COMPANY LAW TIPS AND TRAPS

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1. TURQUAND RULE

We must understand the Turquand rule before we understand the doctrine of constructive notice.

“In the recent High Court decision of One Stop Financial Services (Pty) Ltd v Neffensaan Ontwikkelings (Pty) Ltd and Another, the Court confirmed the requirements for reliance on the common law Turquand rule as well as the implications of the statutory Turquand rule in respect of individual directors who purport to bind the company.

The Turquand rule is **applied by the South African courts** when deciding whether a company should be bound to a contract concluded with a third party in the circumstances where the company’s representative concluding the contract on behalf of the company is unauthorised to do so due to an **irregularity in the company’s internal procedures, or failure to comply with all internal approvals** before concluding the relevant contract. **The rule protects third parties and creates commercial certainty** in that it presumes in favour of the third party that all aspects of the company's internal governance have been duly fulfilled.

The One Stop case confirmed the application of the common law Turquand rule where a third-party contract with a board of directors (as opposed to an individual director) or a managing director or someone who holds another executive position in the company which carries with it a representation of authority usual to that position. In these scenarios a **third party is ordinarily entitled to assume that the requisite authority has been granted for purposes of binding the company.** The same assumption does not hold true for an individual director. It is clear that just because the company's constitution permits the board of directors to delegate authority to a single director, this **does not entitle the third party to assume that any director with whom he deals has the authority to bind the company**. The Turquand rule **only comes into operation once the third party proves that the individual director (purporting to represent the company) has authority** (i.e. ostensible authority) to bind the company. Once this is proved, the Turquand rule will enable the contracting party to assume that there has been compliance with the internal requirements of the company in authorising its representative.

The Turquand rule has essentially been codified in section 20(7) of the Companies Act, 2008 which provides that a person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company, unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.

The court addressed the codification of the Turquand rule as provided for in section 20(7) and (8) of the Companies Act and stated that the Companies Act is not intended to change the well-established principles of the common law Turquand rule, and as such cannot be seen to now allow a third party to presume the authority of an individual, ordinary director. The Court emphasised that in order for the third party to presume compliance with the "formal and internal procedural requirements" of the constitution (as provided for in section 20(7)), the third party should have been dealing with the "company". The section does not state that the third party may make any assumption when dealing with a purported representative per se. This reinforces the view that in order for section 20(7) to apply (as with the common law rule), the third party must establish that he was contracting with someone who had actual or ostensible authority to bind the company, only in those circumstance can the third party say that he was dealing with the company."

Above is courtesy of Ineke Brink, Partner Bowman Gilfillan Africa Group

So the effect of the Turquand rule is that when contracting with a company the parties contracting with the company must ensure that the representative of the company has the authority to conclude the contract.

On a big contract obtain a directors resolution properly constructed. When dealing with government make sure the representatives are properly authorized.

2. DOCTRINE OF CONSTRUCTIVE NOTICE

The difference between the old Companies Act and the new Companies Act is that in terms of the old Companies Act is that the ***doctrine of constructive notice*** applied to the MOI and that all parties dealing with the company were deemed to know what the contents of the MOI were as there was no reason why anyone dealing with the company did not have access to the MOI at the CIPC.

Under the New Act this has changed in that the Doctrine of Constructive Notice does not apply to the MOI anymore. This means that parties dealing with the company do not need to have knowledge of the contents of the MOI.

The Doctrine of Constructive notice under the new act does not apply other than when certain conditions in the MOI are ***Ring Fenced*** or **RF** conditions are indicated in the MOI. These RF conditions are specified in terms of s15(2)(b) or (c) of the new act. In terms of s 11(3)(b) the name of the company must be followed by **RF**. This is notice to all parties dealing with the company that there are ring fencing conditions being conditions that they should be aware of before they do any business with the company.

3. 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**. The question is **do they know it and are they trained to know all the rules.**

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 exercised 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

4. REMOVAL OF DIRECTORS

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 director 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.

5. RULES OF THE COMPANY

The **Rules** of a company is a new concept that comes out of the United States or Canada. Rules are very similar to bi-laws in a City Council. They are an addition to the constitution of the city council and would probably deal more with operational details not contained in the constitution of the city council.

The rules of a company are in fact an extension of the MOI and are designed to govern the internal affairs of the company. The problem with rules are that there are no examples and no definition of what should be included in the rules. The rules may deal with any corporate governance issues not contained in the act or in the MOI. The rules cannot be in conflict with the act or the MOI.

