and of course also in the common law.

There are various sections in the Act and Section 66(2) of the 2008 Act says that every company in particular a private company or a personal liability company must have at least one director and a public company or a non-profit company at least three. There are various rules in the way these directors can be appointed, however any person can be a director of a company and the MOI can impose minimum qualifications for being a director. There are however some people who are ineligible or could be disqualified from being a director. For disqualifications look at Section 69(8). It is the MOI that gives directors power to run the company.

Company Secretarial Practitioners must take cognisance of the voting rights between the directors and shareholders so that the power is not held in the incorrect hands and that in reality it is really the shareholders who have the power.

1.2 DUTIES AND LIABILITIES OF DIRECTORS

1.1.1 The common-law duties of Directors

The duties of a Director are both diverse and numerous. It is impossible to lay down the rules for every single situation. Each particular action by directors must be judged upon its own merits. The ***common-law*** duties which set out a unique set of obligations which are owed by the directors of the company play a crucial role in the governance of a Director's duties and liabilities. These common laws are very protective of the company. The Director in effect acts as an agent of the company and also has a fiduciary duty towards the company. This means that the director has a duty to protect the company's interest.

It should be remembered that the duties will relate not to the powers that a Director has but the way he carries out these powers.

1.1.2 Duty to exercise care and skill and diligence.

There is no question that the Director needs to ***exercise his duties with care and skill***. The question is, what is care and skill and how is it measured? It is measured on the basis of what a reasonable person would be expected to do.

It is clear from case law that a Director is ***not expected to be an expert in everything***, unless the Director is appointed for a specific reason or as a specific expert or for the purpose in which he has the necessary skills. A Director is not expected to have any knowledge or to exercise skills which they do not possess.

In making a decision a Director may ***make the use of an outside expert*** however, upon receiving such advice the Director must exercise their mind and make a proper judgement not blindly following the expert. A Director is entitled to rely on his co-directors and employees of the company, but such reliance cannot be unquestioning.

If there are ***negligent actions or fraud by an employee*** of the company, the Director can be ***held liable*** if he has failed to take reasonable care in the selection and supervision of the employees. There must be a common-sense view in regard to particular actions. A Director cannot be expected to attend to every conceivable detail, accepting reports from subordinates on routine matters, unless it can be shown that Director knew that some incorrect action was being committed and such act was unlawful. The Director will not necessarily be liable for the unlawful acts of an employee.

A Director must ***carry out their duties and functions diligently***. Diligent means the Director must devote a reasonable amount of time and attention to the company's affairs. Failure to exercise proper diligence may indicate that the Director has acted negligently and, in some cases, may even indicate that the Director has acted dishonestly. For example, if the Director failed to investigate a fraud that is reported he could be held to be negligent as well as dishonest. In a case of a listed company shareholders may be able to claim if something was not disclosed in the annual financial statements resulting in shareholder loss.

It is not necessary for a Director to attend every board meeting, but ***continuous non-attendance*** may render him guilty of negligence.

Ignorance of some facts which a Director should have been aware may also render that Director liable.

The duty to exercise care, skill and diligence is not a fiduciary duty, it is derived from the law of delict, which is why Section77(2) draws a distinction between the duty and the remaining codified duties of Directors set out in Section 75 and Section 76.

1.1.3 Duty to Act in the best interest of a company.

The common law regards the fact that a Director has a fiduciary duty to the company, this means to the general body of a Company shareholders, to the exclusion of all other stakeholders. ***The common law is now wider to include other stakeholders***.

1.1.4 Duty to act within their powers and for a proper purpose.

The Powers of a Director can only be used for the purpose for which they were granted. A Director does not have powers for any ***unauthorised or improper purpose*** and in fact this cannot be done. Where a Director carries out an action which is improper and which is unauthorised and is beyond the powers of the Act and the MOI and Common Law the transaction can be cancelled and the shareholders may make a claim against the Directors.

Any action by a Director must be within the Law, and if it is not honest it can be subject to criminal liability as well as personal liability.

A Director ***cannot use information*** for his/her own purposes or disclose confidential information to an outsider.

1.1.5 Duty to exercise independent judgement

A Director must make proper decisions and ***cannot be a puppet*** for anyone else. In the event that a majority shareholder tries to control him and tell him how to vote this cannot be done, the Director has to make his own decisions in regard to any particular matter within the Company.

1.1.6 Duty to avoid conflict of interest

A Director cannot have any ***conflict of interest*** in anything that is in conflict with the company. There cannot be any personal interest or have a duty to another party.

The Director cannot be involved in competing situations with the company. In regard to non-executive directors the legal position is not clear as there are many examples of this breach of duty, as a non-executive Director may hold positions in competing concerns.

If there is a breach of duties by the Director and there is a conflict of interest the company or the shareholders may recover damages.

A Director must make full disclosure of all his other interests.

1.1.7 Corporate opportunity and no-profit rules

A Director ***cannot make a profit*** if he enters into a transaction that was for the benefit of the company. This can only be done if there is full disclosure and he obtains the consent of the remaining Directors.

If he does so and the profit belongs to the Company the law will disregard the transaction and the company may make claims against the Director.

There are two famous cases in this regard. ***Da Silva and others vs CH Chemicals (Pty) Ltd*** and ***Robinson vs Randfontein Estates Gold Mining***.

1.3 GROUP OF COMPANIES

There is nothing in law that recognises the legal personality or legal status of a group of companies. It is a fact in law that a Director owes his fiduciary duty to that of the company that he is a director of and not to a group. When looking at inter-company transactions the director must consider his duties to the company that he is a Director of. It may be that a Director is a Director of two companies in the group where there are intercompany transactions. In this situation, each transaction must be judged according to the interest of a company he is a director of. The test to make this determination is a subjective one and the Courts will have a look at whether the Director believed that they have acted in good faith.

