



**COMPANY LAW AND SECRETARIAL PRACTICE IN A PRIVATE COMPANY ENVIRONMENT**

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## COMPANY LAW NOTES

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## 1 COMPANY LAW COURSE

### 1.1 INTRODUCTION

Its now been **over 10 years** since the new companies act was promulgated. A lot has happened and a lot has been learned and there have been a number of court cases and a fair number of articles that explain certain aspects. We have even reached a point where a **draft bill 2021** has been released but has not been promulgated. There are certainly many issues that need to be ironed out.

The CIPC has published a guidance note which makes a **compliance check list** mandatory in certain instances. This means that secretarial practitioners need to understand the legislation otherwise they cannot be compliant where the check list has to be done for most companies.

The act is also not the easiest document to read even though the language is easily understandable because of all the cross references and circular references. In the courses, I am presenting, the Basic and Advanced, I have tried to break it down in terms of what you need to know as a company secretarial practitioner. If you consider yourself to be an **advanced user** there are a number of concepts dealt with in the basic course that you must know! What I have attempted to do is to produce a practical course and guides to controversial issues, and some issues that require some debate.

As a software developer it has always been our goal to make the routines of Company Secretarial Practice as simple and automatic as possible and I think with the current version of our software we have achieved this. I can comfortably say that we in fact the only vendor that has a comprehensive understanding of what is required.

The new Companies Act, although fairly easy to read has a lot of nooks and crannies that require you to jump all over the place because of all the cross references, and although it may refer to other sections one needs to spend some time to go through other sections to make sure that one understands the section you are looking at. This particular set of notes or publication is brought about by the fact that being software developers we are required to understand this Act as best as we possibly can and in order to do this we have come across a number of practical issues and uncertainties in the law as well as the regulations. The purpose of this document is to explain secretarial practice and to actually point out all the problem areas and where we can suggest alternatives or work-a-rounds and of course bring you up to date.

This particular publication is in no particular order.

If you are going to go through this document, we would really appreciate some feedback and any suggestions for improving it in the future.

During the course of any week I receive a number of questions on Company Secretarial Practice. It is clear that many Company Secretarial Practitioners that work in an accounting Practice do not understand many things about company law as they don't have the theoretical background. This is possibly because they have not been taught the formal company law background that goes into Company Secretarial practice. They have been taught by the firm and the processes required by the CIPC, however with the advent of the new companies act there are aspects of law that one really needs to know. What is quite strange is that there should be partners within the firm that should be able to answer the issues, but they don't know. I would go so far to say that you need to point out certain situations to the partners in your firm, because clearly, they do not know the consequences and the risks involved of not knowing. The question that I have for everybody is;

***How can you advise your client or process a transaction if you are not in possession of all the legal facts of the situation? There are many things that can go wrong!***

Mark Silberman

October 2022

## 1.2 THE NEW ACT

Company Law is governed by a number of things one of which is **statute** which is the Companies Act 2008 which became law on the 1<sup>st</sup> April 2011. Prior to this there was the 1973 act which was around for some nearly 40 years and was amended from time to time. The Act governs much of what we do with companies, how to administer them the rules for directors and what they are allowed to do. There are other acts like the income tax act and POPIA that we should also be concerned with. There are a number of instances where you have to have knowledge of a number of acts. i.e. income tax plays a very important role in regard to companies and you should have knowledge of income tax aspects like **contributed tax capital** which will affect the way you carry out your company secretarial work and certainly the way dividends are handled.

Company Law is also governed by what we call **common law**, these are cases that have been tried in court in regard to principles of law and in many instances, we would look to common law to decide on a particular issue. There is the court case on where the registered office should be, i.e. the auditor's office or the physical address and it was held that it should be the place of business - Sibakhulu Construction.

We also have what we call the **King code** which is now up to **King IV**. We call this **aspirational law** as it is strongly suggested that large corporate companies adhere to King. This is very important in regard to listed and larger companies and will rarely come into play in the small company environment.

The New Companies Act 2008 follows the 1973 Act which was in existence from 1973 right through until 2011. The new Act has been modernised and has introduced a whole series of new concepts. Company Law has gone through an arduous reform process which has now resulted in the new 2008 act. Despite this there are a number of issues in the new act which need to be tidied up. Two issues that come to mind are the **interpretation of a buy back** in a smaller company and the fact that a smaller company has to make **application to the takeover regulation panel** under certain conditions.

The new Act is more reader friendly and it is written in modern English, but unfortunately does contain some unfamiliar words for South African lawyers. It has been reduced dramatically in size.

It should also be noted that in terms of company secretarial practice the **common secretarial practice** is important as this indicates the way things are done in practice and have been handed down over the years. This also needs to be taken into account as not every aspect is defined by law or regulation or is readily available.

There are a number of schedules that have been attached to the Act;

**Schedule 1** deals with non-profit companies,

**Schedule 2** governs the conversion of close corporations and

**Schedule 3** contains various amendments that harmonise with other statutes. The bulk of these amendments relate to the close corporations Act 1984.

**Schedule 4** contains a list of 15 other statutes which the CIPC must also administer, these include the Close Corporations Act of 1984, the Copyright Act of 1978, the Patent Act of 1978, and the Trademarks Act of 1993.