The rules and the MOI are in fact binding on the following in terms of S15(6);

- between the company and each shareholder
- between or among the shareholders
- between the company and each director or prescribed officer of the company in exercise of their functions within the company
- any other person serving the company as a member of a board committee in exercise of their respective functions of the board within the company.

The last two are new and overrides the long-established principle that the company's constitution is binding on a company and its shareholders only and only in the capacity of shareholders not directors. Owing to this change each party can enforce the MOI or the rules against one another in any lawful manner, this could be by way of an interdict or a damage claim arising from a breach.

The rules create a contract between the abovementioned parties in the abovementioned capacities. Please note that if the director or shareholder act in another capacity to the company then the rules can't be applied.

The rules can be changed or created quite easily without changing the MOI. Remember the rules are ***over and above***, or one can say an ***extension of the MOI***. It should be noted that the ***MOI will always take precedence*** over the rules. Where there are rules inconsistent with the MOI or the Act, these rules will be void to the extent of the **inconsistency**. The rules are still subject to anti-voidance sections of the Act. Rules cannot be used to alter the ***unalterable***

provisions of the act. One can make unalterable provisions stronger by inserting clauses in the MOI.

The advantage of having rules is that the directors can in fact ***compile*** and ***publish*** the rules and once the rules have been published, they are binding on the company. Regulation 16(1) provides that any rules of a company must be filed on Form Cor 16.1 within 10 business days after being published by the company.

See s15(4)(b), the board may change or append rules in any manner. It is important to know that the rules must be ***ratified*** **at the next available shareholders** meeting by way of an ordinary resolution. After the rules have been ratified the necessary form has to be filed with the CIPC. Regulation 16.2 is to indicate the rules have been ratified or rejected. It is not necessary to call a shareholders meeting to specifically ratify the rules, the ratification can wait until the next shareholders meeting.

Before the rules have been ratified, they are nevertheless still binding even though they are at an interim stage. What happens when the rules fail to be ratified (I.e. the shareholders vote against the rules or a particular rule) at the next general meeting? The position in this case is that even though they were in an interim stage everyone can rely on them to that point as everyone is bound by them. Once a rule has failed the ratification vote they are therefore no longer binding from that point in time. Once a rule has failed ratification it cannot be reintroduced by the directors for a further 12 months unless approved in advance by an ordinary shareholders resolution.

The advantage of compiling rules is that the directors can do it very easily without going to shareholders and the rules can be binding whilst waiting for ratification. In smaller companies it could be that ratification takes a long time because there are no shareholders meeting to ratify the rules.

Rules would deal with matters of meetings, the maximum number of Directors and potentially anything in relation to the corporate governance not in conflict with the MOI or the Act.

Some examples could be;

- Authority level of chairman of the board and frequency of director's meetings.
- Financial and marketing strategy
- Succession planning

6. REGULATION 31 CONVERSION OF PAR VALUE SHARES

INTRODUCTION

Where a pre-existing company (a company that was formed under the old companies act) has par value shares at the effective date (the date the Companies Act 2008 came into existence) on 1 May 2011 and the board of directors wish to increase the authorised number of the par value shares then they have to adopt the procedure as set out in terms of Regulation 31 of the Companies Act 2008.

THE LAW

Schedule 5, Section 6 (2) says that **par value** shares may continue to exist forever after the effective date subject to any regulations made by the minister.

Where directors wish to increase the authorised share capital as there are not enough shares to issue the formalities of Regulation 31 must be carried out.

It is important to note that many of the Companies Act Regulations refer to the various sections in the act on ***how to*** carry out the procedures. This particular regulation 31 does not appear to be based on the act as it appears to be an **afterthought** actually extending the requirements of the law with even SARS having some input in regard to some tax issues.

In terms of section 36(2)(a) of the act a ***change of the authorised share capital*** is in fact an amendment to the MOI and requires a special resolution and submission of form **CoR 15.2** together with the **special resolution**.

Form CoR 31 and regulation 31 (3) appear to be in conflict with this section as the regulation says that when a company has par value shares for which no shares are in issue a director's resolution and form **CoR 31** will be sufficient to request the CIPC to change the share class from par value to no par value. It appears Form CoR 31 is in conflict with the act as even though no shares are in issue this is a change to the MOI and it would seem to be necessary to file a special resolution and form CoR 15.2 to make this change. This regulation specifically allows a director's resolution in place of a shareholder's resolution, where you have the situation of a share class where no shares are in issue as no shareholders are affected by this. It is necessary to file the CoR 31 and CoR 15.2 and the director's resolution changing the MOI.

Please also note that in terms of Regulation 31 (5) (b) the directors may issue **par value shares** if there are ***sufficient authorised*** shares available. Where no changes in the share

capital is envisaged par value shares can remain in existence forever as there is no minister's regulation to this affect.