1.4 THE CODIFIED DUTIES OF DIRECTORS

For the first time, some of the duties of a director under common law have been partially codified by Sections 75 and 76 of the Act. These partially codified duties prevail over any conflicting common law duties. If there is no conflict with the codified laws then the Common Law remains applicable. In most instances the codification has not affected any of the common law to the duties of the Directors. Quite the opposite. The codified duties of Directors are more lenient than those of the Common law in some important instances.

The transitional arrangements provide that despite anything to the contrary in a Company's MOI and the provisions of the Act in respect of the duties, conduct and liabilities of Directors apply to a pre-existing Company as from 1 May 2011.

1.1.8 The expanded meaning of Director

In terms of Section 76(1) a director also includes an ***alternate director***, a ***prescribed officer***, a ***member of the board committee*** or a ***member of the Companies audit committee*** irrespective of whether or not a person is also a member of the Companies Board.

These persons are bound to observe the same duties of Director and the same set of standards apply.

1.1.9 Standards of a director's conduct

S76 (3) codifies what are generally regarded as the most important common-law duties of directors. A director must be subject to ss 76(4) and 76(5) when acting in that capacity and in the execution of the powers in order to perform the functions of a Director.

These functions must be:

a. In good faith and for a proper purpose;
b. In the best interest of the company;
c. With the degree of care, skill and diligence that may reasonably be expected from a Director.

1.5 LIABILITY OF A DIRECTORS

S 77 gives a clarification of the common law liabilities and consolidates most of the other sections of the act.

1.1.10 Common-law liabilities of directors

S77(2) codifies the common-law position. It provides that a director may be held liable in accordance with the principles of the common law relating to-

a. Where there is a breach of fiduciary duty for loss or damages or costs sustained by the Company, this can be claimed from the Director.
b. Delict or Law Governing wrong or unlawful acts or omissions for any loss or damage or cost sustained by the company can be claimed from the Director.

1.1.11 Statutory Liabilities of Directors

S 77(3) provides that the Director is liable for any loss, damages, or costs sustained by the company as a direct or indirect consequence of the Director having-

a. Acted in the name of the company, signed on behalf of the company and purported to have been acting for the company despite knowing that he did not act for the company and lacked the authority to do so.
b. Tacitly agreed to carry on business despite knowing it was prohibited in terms of s 22(1) because it was reckless, negligent or fraudulent behavior.
c. Being party to an act or omission despite knowing that it was calculated to defraud a creditor, employee or shareholder of the company.
d. Signed or consented to or authorised the publication of any financial statements which are false and misleading or a prospectus which was untrue.

SECTION 77(3) (e) is a consolidation of various Sections being 38(3), 41(5), 42(4), 44(6) and 45(7) 46(6) and 48(7). Listed below are the issues.

1. The issue of unauthorised shares despite knowing that those shares had not been authorised.
2. The issue of any authorised securities despite knowing that the issue of those securities was inconsistent with s 41.
3. The granting of options to any persons contemplated in s 42(4) despite knowing that any shares of which the options could be exercised or to which any securities could be converted had not been authorised in terms of s 36.
4. The provision of financial assistance to any person contemplated in s 44 for the acquisition of the company securities, despite knowing that the provision of financial assistance was inconsistent with s 44, or the Company's MOI.
5. Provision of financial assistance to Directors for the purpose contemplated in s 45 despite knowing that the provision of Financial Assistance was inconsistent with s 45 or the Company's MOI.
6. Subject to s 77(4) a resolution approving a distribution despite knowing that the distribution was contrary to s 46.
7. The acquisition by the Company of any of the Shares or the Shares of its holding company despite knowing that the acquisition was contrary to ss 46 and 48.
8. An allotment by the company despite knowing that the allotment was contrary to any provision of Chapter 4 public offerings.

1.6 COMPANY SECRETARY

Another officer of the company is in fact the Company Secretary of the company who in my opinion has a very important position. As a rule, the Company Secretary does not play a role in the smaller company but is very important in the larger listed company as he is the person responsible for corporate governance to make sure that the Directors are kept in line and conduct themselves in terms of the Act and all other laws.

You can do your own reading on the Company Secretary, however by and large the person involved in the accounting firm where the accounting firm has been appointed as the Company Secretarial practitioner has also been placed in a very important position in that they have to ensure that the company conducts itself in accordance with the Act. The company secretarial practitioner needs to ensure that they know company law so that they can guide the directors of the company. Where this is the case it's important that a mandate or engagement letter is signed in relation to secretarial duties by the client so that responsibilities are clearly defined.

The problem as to where we are today being that most people are unfamiliar with the duties and functions of the Company Secretary. There are certain things that could go wrong where the client or company could hold the Company Secretarial practitioner liable for damages. Later on, we will be dealing with the situation when a private company can become a regulated company which could result in a damage claim against the practitioner. Sections from 86 to Section 89 govern the situation of the Company Secretary. It is important to understand that the Company Secretary is accountable to the Company's Board and the duties may include providing the Directors collectively and individually with guidance as to their duties, responsibilities and powers. As a company secretarial practitioner how much of this have you taken on. We would need to look at the mandate signed with your client. An accounting firm should never appoint themselves as the company secretary, however it is absolutely essential to have a mandate that governs the relations between the firm and the client where the firm just processes secretarial transactions as I have already mentioned.

Some of the duties of the company secretary are listed below.

Reporting to the company's board any failure on the part of the company or director to comply with the **MOI** or **Rules** of the Company or the **Act**.