**Schedule 5** is headed Transitional Arrangements and strives to make the transition from the old to the new act as smooth as possible. There are a number of consequences that the transitional arrangements created which we should be aware of, even today.

It is also important to understand that the Minister had the power to prescribe certain things in regard to regulations etc. There are over a hundred matters in respect of which the Act empowers the minister to make or prescribe regulations ranging from the functions of regulatory agencies to procedural and technical matters. All regulations must be expressly mandated by a specific provision or reference within the Act or necessary to provide sufficient or additional detail to ensure that any provisions of the Act can be properly implemented and administered.

There is a lot more to the new companies act which we will deal with through this course!

## 2 ENTITY TYPES

### 2.1 SOLE TRADER

This is where an individual person in their own capacity wishes to operate a business. They would not form an entity so it could be Joe Dlamini trading as Efficient Plumbing Services. In a situation like this he would open a bank account in the name of Joe Dlamini trading as ...or maybe not and just use his personal account. All his income and expenses would go through this business bank account. Profits he makes need to be reported in his tax return. If things go wrong, he would have no protection for his personal assets and could land up losing everything.

### 2.2 PARTNERSHIP

This is where more than one person enters into a joint venture and run a business together. The profits are split on an agreed basis. Money drawn by the partners is known as drawings but could also be as a result of the partnership making profits. Firms of accountants and lawyers would make use of a partnership.

Partnership does not protect the individuals in case of insolvency. If the sole trader or the partnership went into liquidation the individuals involved would be liable for the debts and may lose personal assets. Partnership income is accounted for in an individuals tax return.

We now have something called a **profit company** which is a **personal liability company** and would give some protection to the partners under certain conditions. Must have incorporated - Inc after its name.

### 2.3 CLOSE CORPORATIONS

The Close Corporations (cc) has its own Act that governs all aspects of the way a cc runs. The cc gives the owners of the cc certain protection in case of insolvency. The cc came about in 1984 because the Companies Act at that point was clearly designed for larger businesses. As part of the government reform process the cc was instituted to cater for small businesses. The cc has been incredibly successful in that they outnumber companies by 8 to 1. There are less formalities in a cc seeing that one does not have to perform an audit and comply with all the requirements of companies.

It is definitely government's intention to move the more than 1 million cc's into the company environment as soon as it becomes feasible from a CIPC point of view. They have indicated a period of ten years.

It is probably best in today's strenuous tough business environment for all businesses once a start-up takes off and risk is introduced for the business to become a company. The new

Companies Act prohibits new close corporations from being formed but allows cc's already in existence to remain forever at this point. The intention is to in time make all cc's companies.

#### **2.4 FUNDAMENTAL DIFFERENCES BETWEEN A CLOSE CORPORATION AND A COMPANY**

The fundamental difference between a close corporation and a company is that in a company, shareholders participate in the equity of a company by issuing share certificates which reflect the number of shares held and they participate in the profits based on the percentage a shareholder holds to the total shares issued. As a rule, the percentage of shares that an individual shareholder holds to the total **ordinary** or **common** class of shares. In a close corporation a **percentage interest** is allocated to each member in the close corporation. The percentage held indicates the percentage owned by the member. We normally call this a **member's interest**. As part of the Accfin Software range we issue a member's interest certificate to indicate the percentage holding of the members even though it is not necessary.

#### **2.5 WHO RULES OR WHO HAS THE POWER**

In terms of the management of the Close Corporation the members have all the power in accordance with the ratio of the percentage interest they hold and in a company the directors manage a company for and on behalf of the shareholders. The shareholders in a company who hold over 50% rule.

**In a cc 51% rules.** A company is more complicated because management takes place through the directors for the shareholders. In the old act this was fairly straight forward as the shareholders had the power and had to approve material decisions.

In the New Companies Act which is more flexible because of the **one size fits all approach** the shareholders can determine through the MOI exactly what kind of power they wish to give to the Directors.

The New Companies Act is really about **who has the power** and where the Directors and the Shareholders are the same, there is really no issue, if the shares they hold are equal. The directors have all the power to determine all aspects of share capital, how much authorised share capital there is, how they can issue the shares, the number of shares, the buy-back etc. Under the old Act there were severe restrictions on exactly what directors could do. Shareholders have the overriding rights and they are given these rights by changing the MOI accordingly. Secretarial practitioners, directors and shareholders need to understand exactly how it all fits together and the connection between the act, alterable and non-alterable provisions and the MOI.

One of the most fundamental provisions under the old Act was the ***maintenance of share capital***. This really means to keep the share capital of the company intact, because once the share capital is lost all stakeholders which include shareholders, creditors and employees lose out.

There was the view that if one issued shares at par value (nominal value e.g. R1) then at a bare minimum the company was to retain this value for the shares. Under the old act this was meaningless as smaller companies used other means of financing like loan accounts. Under the New Act this has been substituted by the ***solvency and liquidity*** test and the shares have been changed to a ***no par value*** shares only. The intention here is that shares should be issues at a more realistic value based on the value of the company at different points in time, and of course this value could change as the company grows in value. The authorities believe that this would result in more protection for the creditors. The ***solvency and liquidity*** test is designed to keep the company from going into liquidation when certain distributions take place.