Regulation 31 (5) (c) says that an amendment to the MOI may be filed at no charge in order to change a class provided that sub-regulations 6 to 11 are complied with. This regulation kicks in when a company wishes to increase its authorised share capital.

SARS

It is interesting that sub-regulation 6(a) says that this amendment must not be designed substantially or predominantly to ***evade the requirements of any applicable tax legislation*** and 6(b) says that such conversion will ***only be approved by a special resolution adopted by the holders of the shares for each such class*** and ***a further resolution adopted by a meeting of the company shareholders*** called for that purpose.

BOARD REPORT

Sub-regulation 7 deals with the ***board report*** that must be sent out with the proposed special resolution to convert par value shares to no par value shares. The following items should be dealt with in the board report.

a. The report must state ***all information that may affect the value*** of the securities caused by the proposed conversion; and

b. The report must ***identify the class of holders*** of the company securities affected by the proposed resolution and;

c. The report must ***describe the material effects*** that the proposed conversion will have on the ***rights of any holders*** of shares, and;

d. The report must ***evaluate any material adverse effects*** of the proposed arrangement ***against any compensation*** to those persons who receive compensation owing to the conversion.

It appears that the board report is designed to indicate if there is a change to any of the rights of shareholders which ***may trigger a capital gains event*** as the board report and the special resolution **must be filed at SARS**.

Regulation 31 (8) says that the company must ***publish a special resolution*** contemplated in sub-regulation (6) together with the ***report required*** by sub regulation (7) which must be made available to the shareholders before the meeting (which ***must have proper notice***) at which the resolution is to be considered. It appears that the ***notice cannot be waived*** in this instance.

The special resolution and the report must be filed with the CIPC as well as the South African Revenue Service by emailing the special resolution and board report to ***regulation31@sars.gov.za***. We suggest that a certified copy of the email proving submission to SARS or a copy of the documents with the SARS official stamp will reduce the chance of rejection by the CIPC.

Sub Regulations 9 to 11 deals with various instances where applications can be made to court to obtain a declaratory order in regard to this conversion.

SPECIAL RESOLUTION

I have set out an example of the kind of wording that should be used in regard to the Special Resolution of a smaller company. Perhaps one should put in a preamble as to the reasons why the special resolution needs to be taken.

REASON FOR THE SPECIAL RESOLUTION

The Companies Act 2008 regulations **do not allow the increase of authorised** par value shares where there are no further authorised par value shares to issue. The directors have decided that in order to comply with the requirements of the act that the share capital of the company must be converted from par value to no par value shares.

SPECIAL RESOLUTION 1

Resolved that the authorised Ordinary Share Capital comprising of 10,000 shares which have a par value of R1 each is converted to 10,000 Ordinary Shares of no par value, each share to rank pari passu in every respect with the existing shares of the company.

Comment – it's important to show that all the rights and limitations remain the same on the conversion. SARS are looking for a capital gain event.

SPECIAL RESOLUTION 2

The authorised Ordinary Share Capital of 10,000 shares of no par value be increased to 100,000 shares of no par value to rank pari passu in every respect with the existing shares of the company.

Comment – it's a good idea to increase the authorised number at the same time.

ORDINARY RESOLUTION

3. Resolved that subject to the passing of special resolution number 1 that the Ordinary Share Capital account of R10,000 and the Share Premium account related to this share capital of R40,000 both be transferred to the stated capital account of the company.

Comment; It may be that the company wishes to retain the share premium account as they may want to repay this to shareholders at a later time. Consider this in relation to an actual buy back of shares. It will be much easier to just pay back the share premium as opposed to buying back shares because of the compliance issues in a share buyback. There is no reason why the share premium account cannot be retained.

REPORT TO ACCOMPANY THE SPECIAL RESOLUTION

An example of the board report in the case of companies which are small companies and where shareholders rights are not affected will be as follows:

"Owing to the fact that the board of directors need to increase the authorised share capital of the company to allot more shares it is proposed that the ordinary 10,000 shares of par value be converted to 10,000 ordinary shares of no par value in order to meet the requirements of the Companies Act 2008.

10,000 issued ordinary shares of par value, details of which are contained in the share register which is available for inspection at the registered address of the company will be affected. The share certificates of par value as indicated in the share register will all be cancelled and a new class of shares of no par value will be created and the shares will be re-issued under the same certificate numbers on registration of the special resolution.

There is no effect on any of the rights of any shareholder, as the rights remain the same.

Owing to the fact that no rights of any shareholder have been affected by this conversion no compensation has been paid out."