Ensuring that the ***minutes*** of all the shareholders meetings, board meetings and meetings of any committee of the Directors or of the Company Audit Committee are properly recorded in accordance with the Act.

Certifying the Company's Annual Financial Statements and whether the Company has filed the required returns and notices in terms of Act and whether all such notices and returns are true, correct and up to date.

Carry out the functions of a person designated in terms of s 33 - Company's Annual Return.

As you can see from the above that the Company Secretary has a large number of functions which in the listed company environment would include all the JSE listing requirements and King requirements etc. It is because of this today that most accounting firms do not appoint their firms as the company's secretary because clearly on a part time basis you cannot take on this onerous responsibility. It is therefore most important that you have a mandate for your clients where you specify exactly what aspects of secretarial practice you are going to attend to so that a client is totally aware of your responsibilities and their own responsibilities.

1.7 PRESCRIBED OFFICERS!

During consultation with clients, the question often arises as to which individuals in a company would be considered to be a Prescribed Officer in terms of the Companies Act 71 of 2008 ("the Act"), and what does this mean for such an individual? Is it merely a selection based on random function, or is there a logic and motivation driving who such individuals will be? You would have seen they have the same obligations as directors.

This article will set out to address the abovementioned questions in the light of the provisions of the Act, as well as relevant case law addressing this issue.

PRESCRIBED OFFICERS IN TERMS OF THE ACT

"The Act introduces the definition of a Prescribed Officer which, in terms of Regulation 38 of the Act, is a person who, despite not being a director of a company, exercises general executive control and management over the whole, or a significant portion of the business activities of a company or a person who regularly participates, to a material degree, in the exercise of general executive control and management over the whole, or a significant portion, of the business and activities of the company. This is the case irrespective of any particular title given by the company to the office held by the individual in the company or the function performed by the individual in the company.

The effect of being a Prescribed Officer in terms of the Act would be that such an individual would be subject to the same duties and liabilities of directors, including adherence to Section 75 and Section 76 of the Act, relating to personal financial interests and director's standards of conduct. This would entail that such an individual would owe fiduciary duties to

the company to act in the company's best interest, not to make a secret profit or misappropriate opportunities that should be opportunities of the company.

APPLICABLE CASE LAW

In the matter of Volvo (Southern Africa) (Pty) Ltd v Yssel [2009] JOL 24109 (SCA), the court had to decide whether an individual rendering services to the appellant owed a fiduciary duty to the appellant. In this particular case, the appellant required a manager for its information technology division. The respondent was placed by a personnel placement agency in such position. During the course of rendering services to the appellant, the respondent entered into an agreement with the relevant personnel placement agency in terms of which the respondent would earn a commission if he arranged for personnel placed by other labour brokers at the appellant, to be transferred to the particular personnel placement agency that placed the respondent. The respondent did not disclose this commission to be earned by him to the appellant.

The question before the court was whether the respondent owed a duty to the appellant to disclose such secret commission and whether the respondent was under a fiduciary duty to act in the best interests of the appellant and not his own.

In its judgment, the court did not refer to the provisions of the Act. However, the court sets out the following reasons for finding that the respondent did, in fact, owe a fiduciary duty to the appellant:

- The respondent occupied the most senior position in the appellant's information technology division.
- The fact that there was no contractual relationship between the appellant and the respondent is not of meaningful consequence. It is the position to which the respondent was appointed, as opposed to the contractual relationship, that determined what the appellant could expect from the respondent.
- The respondent attended to arrange matters between the appellant and its staff as an incident of his function as manager of the division.
- It is because of his position as manager of the division that the appellant could be induced to relax the care and vigilance it would generally have excercised if it was dealing with a stranger.

CONCLUSION

If one considers both the requirements of Regulation 38 of the Act, as well as the reasons for the judgment handed down in Volvo (Southern Africa) (Pty) Ltd v Yssel [2009] JOL 24109 (SCA), it has to be concluded that the determination of who will be a Prescribed Officer in term of the Act is not determined merely as a selection based on random function. In my view, the logic and motivation applied by the court Volvo (Southern Africa) (Pty) Ltd v Yssel [2009] JOL 24109 (SCA) fuels how the requirements of Regulation 38 of the Act should be applied. It is clear that an individual should only be deemed to be a Prescribed Officer if there is good reason to state that such individual stands in a position of trust to the company, and as such, such an individual should not allow their own interests to prevail over the best interest of the company."

Phillip Kruger

Regional Divisional Director RSM | Legal, Johannesburg

2. REMOVAL OF DIRECTORS

2.1 SECTION 71 IN THE ACT IS EQUIVALENT TO SECTION 220 IN THE 1973 ACT

S71(1) is a crucial ***unalterable provision*** which entrenches the fundamental common law principal that the ***shareholder is king*** by allowing the shareholders to ***remove a director at any time and for any reason they think fit***. It provides that despite anything to the contrary in a company's MOI or rules, or any agreement between a company and Director or between any shareholder and director, ***a director may be removed by an ordinary resolution***, adopted at a shareholders meeting by the persons entitled to exercise voting rights in the election of that director.

Only the person's entitled to exercise voting rights in election of a particular director may remove that director. The way this works is that the director must be given an opportunity to prevent removal from happening by ***stating his case at the meeting*** where the vote is going to take place. It is not necessary for the resolution to give reasons as to why the shareholders want the directors removed.

At this point it would be a good idea to understand what s 66(4) says – a company's MOI may provide for the director appointment and ***removal of one or more directors*** by any person who is ***named in the MOI***. This means that the person so named may appoint and remove directors. It appears that this person has a right to appoint 50% of the directors as the other 50% must be appointed by the shareholders.