I don't think that much has changed for smaller companies by changing the share capital from par value to no par value. We will discuss this later on.

## **2.6 ONE SIZE FITS ALL APPROACH**

It is the intention of government to eventually phase out the Close Corporation so the New Companies Act is essentially an Act of ***one size fits all***, in other words it caters for the smallest of companies as well as the larger JSE or listed companies. The act does this by the way the ***MOI*** or ***Memorandum of Incorporation*** is produced. The MOI is the constitution of the company. There is a new concept of where over 50 ***alterable provisions*** in the Act have been introduced to change governance to what the shareholders want. The alterable sections of law introduce a more flexible approach and is a choice in the way certain regulations work. There are also ***unalterable provisions*** which are laws embedded in the Act which cannot be changed by the MOI and are not flexible. The unalterable provisions are in fact a minimum requirements standard for companies. If you are to look at the standard ***Long Form MOI*** produced by the CIPC you will have an idea of what the alterable provisions are as a choice is provided. When submitting the standard long form MOI the provisions that you want to apply to the company must be ticked off.

Essentially a company is formed in terms of Section 19(1)(c) of the 2008 act and is constituted in accordance with

1. The ***unalterable provisions*** of the Act;

2. The **alterable provisions** of the Act, subject to any ***negation, restriction, limitation, qualification, extension*** or other alteration that is contemplated in an alterable provision, and has been noted in the Company's MOI and;
3. Any further provisions of the Company's MOI.

Very simply put, an unalterable provision is something in the Act that cannot be weakened, however in certain instances it may be made stronger. An alterable provision is something in the Act that can be changed by being negated, restricted, limited, and qualified or extended.

Section 15(2) expands on s 19(1)(c) as it provides further that the MOI may include any provision dealing with a matter that the Act does not address. The MOI may include any provisions altering the effect of an alterable provision and include any provision of a higher standard, greater restriction or longer period of time or any similar onerous requirement. This is a crucial provision because it enables a company's shareholders to effectively override or veto what they want.

### 3 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.

#### 3.1 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.

#### 3.2 DUTIES AND LIABILITIES OF DIRECTORS

##### 3.2.1 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.

### 3.2.2 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 Section 77(2) draws a distinction between the duty and the remaining codified duties of Directors set out in Section 75 and Section 76.

### 3.2.3 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.***

### 3.2.4 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.

### 3.2.5 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.

### 3.2.6 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.

#### 3.2.7 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***.

### **3.3 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.

### **3.4 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.

#### 3.4.1 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.

#### 3.4.2 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.

### **3.5 LIABILITY OF A DIRECTORS**

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

#### 3.5.1 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.

#### 3.5.2 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.

### **3.6 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.

### **3.7 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 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**

*Regional Divisional Director RSM | Legal, Johannesburg*

## 4 DIFFERENT TYPES OF COMPANIES

### 4.1 PROFIT COMPANY

A profit company is a private company if it is not state owned and its MOI prohibits the offer of securities to the public and restricts the transferability of its shares. This is in terms of s 1 read together with s 8(3)(b).

The core characteristic is that the shares or securities **may not be offered to the public** and there is a **restriction on the transferability of shares**. Essentially this is the fundamental difference between a private company and a public company.

A private company under the new 2008 Act is very close to a private company under the 1973 Act except that the restriction of 50 shareholders in a private company has now been abolished. This is in the interest of flexibility in an organization and the fact that the number of shareholders really does not bear any correlation as to the true nature and size of the company.

The restriction on the transferability of the shares has now being widened in the new Act. As a rule, the restriction must be set out clearly in the MOI.

A profit company's main goal is for financial gain for its shareholders.

The accountability of the company really depends on its size and one has to look at the Regulations which have been published together with the 2008 act as to when a company requires an audit or needs to appoint a secretary.

### 4.2 NON-PROFIT COMPANY

A non-profit company under the act is the equivalent of an "association" not for gain referred to as a Section 21 company under the old Act. Fundamentally the principals are the same except in two aspects:

- A nonprofit company may have members and;
- A nonprofit company is not a public company as it was under the old Act. It is now a unique company.

Non-profit companies or NPC's are governed mainly by s 10 and Schedule 1 of the new Act. One of the stated purposes is to provide for formation, operation and accountability of non-profit companies in a manner to design, promote, support and enhance the capacity of non-profit companies to perform their functions.

## 5 CONSTITUTIONAL DOCUMENTS OF A COMPANY

There are various documents that are fundamental to the running of a company. These are;

- **MEMORANDUM OF INCORPORATION OR MOI**
- **RULES**
- **SHAREHOLDERS AGREEMENT**

### **5.1 MEMORANDUM OF INCORPORATION**

Owing to the fact that the New Companies Act 2008 is quite complicated and took practitioners a long time to understand all the ins and outs and especially in regard to the standard form MOI's provided by the CIPC most practitioners started the process of changing the MOI for their clients very **late**. In fact, even today amazingly, there are many companies without new company act MOI's.