SUBDIVISION OF SHARES

In the case of a subdivision of shares whether they are ***par or no par value***, is that the ***number of shares in issue are increased*** (i.e. more shares are created by the sub division), and the share capital ***value remains the same***. The Companies Act 2008 does not deal with the subdivision of shares at all. We however need to differentiate the position between ***par value*** and ***no par value*** shares as subdivision is slightly different.

Where the shares are, ***par value*** a conversion of the shares must first take place as a subdivision of the authorised shares is also necessary. This is necessary as the number of authorised shares must be increased in order to carry out the subdivision. We therefore need to look at the requirements of Regulation 31 and comply with them first ensuring that all the shares are converted to NPV shares before we run this procedure.

In a ***par value*** share situation, the authorised shares are subdivided as well as the issued shares because of the nominal value of the shares. As we can't increase the number of authorised par value shares, we must convert the shares in terms of regulation 31 first making sure that there are a sufficient number of authorised shares. The increase in the number of authorised shares must be part of the conversion process. In my **opinion** a subdivision of no par value shares is only performed on the issued shares and is not necessary to do so on the authorised shares as there is no value placed on the authorised shares. We would just need to make sure that the authorised shares are sufficient in number to do the subdivision of the shares.

On conversion, from PV to NPV it is required to have a special resolution and of course the board report with all the necessary points as specified in Regulation 31 above.

There is a view that one can't do a subdivision of no par value shares. I disagree because this may very well be of commercial necessity to prepare for a transaction or to create better trading conditions for a share that is listed. You certainly can do a conversion of no par value shares that have been issued as there is a value. A subdivision is really just an increase in the number of shares, without affecting the total value of the share capital account. The subdivision will affect the value of each share which will be smaller. One could also do it by allotting additional shares at no value but this certainly does not make any sense, as this is an MOI change. Please remember we are talking about no par value shares in this instance.

I do not see why we are unable to do this; there is nothing in the law that prevents this from being done in my view.

This is how you do the subdivision of par value shares;

Let's say you have a company with 1000 shares which have a par value of R1 each and authorised shares of 10000. I.e. total capital is R1000 and the directors wish to create 10,000 shares by way of a sub-division.

1. Convert the 1000 PV shares to NPV shares and increase the authorised number of shares to 50000.

2. Prepare a special resolution and the board report for submission to CIPC and SARS to convert PV to NPV and increase the authorised number of the NPV shares as part of the same resolution. Remember this affects the MOI and needs to be submitted to the CIPC.

3. Do not mention subdivision of shares in the resolution submitted to the CIPC. This resolution must cover the conversion of the shares and an increase in the authorised share capital of the company only, say to 50,000 shares or whatever the requirement is.

4. After you have approval of the special resolution in 2 above you then prepare another special resolution sub-dividing the issued shares to the number you want. This means you increase the number of shares in issue but retain the total value of the shares. This special resolution does not need to be filed at the CIPC as all you are doing is increasing the number of shares in issue and the CIPC does not need to know about this in terms of the new Companies Act 2008.

CONCLUSION

Regulation 31 clearly was an **afterthought** with SARS getting involved. I don't see why there was this need for SARS to get involved in the companies act as they could quite as easily put this legislation into the income tax acts. This procedure was probably intended for larger companies but clearly affects all small companies unnecessarily creating a huge amount of additional company secretarial labour.

One also needs to look at all the tax consequences for the transactions above and the future tax situation of the shares converted or subdivided or share premium paid back.

QUESTION ON SHARE PREMIUM

A company converts its Par Value shares (PV) – 100,000 shares in issue to No Par Value (NPV) shares in terms of **Regulation 31**. There is a rand balance on the share capital and on the share premium account, of R100,000 each. Is it necessary to move the balance of share premium to the NPV share capital account – stated capital or can the company leave it as a share premium account?

ANSWER

It would be a good idea to leave the balance in share premium with a view to a future payback of capital when the company is in a position to do so instead of paying a dividend. By doing it this way the company avoids appointing an independent expert or even going to the TRP because it's regulated as it does not fall into the ambit of a share buyback. Paying back share premium is just a method of paying back share capital without all the formalities. The directors

would need to obviously comply with all the ***distribution rules*** including the ***solvency and liquidity test***.