The MOI cannot provide that a higher percentage on the voting rights for the removal of a director i.e. more than 50% of the voting rights is required to remove the director.

The old Act provided that in order to remove a director 28 days special notice was required. This requirement has been abolished in the 2008 act.

As well as the above in terms of s 71(3) the board has been given the power to remove a Director even in limited circumstances. It provides that if a company has more than two directors which is obligatory for public companies and non-profit companies and a **shareholder** or a **director** has alleged that a director has become ***ineligible*** or ***disqualified*** or has become ***incapacitated*** to the extent that the director is unable to perform the functions of a director and he is unlikely to regain that capacity within a reasonable time – (these cannot be grounds as contemplated in s 69(8)(a) which are the disqualification grounds), or has neglected or been derelict in a performance of the functions of a director, they can be removed.

The board (other than the director concerned) must determine the matter by resolution, i.e. the remaining directors may determine whether or not the allegation is correct by a simple majority vote and may remove the director.

Prior to the meeting the ***director must be given notice*** of the meeting including a copy of the proposed resolution setting out the reason for it with sufficient specificity to reasonably permit the director to prepare and present a response. The director concerned must be afforded a reasonable opportunity to make a presentation in person or through a representative to the meeting before the resolution is put to the vote.

Unlike s 71(1) the board may remove a director in the circumstances described in 71(3) irrespective of whether the Director concerned was originally appointed or elected by shareholders.

Where the situation has occurred that the ***person who originally appointed the director*** as specified in s 66(4)(a) (i) or who voted in favour of the director may make an application to court who may either confirm the board's determination or remove the director from office on the grounds specified in 71(3).

One cannot remove a director by around robin resolution under S60 as in this way the director cannot present his case.

S 71(3) does not apply if a company has fewer than three directors. In the circumstances contemplated in s 71(3) any director or shareholder of such a company may apply to the tribunal to make a termination as contemplated in s 71(3). There is another innovation in that various people can apply to court to declare a Director either delinquent or thus prohibited from being a director or under **probation** and thus restrict the serving as a director within the condition of that probation.

S 162 sets out this remedy, it is available to a company, a shareholder, director, company secretary or prescribed officer of a company as well as a registered trade union that represent the company's employees or another representative of a company's employees. Any of these persons may apply to court for an order declaring a director of that company or person who within 24 months immediately preceding the application was a director of that company. For more information on this you need to read s 162.

2.2 INELIGIBILITY AND DISQUALIFICATION OF A DIRECTOR

This is governed by s 69 which applies to all types of director including alternate, ex-officio directors as well as board committee members or audit committee members in respect of whether they are directors or not.

S 69 talks about an ***ineligible person*** – such a person can never become a director whereas a ***disqualified person*** may become a director after that person's terms of disqualification ends. An ineligible or disqualified director cannot be appointed or elected to serve or continue to serve as a director.

S 66(6) provides that the election of appointment of a person as a director is a nullity if at the time of election of appointment that person is ineligible or disqualified in terms of S69. For All the reasons why, a director is ineligible etc. please have a look at S69.

3. S44 FINANCIAL ASSISTANCE TO ACQUIRE SHARES AND THE LENDING OF MONEY

3.1 SECTION 46 (1) (b) (c)

This section uses the words ***"it reasonably appears that the company will satisfy the solvency and liquidity tests"*** and the board has acknowledged that it has applied the test.

However, in regard to s 44 and s 45 different words are used and in both the instances of ss 44 and 45 the transaction must meet certain requirements one of which is ***"the board is satisfied that the company would be in compliance with the solvency and liquidity test."***

Does this mean that if the board is satisfied no matter how unreasonable they are in the way they apply the test or does it mean that if they are satisfied that the requirements for this section is met?

There appears to be no reason why there is this slight difference of wording which will cause quite a bit of inconsistency, the problem with these tests is that it is based on the predictions of the directors especially in regard to the solvency situation. The Act in itself does not really supply much help except in Section 4, the boards enquiry must be carried out from any financial information contained in accounting records and financial statements. The board must consider a fair valuation of the company's assets and liabilities including any ***reasonable foreseeable contingent assets and liabilities*** irrespective of whether or not arising as a result of the proposed distribution or otherwise. It may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances. In determining the company's assets and liabilities the board must take into account any reasonable foreseeable contingent assets and liabilities to give a true picture of the company's solvency and liquidity position.

If the company has property that is shown at cost, could the directors take into account market value? I think yes.

Contingent liability is one that will become due and payable on the happening of a particular event.

S 44 is as follows;-

44. Financial assistance for subscription of securities.—(1) In this section, "financial assistance" does not include lending money in the ordinary course of business by a company whose primary business is the lending of money.

(2) Except to the extent that the Memorandum of Incorporation of a company provides otherwise, the board may authorise the company to provide financial assistance by way of a loan, guarantee, the provision of security or otherwise to any person for the purpose of, or in connection with, the subscription of any option, or any securities, issued or to be issued by the company or a ***related or inter-related company***, or for the purchase of

any securities of the company or a related or inter-related company, subject to subsections (3) and (4).

[Sub-s. (2) substituted by s. 30 (*a*) of Act No. 3 of 2011.]

(3) Despite any provision of a company's Memorandum of Incorporation to the contrary, the board may not authorise any financial assistance contemplated in subsection (2), unless—

(*a*) the particular provision of financial assistance is—

(i) pursuant to an employee share scheme that satisfies the requirements of section 97; or

(ii) pursuant to a special resolution of the shareholders, adopted within the previous two years, which approved such assistance either for the specific recipient, or generally for a category of potential recipients, and the specific recipient falls within that category; and

(*b*) the board is satisfied that—

(i) immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test; and

(ii) the terms under which the financial assistance is proposed to be given are fair and reasonable to the company.