It was not necessary for us to have all the MOI's in place by the 1<sup>st</sup> May 2013 (the act gave a transitional period of two years) despite the persistent rumours that we had to. Many secretarial practices and legal firms used the **fear factor** approach to force this change. I think that it was wrong to foister new MOI's onto clients without going through the details of the MOI so that the clients actually understand it. If we do not understand it ourselves how are we going to get our clients to understand it? I think this is a huge risk area in regard to providing clients with a MOI.

### **5.2 DEFINITION OF THE MOI**

The definition of the MOI says that the MOI sets out the **rights, duties and responsibilities** of the shareholders, directors and others within and in relation to a company. This applies to any company that was incorporated under the New Act and for any **pre-existing company** i.e. a company that existed prior to the effective date of 1 May 2011.

This means that the current Memorandum of Incorporation and Articles of Association of a pre-existing company, a company formed under the old act is in fact a MOI as defined in the New Act. You might say so what, why do we need to know this? Unfortunately, there are many misconceptions regarding the MOI of a pre-existing company. One of the main issues being in regard to the audit – where an old MOI was in place during the transitional period an audit had to be performed, but once the transitional period was over the new act kicked in and the new rules applied and therefore the audit requirement falls away in my view, or so we thought. SAICA and legal experts say that right now if the company still has the old MOI then an audit must be performed.

### **5.3 THE TURQUAND RULE**

Before we deal with the Doctrine of Constructive Notice, we must understand the Turquand rule

“In the recent High Court decision of One Stop Financial Services (Pty) Ltd v Neffensaam 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*

#### **5.4 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 Construction now does however apply where certain conditions are **Ring Fenced** or **RF** conditions are placed 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.

#### **5.5 CONFUSION IN THE RING FENCING PROVISIONS**

If one reads the text of Section 15(2)(b) or (c) the ring fencing provisions deals with the situations where in the MOI there is a term that **impedes the amendment** or there is a term that **prohibits the amendment** of a MOI. The act really does not deal with anything else in regard to ring fencing. The way it is worded has caused a lot of confusion as when to make

use of RF. There also appears to be overuse of RF by many practices where it does not really apply as many practitioners don't really understand RF.

S 13(3) provides that if the company's MOI includes any provision contemplated in 15(2)(b) or (c) the notice of incorporation must include a prominent statement drawing attention to each such provision and its location in the MOI. It is necessary to advise the CIPC as to what the RF conditions are. This is done by Special Resolution and by completing form CoR 15.2 and CoR 15.2 Annexure A.

In reading the text books and the Act it appears that the ring-fence provision really was for any kind of restriction placed on the amendment in the terms of the MOI as well as any kind of prohibition, however in practice this seems to have become a lot more.

Carl Steyn in the ***New Companies Act Unlocked*** talks about the fact that these ring-fence conditions were used as special purpose vehicles in BEE transactions. This could be used in the case where the ***special purpose vehicle*** could be prevented from paying a dividend until the loan or the financing, they received to acquire the stake in a company was repaid. By making this an RF term in the MOI the financiers could protect their investment by making sure that the RF article cannot be changed and making sure that the directors can't declare dividends before the loans are repaid.

There is also no definition of the words ring-fencing, which appear on form CoR 15.2A. Ring Fencing is not mentioned in the act.

To this end the CIPC was asked to put out a ***non-binding opinion*** in terms of section 188(b) of the Companies Act to actually deal with where the term "RF" should be used as there is quite a lot of uncertainty in regard to its usage. In fact, the CIPC issued a further guide a practice note as I think they got the ***non-binding opinion*** wrong which resulted in more **RF** companies being formed causing much confusion and unnecessary work.

### ***5.6 EVENTS LIKELY TO ARISE IN PRACTICE***

As one can see from the ***non-binding opinion*** the scope of ring-fencing has widened to include virtually any kind of disclosure that should be made to third parties, for example let us say that in order for a company to do a transaction of say over R1 million rand and the MOI says that in order for this transaction to be approved it has to be approved by ***all*** the directors of the company. As this is a term in the MOI that may require disclosure to third parties the term RF should be behind the name. If a transaction is done on this basis and only one director signs the resolution and not all the directors, then the third party dealing with the company cannot hold the company bound to the contract because the authority for the transaction is not correct. The courts will need to decide! The question that arises here is does a company

need to involve outsiders in corporate governance issues in a company as it could become a nightmare when things go wrong?

Another example is if the company is prohibited from entering into any transaction with a software company and this is entrenched in the MOI then the third party cannot get out of this contract if there is no RF behind the name. If there is an RF the company may be restrained from performing under the contract, for instance by its shareholders, but the contract is not void, the shareholders may have a claim for damages against the directors. In this instance the third party would have deemed knowledge of the MOI and would not be in a position to claim for damages.

The RF provisions create complexity in the law and may cause litigation where parties believe they can use RF conditions to their advantage!

For the purpose of convenience, I have quoted the important points from the practice note on RF below dated Nov 2012!