The share capital account before the transaction is;

Share capital	R100,000	Par value shares of R1 each
Share Premium	R100,000	
Total Share Capital	R200,000	

After the transaction it could be as follows;

Share capital – stated capital account	R100,000	100,000 No Par value shares of R1 each
Share Premium	R100,000	
Total Share Capital	R200,000	

However, we could make it look like this;

Share capital NPV	R10,000	10,000 No Par value shares of R1 each
Share Premium	R90,000	**90,000 par value shares of R1 each transfer to share premium.**

Share Capital	R 10,000
Share premium	R 190,000
Total Share Capital	**R 200,000**

The share capital of the company in the above instance is 10,000 shares of no par value of R1 each. The R90,000 which was in the old share capital account is transferred transferred to the share premium account.

7. WHEN A PRIVATE COMPANY BECOMES REGULATED

INTRODUCTION

The new companies act brings in an entirely new concept in that under certain conditions a private company can become regulated. In order to understand this concept, there are some terms we need to understand viz. ***fundamental transaction*** and ***affected transaction***. This section is aimed at company secretarial practitioners who handle company secretarial work for private companies. The Companies Act 2008 is quite different to the previous act in regard to **regulated companies** and **affected transactions** in that a private company can now fall within the definition of a regulated company resulting in additional administrative requirements.

There is confusion as ***many practitioners don't know about these requirements and in the case of many smaller companies there is probably no compliance.***

FUNDAMENTAL TRANSACTIONS

Chapter 5 SS112 – 117 of the Act is headed fundamental transactions, take overs and offers.

The expression ***fundamental transactions*** are not defined in the Act. It is used to describe three types of transactions, each of which ***fundamentally*** alters a company due to a material change in its ***assets***, its ***securities*** or its ***shareholders***.

- The disposal of all or the greater part of the company's assets or undertaking – s 112;

  "all or the greater part of the assets or undertaking", when used in respect of a company, means—

  (*a*) in the case of the company's assets, more than 50% of its gross assets at fair market value, irrespective of its liabilities; or

  (*b*) in the case of the company's undertaking, more than 50% of the value of its entire undertaking, at fair market value;

- A scheme of arrangement between a company and its security holders – s 114;

  Proposals for scheme of arrangement.—(1) Unless it is in liquidation or in the course of business rescue proceedings in terms of Chapter 6, the board of a company may propose and, subject to subsection (4) and approval in terms of this Part, implement any arrangement between the company and holders of any class of its securities, by way of, among other things—

  (*a*) a consolidation of securities of different classes;

  (*b*) a division of securities into different classes;

  (*c*) an expropriation of securities from the holders;

  (*d*) exchanging any of its securities for other securities;

  (*e*) a re-acquisition by the company of its securities; or

  (*f*) a combination of the methods contemplated in this subsection.

  [Sub-s. (1) substituted by s. 70 (*a*) of Act No. 3 of 2011.]

and

- An amalgamation or a merger- s113.

“amalgamation or merger” means a transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in—

(a) the formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies; or

(b) the survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new company or companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement;

A PARAMETERS THAT WOULD FORCE S48(8) TO MOVE TO S114

The parameters that would force a buyback under s48(8) to s114 as a fundamental transaction.

The parameters that would force a share buyback under **Section 48(8)** to fall under **Section 114** as a fundamental transaction (even with the removal of the 5% rule) involve considerations related to the nature and impact of the transaction. Here's a detailed list of the key parameters:

1. Nature of the Buyback - Scheme of Arrangement

- **Section 114(1)(e)**: A buyback may be classified as a **scheme of arrangement** if:
  - It involves a negotiated agreement with one or more shareholders.
  - The transaction fundamentally alters the rights or obligations of shareholders (e.g., differing classes of shares, voting rights, or ownership percentages).

2. Impact on Ownership Structure

- A buyback that significantly changes the **control or voting power** within the company can be classified as a fundamental transaction. Examples include:
  - **Buyback from a majority shareholder**: This could lead to a shift in control or concentrated power among remaining shareholders.

- **Substantial reduction in public float**: For listed companies, this may affect the shareholding base and market dynamics.

3. Procedural Complexity

• If the buyback requires shareholder **approval via a special resolution** under **Section 115**, it is more likely to be categorized as a fundamental transaction.

4. Involvement of a Regulated Scheme

• If the buyback triggers provisions of **Section 118 (Takeover Regulations)**, such as:

- The buyback involving **related or interdependent transactions** that fall under regulatory scrutiny.
- The company being subject to the Takeover Regulations Panel's oversight due to the magnitude or nature of the buyback.

5. Financial and Legal Thresholds

• A buyback that affects the company's **capital structure**, **solvency**, or **liquidity** may attract scrutiny under Section 114. This includes:

- Transactions funded by significant debt or which materially impact the company's financial health.
- A reduction in share capital that disrupts shareholder equity or distributions.