(4) In addition to satisfying the requirements of subsection (3), the board must ensure that any conditions or restrictions respecting the granting of financial assistance set out in the company's Memorandum of Incorporation have been satisfied.

(5) A decision by the board of a company to provide financial assistance contemplated in subsection (2), or an agreement with respect to the provision of any such assistance, is void to the extent that the provision of that assistance would be inconsistent with—

(*a*) this section; or

(*b*) a prohibition, condition or requirement contemplated in subsection (4).

(6) If a resolution or an agreement is void in terms of subsection (5) a director of a company is liable to the extent set out in section 77 (3) (*e*) (iv) if the director—

(*a*) was present at the meeting when the board approved the resolution or agreement, or participated in the making of such a decision in terms of section 74; and

(*b*) failed to vote against the resolution or agreement, despite knowing that the provision of financial assistance was inconsistent with this section or a prohibition, condition or requirement contemplated in subsection (4).

[Sub-s. (6) amended by s. 30 (*b*) of Act No. 3 of 2011.]

3.2 FINANCIAL ASSISTANCE TO ACQUIRE OWN SECURITIES OR THOSE OF A RELATED OR INTER-RELATED COMPANY

S 44(2) is stated for convenience

"Except to the extent that the memorandum of incorporation of a company provides otherwise, the board may authorize the company to provide financial assistance by way of a loan, guarantee, the provision of security or otherwise to any person for the purpose of, or in connection with, the subscription of any option, or any securities, issued or to be issued by the

company or a related or interrelated company, or for the purpose of any securities of the company or a related or inter-related company, subject to subsection (3) or (4)".

Financial assistance is not defined except where s 44 says that financial assistance does not mean lending of any money by a company whose primary business is the lending of money. The word "securities" are widely defined in s 1 and includes shares, debt instruments as well as debentures.

S 44 (3) is an ***unalterable provision*** that has four requirements which must be met before a board can authorize financial assistance.

- *S 44 (3) (a) provides that despite anything in a company's MOI to the contrary the board may not authorize any financial assistance unless it is covered by a **special resolution** of the shareholders within the previous two years. This special resolution must be approved for a specific recipient or generally for a category of potential recipients and the specific recipient falls within that category. The special resolution is not required if the particular resolution is in terms of an employee's share scheme that satisfies the requirements of s97.*
- *The board may also not authorize any financial assistance unless immediately after providing the financial assistance the company would satisfy the **solvency and liquidity test**.*
- *The third requirement is that the board cannot authorize such financial assistance unless it is satisfied that the terms under which the financial assistance is proposed to be given is **fair and reasonable to the company**. The Board's decision cannot be challenged under the basis that the directors have not properly exercised their duties to the company and in no way would have prejudice creditors and shareholders.*
- *The board must also be satisfied that if there are any restricting conditions in the MOI that these conditions have been satisfied.*

If the directors do something wrong in terms of this section it is not a criminal offence but the directors could be held personally liable.

4. S45 - LOANS OR OTHER FINANCIAL ASSISTANCE TO DIRECTORS

4.1 INTRODUCTION

S 45 is the equivalent of S226 in the old Act and s 45(2) provides that except to the extent that the companies MOI provides otherwise and subject to s45(3) and s45(4) the board may also authorize the Board of companies direct or indirect financial assistance to

- a director or prescribed officer
- a director or prescribed officer of a company which is related or inter-related to the company
- a company or corporation who is related or inter-related to the company
- a member or corporation who is related or inter- related to the company
- a person who or which is related to the company or any of the above.

4.2 S 45

45. Loans or other financial assistance to directors. —(1) In this section, "financial assistance"—

(*a*) includes lending money, guaranteeing a loan or other obligation, and securing any debt or obligation; but

(*b*) does not include—

(i) lending money in the ordinary course of business by a company whose primary business is the lending of money;

(ii) an accountable advance to meet—

(*aa*) legal expenses in relation to a matter concerning the company; or
(*bb*) anticipated expenses to be incurred by the person on behalf of the company; or

(iii) an amount to defray the person's expenses for removal at the company's request.

(2) Except to the extent that the Memorandum of Incorporation of a company provides otherwise, the board may authorise the company to provide direct or indirect financial assistance to a director or prescribed officer of the company or of a related or inter-related company, or to a related or inter-related company or corporation, or to a member of a related or inter-related corporation, or to a person related to any such company, corporation, director, prescribed officer or member, subject to subsections (3) and (4).

(3) Despite any provision of a company's Memorandum of Incorporation to the contrary, the board may not authorise any financial assistance contemplated in subsection (2), unless—

(*a*) the particular provision of financial assistance is—

(i) pursuant to an employee share scheme that satisfies the requirements of section 97; or

(ii) pursuant to a special resolution of the shareholders, adopted within the previous two years, which approved such assistance either for the specific recipient, or generally for a category of potential recipients, and the specific recipient falls within that category; and

(*b*) the board is satisfied that—

(i) immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test; and

(ii) the terms under which the financial assistance is proposed to be given are fair and reasonable to the company; and

[Para. (*b*) substituted by s. 31 (*a*) of Act No. 3 of 2011.]

(4) In addition to satisfying the requirements of subsection (3), the board must ensure that any conditions or restrictions respecting the granting of financial assistance set out in the company's Memorandum of Incorporation have been satisfied.