4. It is against this background that that it must be considered whether the requirement to use (RF) in the company name is applicable or not in any particular case. In principle, ***if a limitation could have any effect on third parties***, it would be advisable to use (RF) in the name. If on the other hand, ***it is of no consequence to third parties*** there would also be no need to warn them.
5. Inconsiderate use of the expression "RF" in the name of a company could lead to unnecessary confusion and in the circumstances, it is submitted that the expression "(RF)" be used only in cases where it is evident that —
  - 5.1 the purpose or objectives of the company are restricted or limited in the Mol of the company;
  - 5.2 the powers of the company are restricted or limited in its Mol;
  - 5.3 any other pertinent restricting condition is contained in the Mol of the company;
  - 5.4 any requirement in addition to those set out in section 16, for the amendment of any of the abovementioned restrictions or limitations is contained in the Mol; or
  - 5.5 the Mol of a company contains a prohibition on the amendment of any particular provision of the Mol.
6. The CIPC is further of the view that if the Memorandum of Incorporation contains a provision —
  - 6.1 setting higher standards or more onerous requirements under section 15 (2) (a)

(iii) than would otherwise apply to the company in terms of an unalterable provision of the Act; or

6.2 requiring a special resolution to approve any matter not listed in section 65 (11); such a provision in itself is not a restriction contemplated in section 11 (3) (b) as it does not limit the powers or capacity of the company but rather prescribes a different procedure to perform the activity concerned.

### **5.7 SHORT FORM MOI**

There were quite a few problems with the original short form MOI released with the ACT. Despite the inherent problems of the short form MOI and the fact that it has been widely used there was never a need to panic. Many parts of the short form might be quite adequate especially where the shareholders and directors are common. I will deal with the inherent problems below as there may still be many of these old short forms in circulation. If in your firm, you have any of these original inadequate short form MOI's it would be a good idea to fix them by doing a Special Resolution!

The issue about supplying a short form MOI is that it might be absolutely perfect right now for a smaller business's early requirements, but what happens when down the line the business grows and more shareholders get involved because the company needs capital, will it then be suitable at that point in time. Based on past experience of the old act one never looked at Table B, we just left it as it seemed to be fine because as a rule everyone knew exactly what it contained and they were mostly all the same. In a situation where there was a big share transaction lawyers normally prepared a Shareholder's Agreement to cover the inadequacies of Table B.

Another important aspect of changing the MOI is what do we do about existing Shareholders Agreements as they don't seem to be as important as they used to be? All Shareholder's Agreements prior to April 2011 need to be checked for validity and that they conform to the requirements of the new act. It is suggested that you involve the company's legal advisor to make sure that the original shareholders agreements are up to date and meet with the requirements of the shareholders, that's if they want them or need them.

There is a problem when new shareholders are introduced in that a shareholder's agreement does not apply to the new shareholder unless the new shareholder actual signs the agreement together with everyone else. Each time there is a transaction there needs to be a new shareholders agreement which everyone has to sign.

### **5.8 DID THE ORIGINAL SHORT FORM MOI MAKE THE COMPANY A PUBLIC CO**

There was this persistent rumor going around that said a short form is just not good enough, if you have used the short form the company was then defined as a **public company** and not a **private one**. Personally, I do not think much turns on this because although it could have been a potential problem, I do not think that anybody acted on the basis that a small private company was a public company. No one expected the small one man show to carry out the regulatory requirements of a public company. This does not mean to say that it is right; therefore, if any of these MOI's are still in existence the Secretarial Practitioner should really try and get them sorted out before anything happens.

The original short form MOI actually says in Article 1.1 (1) that the company is **incorporated as a private company** as defined in the Company's Act, and I think this is in fact strong enough. In fact, what more do you need to specify. The company conforms with all the requirements for a private company as is contained in the company's act, other than a restriction on the transferability of shares. Despite this I would suggest in order to make sure that it is a private company beyond a reasonable doubt we need to put in the **restriction on the transferability of shares**. S8 (2) (b) says that a company is a private company if the MOI restricts the **transferability of shares**. In the security section of the Short Form MOI it says in clause 1.1(2) the company must not make an offer to the public of any of its securities in terms of s8 (2) (a). What we need to do in this section of the MOI is to insert a clause to the effect that there is a restriction on the transferability of the shares which is not dealt with by the act or the standard MOI's. This is a good idea as it will protect the existing shareholders.

We could say that the "shares are not freely transferable". Later on, I deal with what we should have in the MOI.

### **5.9 SHORT FORM MOI DOES NOT DEAL WITH PAR VALUE SHARES**

The short form MOI as published on the CIPC website does not indicate that shares are **par value shares** as it only indicates **no par value shares**. The problem here is that many firms wanting to upgrade the MOI submitted the standard short form without taking into consideration the conversion procedures in regard to Regulation 31. This meant that the MOI which mentioned **no par value shares** never went through a conversion of shares in terms of Regulation 31. The short Form MOI as it stands is really aimed at the formation of new companies and should not be used for pre-existing companies with par value shares. In this case, it would be necessary to make a modification of the MOI in regard to its shares.