6. Shareholder Rights and Appraisal

• If the buyback grants dissenting shareholders **appraisal rights** under **Section 164**, this suggests that the transaction impacts shareholder interests sufficiently to qualify as a fundamental transaction.

7. Targeted Shareholders

• **Selective Buybacks** (rather than proportional or open-market repurchases) may require compliance with Section 114 if:

- Certain shareholders receive preferential treatment.
- Specific shareholder rights (e.g., preferential shares) are extinguished or altered.

8. Multiple Case Law and Context-Specific Triggers

• The courts and legal interpretations may also classify a buyback as fundamental based on:

- The **cumulative effect** of transactions that collectively meet the Section 114 threshold.
- The **company's articles of incorporation** or shareholder agreements that impose additional requirements.

Conclusion

Even with the removal of the **5% rule** in **Section 48(8)**, a buyback can trigger **Section 114** if it involves:

1. A scheme of arrangement,
2. Significant structural changes (ownership or control),
3. A need for shareholder approval under Section 115,
4. Procedural obligations like fairness opinions or Takeover Panel involvement.

Each buyback must be evaluated on its facts, considering its impact on the company and its shareholders.

8. BUYBACK OF SHARES THE IMPACT OF SECTION 48(8) AMENDMENTS

Introduction

The practice of share buybacks in South African corporate law, governed by Section 48 of the Companies Act, plays a crucial role in company financial strategies. Recent amendments to Section 48(8) have notably altered the requirements for these transactions, providing companies more leeway while still ensuring regulatory compliance.

Pre-Amendment Scenario

Before the amendment of Section 48(8), share buybacks involving more than 5% of a company's issued shares were automatically subject to stringent requirements under Section 114, classifying them as **fundamental transactions**. This required companies to

1. Obtain a special resolution approved by shareholders.

2. Prepare an independent expert report, providing an opinion on the fairness of the transaction.

3. Offer dissenting shareholders appraisal rights under Section 164.

The automatic categorization as a fundamental transaction added considerable complexity and cost to executing buybacks, often discouraging companies due to the procedural burdens involved.

Key Changes with the New Section 48(8)

The revised Section 48(8) has simplified the landscape for share buybacks. Here's how

1. Removal of the 5% Threshold

The amendment removes the requirement that buybacks exceeding 5% of share capital must automatically be classified as fundamental transactions. This change empowers directors to assess each buyback on its details and merits.

2. Adjustments to Special Resolution Requirements

A special resolution is still required when buybacks **involve shares of a director, a prescribed officer**, **or a related person**, **irrespective of the transaction size**, however buybacks executed through a pro rata offer to all shareholders or transactions on a recognised exchange are generally exempt from these special resolution requirements.

3. Flexibility in Procedural Obligations

Without the automatic linkage to Section 114, companies no longer need to appoint an independent expert or complete the full formalities unless the buyback is part of a scheme of arrangement or another transaction explicitly invoking Section 114.

When Section 114 Comes Into Play

Even with Section 48(8)'s amendments, certain buybacks might still trigger Section 114 requirements if deemed a fundamental transaction. This occurs when;-

- The buyback is part of a scheme of arrangement significantly altering shareholder rights.

- Shareholder approval is required under Section 115 due to substantial changes in company control or ownership structure.

- The transaction involves procedural complexities or related party transactions that warrant broader shareholder and regulatory scrutiny.

Once Section 114 is invoked, adherence to Sections 115 (shareholder approval) and 164 (appraisal rights) becomes mandatory, transforming the buyback into a fundamental transaction.

The Role of the Takeover Regulation Panel (TRP) and Regulated Private Companies

A key consideration under the s114 is the status of a private company as **"regulated",** if a private company meets specific criteria, of a regulated company under the Companies Act. In such cases, the buyback falls under the oversight of the Takeover Regulation Panel (TRP). It is essential for the company to obtain a compliance certificate or exemption from the TRP, ensuring that all aspects of the buyback align with market regulations and uphold shareholder interests.

Conclusion

The amendments to Section 48(8) alleviate some of the previous procedural burdens, making share buybacks more viable for companies without the former automatic classifications as fundamental transactions. However, directors must cautiously evaluate each transaction against criteria outlined in Sections 114 and 115 to ensure compliance. These changes highlight a nuanced balance between greater flexibility for routine buybacks and diligent regulatory adherence, fostering a more dynamic corporate environment for capital management tactics. Additionally, the potential for private companies to be deemed regulated underscores the importance of thorough legal oversight and interaction with the TRP where necessary.

9. REGULATED COMPANY

We need to understand the definition of a regulated company. The takeover provisions ss 117 -127 only apply to a regulated company.