(5) If the board of a company adopts a resolution to do anything contemplated in subsection (2), the company must provide written notice of that resolution to all shareholders, unless every shareholder is also a director of the company, and to ***any trade union representing its employees—***

(*a*) within 10 business days after the board adopts the resolution, if the total value of all loans, debts, obligations or assistance contemplated in that resolution, together with any previous such resolution during the financial year, exceeds one-tenth of 1% of the company's net worth at the time of the resolution; or

(*b*) within 30 business days after the end of the financial year, in any other case.

(6) A resolution by the board of a company to provide financial assistance contemplated in subsection (2), or an agreement with respect to the provision of any such assistance, is void to the extent that the provision of that assistance would be inconsistent with—

(*a*) this section; or

(*b*) a prohibition, condition or requirement contemplated in subsection (4).

(7) If a resolution or an agreement is void in terms of subsection (6) a director of a company is liable to the extent set out in section 77 (3) (*e*) (v) if the director—

(*a*) was present at the meeting when the board approved the resolution or agreement, or participated in the making of such a decision in terms of section 74; and

(*b*) failed to vote against the resolution or agreement, despite knowing that the provision of financial assistance was inconsistent with this section or a prohibition, condition or requirement contemplated in subsection (4).

[Sub-s. (7) amended by s. 31 (*b*) of Act No. 3 of 2011.]

S 45 like s 44 does not define financial assistance, all that it says is that financial assistance includes lending money, guarantee a loan or other obligation and securing any debt obligation but does not include lending money in the ordinary course of the business or of a company whose primary business is the lending of money, or an accountable advance to meet legal expenses of a matter concerning the company or to meet anticipated expenses to be incurred by the person on the person's behalf or an amount to defray the personal expenses for the removal at the company's request.

The fundamental difference between s 44 and s 45 is that s 44 is for the financial assistance for the subscription or purchase of securities whereas the purpose of s 45 is for financial assistance for ***any particular purpose***. The Act does not provide a description of financial assistance in s 45(2) and the words direct or indirect widens the type of financial assistance that may be given. One also needs to look at the definition of ***related or inter-related***.

The way the wording of the section is couched is that it applies to a much wider group of people including intergroup loans which are everyday incurrences in larger groups of companies. There is also a danger that such loans may be in the hands of controlling shareholders which if made could be detrimental to the company.

The experts feel that the situation in regard to S45 is too wide and a practical consequence is that in a group of companies the company will have to table a special resolution every second or bi-annual shareholders meeting for approval of loans to other companies that form part of the group. Another thing that has to happen is that despite the special resolution with every loan the board has to satisfy the **solvency and liquidity test** as well as the fact that the terms of the financial assistance as proposed are **fair and reasonable** to the company.

The board also has to make sure that whatever terms there are in the MOI have been complied with.

4.3 S45 – ADDITIONAL DISCLOSURES

There is also a new disclosure in terms of S45(5) which is not a requirement in S44 which provides that if a resolution in terms of S45(2) is adopted the company must provide written notice of that resolution to all shareholders unless every shareholder is also a director and to any trade union, representing its employees.

There are two conditions where this is applicable, this disclosure must be provided within 10 business days after the resolution is adopted, if the total value of all the total debts or obligations of assistance contemplated in the resolution together with any other previous resolutions during the financial year exceeds one tenth of 1 % of the company's net worth at the time of the resolution or within 30 business days after the end of the financial year in any other case.

In terms of S 45(6) if the granting of such financial assistance is in conflict with any term in the MOI then the transaction is void.

4.4 EXAMPLE OF THE SPECIAL RESOLUTION REQUIRED

This special resolution is with the courtesy of Murray and Roberts

Provision of financial assistance to any company related or inter-related to the Company or to any juristic person who is a member of or related to any such companies

"RESOLVED THAT, as a general approval, the Company may, in terms of section 45(3)(a)(ii) of the Companies Act, 71 of 2008, as amended ("Companies Act") and subject to compliance with the remainder of section 45 of the Companies Act, provide any direct or indirect financial assistance ('financial assistance' will herein have the meaning attributed to it in section 45(1) of the Companies Act) that the board of directors of the Company may deem fit to any related or inter-related company or to any juristic person who is a member of or related to any such companies ('related' and 'inter-related' will herein have the meaning so attributed in section 2 of the Companies Act) (on the terms and conditions, to the recipient/s, in the form, nature and extent, and for the amounts that the board of directors of the Company may determine from time to time)."

Reason for and effect of special resolution number 1:

The reason for and effect of special resolution number 1 ("Special Resolution"), if adopted, will be to confer authority on the board of directors of the Company to authorise financial assistance to companies related or inter-related to the Company, or to any juristic person who is a member of or related to any such companies generally as the board of directors of the Company may deem fit, on the terms and conditions, and for the amounts that the board of directors may determine from time to time, for a period of about fifteen months up to and including the 2012 annual general meeting of the Company from the date of adoption of the Special Resolution, and in particular as specified in this special resolution. The granting of the general authority would obviate the need to refer each instance of provision of financial assistance in the circumstances contemplated in the Special Resolution for ordinary shareholder approval.

This general authority would assist the Company with, inter alia, making inter-company loans to subsidiaries of the Company, or inter-related companies, as well as granting letters of support and guarantees in appropriate circumstances. This would avoid undue delays and attendant adverse financial impact on subsidiaries, or inter-related companies, as it would facilitate the expeditious conclusion of negotiations.