Regulation 31 sets out the procedure to convert from **Par Value** to **No Par Value Shares**. All pre-existing companies who have Par Value Shares who filed a short form MOI did not realise

that their shares have been listed incorrectly as **No Par Value**. In order to rectify this, it is recommended that one just changes the respective clause to deal with par value shares rather than going through the whole conversion of the share capital class in terms of Regulation 31 as a much easier step. Both steps involve a special resolution, but by keeping the par value shares you only have to file the special resolution with the CIPC and not SARS. Only if you increase the authorised shares that you need to run the conversion procedure in terms of Regulation 31.

#### **5.10 WHO HAS THE POWER TO ISSUE SHARES?**

Another potential area for conflict in the future is the fact that the issue of shares is in the hands of the single shareholder/director or even in a company where the directors and the shareholders are the same. It may very well be a problem later on down the line where the company grows and where the shareholders are not fully represented on the board and the board has the power to issue shares. So insofar as the Short Form is concerned, I think that this clause is okay. In terms of the Long Form MOI (for a larger company) it may be that it needs to be strengthened. Perhaps it is a good idea to insert a clause to the effect that where the directors and the shareholders do not align then the power to issue shares **must be with the shareholders by special resolution**. This special resolution does not have to be filed at the CIPC. S41 of the act deals with shareholder approval to issue shares where they are **issued to a director, a related or interrelated person** to the company or a nominee of these. A special resolution is also required where the issue is more than **30% of the company**. Where shares are issued in proportion to existing holdings then a special resolution is not necessary as nothing changes.

#### **5.11 TRANSFERABILITY AND PRE-EMPTION RIGHTS**

It should be remembered that the pre-emptive rights in the Companies Act 2008 in itself only deals with the **issue or allotment of shares**, it does not deal with the **transferability of shares** i.e. when one shareholder transfers shares to another shareholder or to an outsider. This is something that needs to be addressed urgently. I have detailed the necessary clauses below which are unfortunately quite lengthy. If anyone has the desire to make changes, please do so.

S39(2) deals with pre-emption rights but only for the **subscription or allotment** of shares and basically says that if a private company proposes to issue any of the shares of that private company, each shareholder has a right to take them up before any outsider, provided they take them up in a reasonable time period. This basically means that the voting rights before the subscription of the new shares must be the same as the voting rights after the subscription of the new shares, unless a shareholder declines to take up their share of what is offered.

This is all very well, but what happens where there are a number of shareholders in a private company and things turn a bit sour and a particular shareholder who may hold say 25 per cent or 30 per cent wishes to exit and wants to sell shares. Owing to the fact that it is a private company this becomes a very difficult situation and the way the MOI is configured now and the way the Act is configured it is probably possible for the shareholder to go and offer his shares to any outsider or third party who may in fact be a competitor and it may in fact not be in the best interest of the company concerned, unless there is some kind of restriction of the transferability clause.

The latest short form now has a clause 2.1 (2) (e) which says that a transfer needs to be approved by the company. The original one did not.

If one looks at the standard Articles of Incorporation used in the old act, table B together with various amendments that lawyers made in regard to the transferability of the shares where they put in a number of articles preventing a shareholder from basically selling the shares to a third party where the Directors do not approve. Detailed below is my version of what should go into the MOI

#### **5.12 PRE-EMPTIVE RIGHTS AND TRANSFERABILITY OF SHARES**

These clauses can be put into a shareholder's agreement which each shareholder must agree to and sign. In a smaller company, it is probably better to just put it into the MOI and then one does not need to get agreement from future shareholders. Can one put this into the rules?

1. Notwithstanding anything to the contrary contained in this MOI, a shareholder "**offeror shareholders**" shall not be entitled to sell, alienate or in any other manner dispose of or transfer any security in the company unless all the securities are beneficially owned by that shareholder and that those securities have first been offered "**the offer**" in writing to the other shareholders "**offeree shareholders**" in the company who have 30 days after receipt to accept this offer.

2. **The offer** shall not be subject to any other term or condition except that the whole and not a part of the offer must be accepted. If offers to purchase are accepted by the **offeree shareholders** for a greater number of shares than those offered for sale, the shares shall be divided amongst the **offeree shareholders** in the proportions as nearly as possible in which they already hold shares in the company, provided that no **offeree shareholder** shall be obliged to acquire more shares than he shall have offered to purchase.

3. Should the **offeree shareholders** not accept the whole of the offer, then the **offeror shareholders** shall be entitled, within the thirty days after such non-acceptance, to obtain a written offer from a bona fide third party to purchase all of the securities, but at not less than

the price at and on conditions which are more favorable than those at which the **offeree shareholders** were entitled to purchase the shares in terms of 1.

4. Should the **offeror shareholder** obtain an offer from a bona fide third party in terms of 3, then the **offeror shareholders** shall furnish the **offeree shareholder** a copy of that offer showing the name and address of the bona fide third party and all the terms and conditions of that offer; and the **offeree shareholders** shall, within fourteen days after the receipt of the **third party offer**, be entitled, but shall not be obliged, to purchase the shares on the same terms and conditions as set out in that offer.

5. Should the **offeree shareholders** not purchase the shares within the fourteen days referred to in 4 then the **offeror shareholder** will be entitled, within seven days after the expiry of those fourteen days, to sell and transfer all (but not a part only) of the shares to the bona fide third party on the same terms and conditions as set out in the written offer referred to in 3.