A regulated company is defined in terms of s117 (1) (i) as a company in which Part B, Part C and the Takeover Regulations apply as determined in accordance with s 118(1) and (2). This means that in terms of 118 (1) and 118 (2) various types of company are specified as a

regulated company and under certain conditions a private company falls within the definition of a regulated company.

Section 118 (1) states that the provisions of the company's act and the takeover regulations will apply with respect to an affected transaction or an offer involving a profit company or its securities if the company is:

a. A public company;

b. A state owned company;

c. A private company only if the MOI expressly provides that the company and its securities are subject to Part B, Part C of the Takeover Regulations and if more than the prescribed percentage currently (10%) of its issued securities have been transferred (other than between related or interrelated persons) within the 24 month period before the date of a particular affected transaction or offer.

Refer to the definition of related and interrelated in s 2 of the act as it will have a major bearing on whether a private company becomes regulated or not. It is important that we understand what related and inter-related means. In regard to individuals a related party would be a relationship within two degrees of consanguinity or relationship steps, example it would be a brother, but not a cousin as a cousin is more than 2 relationship steps.

In regard to the shares being held by a company, close corporation or trust one would need to look at who in effect controls the voting rights of these entities and determine what the relationship is. If they do not fall within two degrees of relationship steps they are outsiders then the transaction in question would make the company a regulated company if there is an affected transaction.

In a private company if securities of 10% or more were transferred within the last 24 months to an unrelated party this does not necessarily make the company a regulated company. It only becomes a regulated company if there is an offer or proposal for an affective transaction in terms of s 112 s 113 and s 114. It is at this point that the company becomes a regulated company and has to comply with all the necessary requirements and make the necessary applications to the TRP.

S118(c)(i) NOT IN EFFECT

Section 118(c)(i) of the Companies Act, which is currently not in effect, states:

(b) a private company, but only if-

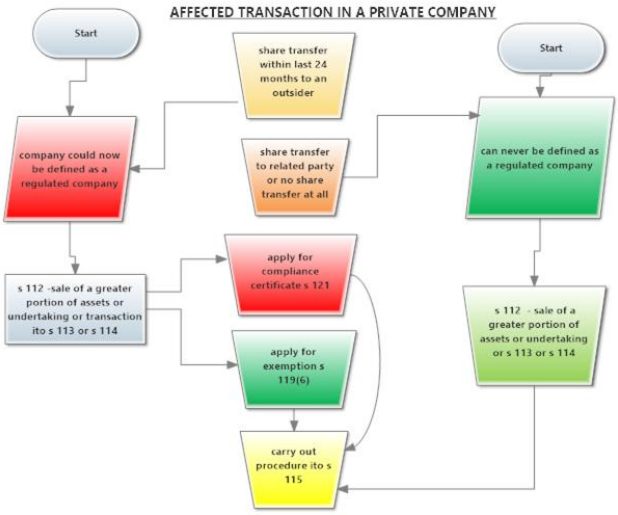
"(i) it has 10 or more shareholders with a direct or indirect shareholding in the company and meets or exceeds the financial threshold of annual turnover or asset value determined in terms of subsection (2): Provided that the Panel may exempt any particular transaction affecting a private company in terms of section 119(6);"

This section is proposed to be substituted by a new provision under Act 16 of 2024, which is yet to be determined.

Subsection 2 of Section 118 of the Companies Act states:
"The Minister, after consulting the Panel, may prescribe a minimum percentage, being not less than 10 percent, of the issued securities of a private company which, if transferred within a 24-month period as contemplated in subsection (1)(c)(i), would bring that company and its securities within the application of this Part, Part C, and the Takeover Regulations in terms of that subsection"

This subsection allows the Minister, in consultation with the Panel, to set financial thresholds based on the annual turnover or asset value of the company to determine which private companies are subject to the provisions of Part B and Part C of this Chapter.

DECISION CHART



EXEMPTION

The panel in terms of s 119 (6) may wholly or partially and conditionally or unconditionally exempt an offeror or an offer to an affected transaction from the application of any provision of Part B and Part C or the Takeover Regulations if;

a. There is no reasonable potential of the affected transaction prejudicing the interest of an existing holder of a regulated company's securities;

b. The cost of compliance is disproportional relative to the value of the affected transaction or;

c. If doing so is otherwise reasonable and justifiable in circumstances having regard to the principle and purposes of Part B, Part C and the Takeover Regulations.

There is a process whereby a smaller company can make application for exemption and all the shareholders need to sign a waiver. The TRP will consider the application and levy a cost of R3420 per hour. In all likelihood the exemption will be granted but at an exorbitant cost.