This general authority would be valid up to and including the 2012 annual general meeting of the Company. In the event that the Special Resolution is adopted by the ordinary shareholders of the Company, thereby conferring general authority on the board of directors of the Company to authorise financial assistance to companies related or inter-related to the Company or to

any juristic person who is a member of or related to any such companies, then the board of directors of the Company shall not authorise any financial assistance contemplated in such Special Resolution unless the board:

1. is satisfied that immediately after providing the financial assistance, the Company will satisfy the solvency and liquidity test contemplated in section 4 of the Companies Act (section 45(3)(b)(i)); and

2. is satisfied that the terms under which the financial assistance is proposed to be given are fair and reasonable to the Company (section 45(3)(b)(ii)); and

3. has ensured that any conditions or restrictions in respect of the granting of financial assistance set out in the Company's Memorandum of Incorporation have been satisfied (section 45(4)).

This Special Resolution does not authorise the provision of financial assistance to a director or prescribed officer of the Company.

5. BUYBACK OF SHARES

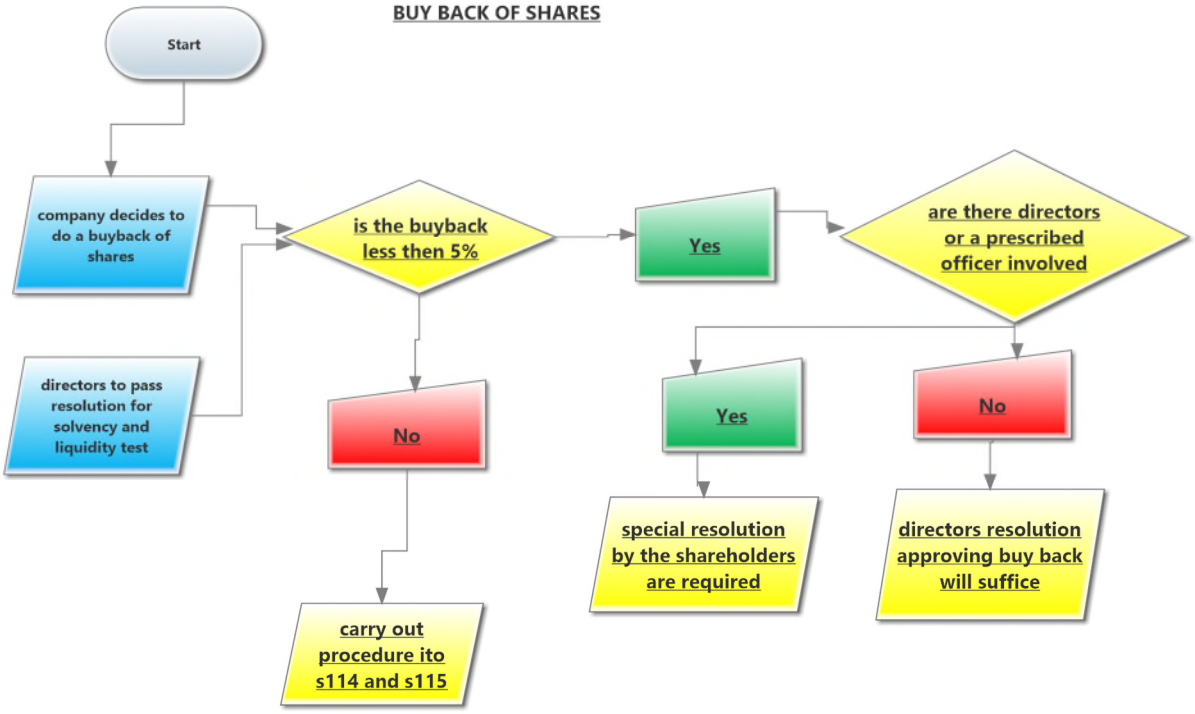
5.1 INTRODUCTION

Under the old Companies Act the buy-back procedure was quite a common procedure for companies to repay capital to their shareholders. Where the directors have made the decision that the company has excess cash and can pay it back to shareholders the obvious thing to do is to pay the capital back to shareholders by buying back shares instead of paying a dividend which is taxable. The buy back in South Africa was not always available under the old act and came about because of changes to the law.

The purpose of this section is to deal with the law and not to go through all the commercial reasons as to why a buyback procedure should be followed. There are in fact numerous commercial reasons as to why buybacks are carried out. Clearly there must be sound commercial reasons for a buy back! For a detailed discussion of the reasons and motivation please refer to Contemporary Company Law by Cassim on page 294. It is important that where a professional company secretary carries out this procedure on behalf of clients that there are sound reasons for doing so.

It is also very important to obtain the correct tax advice as it is so easy for some of the buyback to be viewed as a dividend by SARS.

5.2 DECISION CHART ON BUYBACK OF SHARES



5.3 SECTION 48

S 48 of the companies act deals with the buyback of shares.

1. S48 (1) states that this section does not apply to the situation where a shareholder ***makes a demand***, ***tendering of shares*** and payment by a company to a shareholder in terms of ***appraisal rights*** as set out in s164. Buybacks also do not apply where there is ***redemption by the company*** of any ***redeemable securities*** in accordance with the terms and conditions of those securities.

2. The board of directors may determine that a company may acquire a number of its own shares. The board of a subsidiary company may determine that it will acquire shares of its holding company, but this cannot be more than 10% in aggregate of the number of issued shares of any class of shares of a company and **no voting rights** may be attached to those shares once they are acquired.

   Shares may not be re-purchased by a company or the subsidiary of a holding company where after the transaction no shares in issue are left.

3. Any shares acquired by a company are subject to the requirements of Section 46 which deals with the insolvency and liquidity of the company.

4. S48 (8) (a) says that where a buy-back of shares are acquired from a ***director*** or a **prescribed officer** then such buy-back must be **approved by a special resolution**. Such special resolution does not have to be lodged at the CIPC.