6. Any provision condition or restriction in these clauses 1-10 may be waived if all the shareholders consent in writing thereto.

7. Should any transactions be effected by the **offeror shareholder** in terms of this MOI, the directors shall be obliged to register the transfer of the shares in question unless they have not been satisfied in such manner as they may reasonably require -that the sale and/or transfer of those shares is bona fide and conforms to the requirements of those special requirements; or they have good grounds (which shall be given) for stating that the admission of the proposed transferee is not in the interests of the company.

8. Should the **offeror shareholder** not sell all the shares in question in terms of this article, then all the provisions of these clauses 1-10 shall again apply, with the necessary modifications, should the **offeror shareholder** still wish to sell any share in the company.

9. Subject to provisions of this clauses 1-10, the directors may, in their absolute discretion and without assigning any reason, decline to register any transfer of any shares to a person of whom they do not approve.

10. If the directors refuse to register a transfer they shall send notice of that refusal to the transferee within ten days after the date which the transfer form was lodged with the company.

The above is quite complex and could part of the rules. It could be just as good to insert the clause:

***All share transfers must be approved by the board of directors and all share transfers must be approved by way of special resolution.***

### **5.13 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 by-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 EXPLANATION OF THE SHORTFORM MOI

### 6.1 INTRODUCTION

This document is an attempt to give an explanation of some of the contents of the short form MOI. I believe the standard MOI's are drafted in a very clever way in that where necessary it refers to the act and does not repeat what is in the Act. It is because of this that as Secretarial Practitioners we have to understand these references to the act. We have modified the short form MOI slightly to improve it.

The benefit of the short form is that it's designed for smaller or owner managed businesses. Once selected it is a simple matter to change the MOI by special resolution.

### 6.2 TRANSITIONAL ARRANGEMENTS

The commencement of the new companies act on the 1<sup>st</sup> May 2011 created a transitional period of 2 years whereby the old **Memorandum of Incorporation** and **Articles of Association** (MOI) took preference over any conflicts with the new act. This meant that on the 1<sup>st</sup> May 2013 the situation was reversed and the new act took preference. i.e. All articles in the old MOI that conflict with the new act are void. By 1<sup>st</sup> May 2013 each company should have in fact implemented a new MOI to avoid these conflicts, however it is not essential that this happened by the 1<sup>st</sup> May 2013 but it is highly recommended. Even now it's not too late it is just going to cost the CIPC fee of R250.

The MOI is in fact the constitution of the company and it sets out the rights, duties and responsibilities of shareholders, directors and others within and in relation to a company. All the parties mentioned above are bound by the articles in the MOI. The MOI will also **bind new directors** and shareholders after the company has been formed.

The new companies act is a **one size fits all** act that applies to the largest corporations right down to small companies. There is a great deal of flexibility which has been provided by the so-called **alterable provisions**. Alterable provisions can be modified by the articles in the MOI. It is because of this that each company should have the right MOI for their situation.

The new companies act has various provisions which are called **unalterable provisions**. These are provisions in the act that cannot be changed by the MOI, in other words they can be made stronger, but they can never be made weaker. The **alterable provisions** or flexible provisions of the act are subject to any negation, restriction, limitation, qualification, extension or other alteration that is required, but these changes must be specified in the MOI. It is these alterable provisions that create flexibility for the one size fits all approach.

An alterable provision normally starts with “**except to the extent that is otherwise provided in the MOI...**”. This allows the MOI to modify the contents of the provision.

### **6.3 MOI SHORT FORM**

#### **CoR15.1 A SHORT STANDARD FORM FOR PRIVATE COMPANIES**

##### ***Article 1 - Incorporation and Nature of the Company***

###### ***1.1 Incorporation***

- (1) The Company is incorporated as a private company, as defined in the Companies Act, 2008.

**Article 1.1(1).** This article specifies that the company is incorporated as a **private company**. We need to look at s 8(2)(b) which defines a private company as a **profit company** if it is not state owned or its MOI prohibits its securities or shares from being offered to the public and there is also a restriction on the transferability of its securities or shares.

There is a section on securities in the MOI see article 2.1(2) and 2.1(4) which restricts the offering of shares to the public and a restriction on the transferability of securities. It is this article that in fact makes the profit company a private company.

- (2) The Company is incorporated in accordance with, and governed by; –
- (a) the provisions of the Companies Act, 2008, without any limitation, extension, variation or substitution; and
  - (b) the provisions of this Memorandum of Incorporation.

Article 1.1(2) - 2(a) says that the company is governed by the **provisions of the Companies Act** without any limitations extensions variations or substitutions and; 2 (b) says the company is governed by the provisions of the MOI. This in fact is the constitution of the company and wherever there is a corporate governance issue we need to actually look at the various sections of the act as well as the provisions in the MOI.

## 1.2 Powers of the Company

- (1) The Company is not subject to any provision contemplated in section 15 (2)(b) or (c).
- (2) The purposes and powers of the Company are not subject to any restriction, limitation or qualification, as contemplated in section 19 (1)(b)(ii).