10. THE COMPLEXITY OF DIVIDEND DECLARATIONS

Introduction

Where there is a dispute between directors and shareholders in regard to dividend declarations what should the shareholders do.

In South African company law, the declaration of dividends is a matter that is primarily within the purview of the board of directors. This is because the board is responsible for ensuring that the company meets the solvency and liquidity test as stipulated in Section 46 of the Companies Act 71 of 2008. This test requires that the company's assets exceed its liabilities and that it can pay its debts as they become due for the next 12 months.

The Role of Directors in Dividend Declaration

The directors are tasked with the responsibility of managing the company's financial affairs, which includes determining whether the company is in a position to declare a dividend. This involves a careful assessment of the company's financial health and future obligations. As such, only the directors can resolve to declare a dividend, as they are the ones who must ensure compliance with the solvency and liquidity requirements.

The ***solvency and liquidity test*** is an unalterable provision under the Companies Act, meaning it cannot be overridden by the MOI. This ensures that the directors must always apply this test before declaring any distribution, safeguarding the company's financial health. However, the MOI can strengthen this requirement by adding additional conditions or obligations, such as mandating the board to consider dividends under specific financial conditions or getting the shareholders to finally approve the declaration of the dividend. An ***unalterable provision*** cannot be made weaker but can be made stronger.

Shareholders' Limited Role

Shareholders, on the other hand, **do not have the authority to declare dividends**. Their role is limited to approving dividends if the company's Memorandum of Incorporation (MOI) requires such approval. However, they cannot compel the board to declare a dividend if the directors decide against it. This can lead to disagreements, especially if the majority of shareholders believe that the company is in a position to distribute profits.

Challenges in Case of Disagreement

When there is a disagreement between the board and the shareholders regarding the declaration of dividends, it can become **problematic**. Shareholders may feel that their interests are not being adequately considered, especially if they believe that the company is financially capable of paying dividends. However, without the board's resolution, dividends cannot be declared, as the directors are the ones who must ensure that the company remains solvent and liquid.

Options for Shareholders

In such situations, shareholders have several options, including:

- ***Removing and Replacing Directors:*** Shareholders can vote to remove directors who are unwilling to declare dividends and replace them with those who are more aligned with their interests.

- ***Amending the MOI:*** Shareholders can propose amendments to the MOI to include provisions that mandate dividend declarations under certain conditions.

- ***Seeking Legal Remedies:*** Shareholders can apply to the court for relief if they believe the directors' refusal to declare dividends is **oppressive or unfairly prejudicial**.

Section 163: Legal Remedy for Oppression

Section 163 of the Companies Act 71 of 2008 provides a statutory remedy for shareholders who feel that the conduct of the company or its directors is oppressive, unfairly prejudicial, or unfairly disregards their interests. This section allows any shareholder, not just minority shareholders, to apply to the court for relief if they believe that the actions or omissions of the company or its board have resulted in such unfair treatment.

Key Aspects of Section 163

- ***Broad Court Powers:*** The court has the authority to make any interim or final order it deems fit to or prejudicial **rectify the oppressive situation**. This can include ordering the company to amend its Memorandum of Incorporation (MOI), issue shares, buy out a shareholder's shares, or other tailored remedies.

- ***Potential Grounds for Relief:*** A refusal to pay dividends, especially when the company is profitable, can be considered prejudicial conduct under certain circumstances. This is particularly true if the refusal is coupled with **other actions that benefit** directors or a specific group of shareholders at the expense of others.

- ***Practical Application:*** While majority shareholders typically have other means to protect their interests, such as voting power, Section 163 can be relevant in situations where the

company is controlled by minority directors, there is a deadlock, or side agreements limit the majority's power.

Legal Precedents

- ***Peel v Hamon J&C Engineering (Pty) Ltd***: This case demonstrated the application of Section 163, where the court granted relief to shareholders who complained of prejudicial conduct by the majority stakeholder. The court found that the directors' actions were oppressive and unfairly prejudicial.

- ***Donaldson Investments v Anglo-Transvaal Collieries***: The court acknowledged that failure to pay dividends, especially when directors are self-enriching, can be evidence of unfair prejudice. However, the court dismissed the claim in this case because there was a business justification for the actions.

Conclusion

The declaration of dividends is a complex issue that requires careful consideration of the company's financial position. While shareholders may desire dividends, the ultimate decision rests with the board of directors, who must ensure that the company remains financially stable. This division of responsibilities can lead to disagreements, but shareholders have several avenues to address their concerns and protect their interests. Section 163 provides a powerful tool for shareholders to address grievances related to the conduct of directors and the company, ensuring that their interests are not unfairly disregarded.