5. In terms of s48 (8) (b) where the buyback of shares, if considered alone or together with a whole ***series of integrated transactions*** and if the total of the buyback is more than 5% of an issued share class then the buyback can only be done in terms of s114 and s115.

   This transaction then has the potential for making a private company **regulated** if certain conditions are met. Please refer to s118 (1) (c). If a buyback of more than 5% is in process and within the last 2 years an **outsider** (see definition of related and inter-related persons) has acquired at least 10% of the shares in the company, the company will then fall within the definition of a **regulated company** and a compliance certificate or exemption must be issued by the Take-over Regulation panel.

We will deal with some of the requirements of s114 below; the important thing to note is the decision that has to be made in regard to the buyback is totally in the hands of the directors unless the buy-back is more than 5% and provided that the buy-back is not from a Director or a Prescribed Officer. Where the buyback is more than 5% it falls within the ambit of s114.

Once s114 kicks in the buyback transaction becomes a ***Fundamental Transaction*** in that it is now a ***scheme of arrangement***. If the company is a private company and falls within the definition of being a ***Regulated Company*** then the Fundamental Transaction becomes an ***Affected Transaction.***

6. S48 is an unalterable provision and cannot be removed by a clause in the MOI, however the terms in the MOI can be strengthened to specify that for every buyback that takes place a special resolution is required. See s 15(2)(a)(iii) which says that the MOI may include –

   "any provision imposing on the company a higher standard, a greater restriction, longer period of time or any similarly more onerous requirement, than would otherwise apply to the company in terms of an unalterable provision of this Act;"

5.4 SOLVENCY AND LIQUIDITY –SECTION 46

A buyback falls within the definition of a distribution. It is not the purpose of this paper to deal with all the intricacies of a **distribution** but as a rule the distribution by a company must be authorised by the company's board of directors where the distribution is pursuant to an existing obligation of a company or to a Court Order.

S46 says a company must not make any proposed distribution unless the company satisfies the **solvency and liquidity test** immediately after completing the proposed distribution. If there is an agreement to buy back shares this is ***enforceable*** against the company. However, it is not enforceable if the company falls foul of the **solvency and liquidity test**. If the company alleges that it ***can't fulfill its obligations*** in terms of the agreement the company ***must apply to court*** to prove that it would be in breach of the solvency and liquidity test and if the court is satisfied that the company is in breach of this requirement then the court must make an order;

- That is just an equitable having regard to the financial circumstances of the company
- Ensures that the shareholders are paid at the earliest convenience making sure that the company satisfies its other financial obligations.

Where the company re-acquires shares, which are ***contrary to s48 and s46*** the company must apply to court for an order reversing the transaction. The transaction re- acquiring the shares from a shareholder must be reversed. The shares have to be re-issued and the shareholder has to pay the money back to the company.

If the distribution has not been completed within 120 business days after the board has made acknowledgement in terms of the solvency and liquidity the board has to reconsider the solvency and liquidity test with respect to the remaining distribution by once again passing the resolution and doing the solvency and liquidity test.

In the event that something goes wrong directors are liable as provided for in s77(3)(e)(vi)

5.5 WHERE THE BUY BACK IS MORE THAN 5% OF THE SHARE CAPITAL

Let us have a look at the requirements of s114 which deals with proposals for a **scheme of arrangement** and specifically includes as part of s114 (1) (e) a re-acquisition by the company of its own securities. If we look at ss4 this refers to the conditions as contained in s48 and applies to the situation where the buyback is less than 5% of the share capital.

When the acquisition of a company's own shares is more than 5% it then has to be approved in terms of s115 and s115 sets out the method required and in particular that a special resolution must be adopted. S115(1)(b)(iii) includes the implementation of a scheme of arrangement which as we have read in s114 would include the buy-back or re-acquisition of a company's shares.

Where there is a proposed scheme of arrangement and the company is a **regulated company** the scheme can only proceed if in terms s119 (4) (b) a compliance certificate has been issued or an exemption has been granted by the Take-over Regulation panel. In the situation where a private company does not fall within the definition of a regulated company then the compliance certificate or exemption need not be applied for. However, on a strict reading of s114 and s115 all the other terms need to be complied with as the act does not differentiate between large and small companies.

5.6 INDEPENDENT EXPERT

S114 (2) says the company must retain an **independent expert** who meets the following requirements to compile a report as required in ss 3, and basically says the qualified person must have the competence and necessary experience to understand the type of arrangement proposed, evaluate the consequences of the arrangement, and assess the effect of the arrangement on the value of the securities and on the rights and interest of a holder of any

securities or a creditor of a company and be able to express an opinion, exercise judgment and make decisions impartially.

The person that must be retained must not have any relationship with the company and must have integrity, impartiality of objectivity, cannot have a relationship with the company within the immediately preceding 2 years or be related to a person who had a relationship contemplated above.

The independent expert must prepare a report to the board and cause it to be distributed to all holders of the companies' securities concerning the proposed arrangement. The report must as a minimum state:

a. All prescribed information relevant to the value of securities effected by the proposed arrangement;
b. Identify every type and class and holder of the company securities affected by the proposed arrangement;
c. Describe the material affects that the proposed arrangement will have on the right and interest of the persons mentioned;
d. Evaluate any material adverse effects of the proposed arrangements against;
    (i) The compensation that any of those persons will receive in terms of the arrangements; and
    (ii) Any reasonable probable beneficial and significant effect of that arrangement of the business and prospects of the company.
e. State any material interest of any director of the company or trustees for security holders;
f. State the effect of the proposed arrangement on the interest and person contemplated in paragraph e; and
g. Include a copy of s115 and s116. These Sections must be included in the report that gets sent to shareholders.