**Article 1.2 (1)** indicates that the powers of the company is not subject to the provisions of s 15(2)(b) or (c). This means that the company does not have any **ring fencing** provisions i.e. **RF** between the name and the (Pty) Ltd. A ring-fencing provision is simply something that the company wishes to bring to the attention of an outsider that it deals with as it may affect the transaction with the outsider. A ring-fencing provision or **RF** may also place a restriction on the change of any article in the MOI. The Short Form MOI simply states that there is no restriction in the MOI that an outsider should be concerned with.

**Article 1.2 (2)** refers to s 19(1)(b)(ii) which allows the powers of the company to have some kind of restriction, limitation or qualification. This may in itself be a ring fence RF if it needs to be brought to the attention of outsiders. An example of this will be that the company can only operate as a furniture retailer and nothing else and this would need to be brought to the attention of anyone that the company deals with. In this article in the short form MOI it is simply saying that there is no restriction on the powers of the company.

Essentially the company is a juristic person and has the capacity of an individual except to the extent that the MOI provides otherwise. This means that if there is no restriction in the MOI the company can do anything that an individual can.

### **1.3 Memorandum of Incorporation and Company Rules**

- (1) This Memorandum of Incorporation of the Company may be altered or amended only in the manner set out in section 16, 17 or 152 (6) (b).
- (2) The authority of the Company's Board of Directors to make rules for the Company, as contemplated in section 15 (3) to (5), is not limited or restricted in any manner by this Memorandum of Incorporation.
- (3) The Board must publish any rules made in terms of section 15 (3) to (5) by delivering a copy of those rules to each shareholder by ordinary mail.
- (4) The Company must publish a notice of any alteration of the Memorandum of Incorporation or the Rules, made in terms of section 17 (1), by delivering a copy of the notice to each shareholder by ordinary mail.

**Article 1.3 (1)** means that the MOI can be altered or amended only in the manner set out in s 16, 17 or 152(6) (b). s 16 deals with changes to the MOI which should be made by special resolution of the shareholders of the company and s 17 allows for the MOI to be modified where there are patent errors or alterations and it deals with the situation where a translation is required. This section also deals where there have been many changes to the MOI and it is necessary for the company to consolidate the MOI. S 152(6)(b) relates to a business rescue plan.

**Article 1.3 (2) and (3)** deals with Rules. The Rules are a concept similar to the bylaws of a city council. The rules can be any corporate governance issue not covered by the Companies Act or MOI. The directors publish the rules that they require and all the parties that are bound to the MOI will also be bound to the rules. Article 1.3 (4) deals with the method for publishing an alteration and ratifying rules by delivering a notice to each shareholder. The rules need to be ratified by ordinary resolution at the next shareholders meeting.

### **1.4 Optional provisions of Companies Act, 2008 do not apply**

- (1) The Company does not elect, in terms of section 34 (2), to comply voluntarily with the provisions of Chapter 3 of the Companies Act, 2008.
- (2) The Companies does not elect, in terms of section 118 (1)(c)(ii), to submit voluntarily to the provisions of Parts B and C of Chapter 5 of the Companies Act, 2008, and to the Takeover Regulations provided for in that Act.

**Article 1.4 (1)** A private company is not obliged to carry out the extended accountability requirements as set out in chapter 3 of the act except as indicated in the MOI. By having article 1.4 (1) the company does not voluntarily need to comply even though the company is not expected to comply with these requirements, it may however volunteer if it so wishes. The short form MOI just says in this situation that the company will not elect to comply.

**Article 1.4(2)** deals with s 118(1)(c)(2) which is in relation to the take-over regulations panel and what we call a **regulated company**. This clause basically says that the company does not elect to comply with the take-over regulations provided in the act. It is extremely unlikely that any small company will voluntarily submit to these sections.

## **Article 2 - Securities of the Company**

### **2.1 Securities**

- (1) The Company is authorised to issue no more than the number of shares of a single class of shares with no nominal or par value as shown on the cover sheet, and each such issued share entitles the holder to-

#### **Alternative to the above**

The authorised share capital of the Company consists of **ORDINARY SHARES** and the company is authorised to issue no more than 4000 ordinary shares of R1 each, and each such issued share entitles the holder to:-

- (a) vote on any matter to be decided by a vote of shareholders of the company;
- (b) participate in any distribution of profit to the shareholders: and
- (c) participate in the distribution of the residual value of the company upon its dissolution.

**Article 2.1 (1) (a) (b) (c)** deals with the fundamental ownership of the company and actually refers to the number of shares of a single class of ordinary shares which appears on the first page of the COR 15.1. The alternative in the body is to indicate the type of shares and the authorised number as the MOI document, where there is a change of the MOI from a pre-existing company and not a formation of a new company.

There are basically three fundamental things that the ordinary shares of the company represent and these are reflected in;

- (a) the **voting percentage** on any matter that needs to be decided by the shareholders of the company; this represents percentage ownership the number of shares held as a percentage of the total;
- (b) **participation** by the ordinary shareholders in any **distribution of the profit** of the company; this represents how the dividend declared will be shared by the shareholders in accordance with their percentage of the shares they hold.
- (c) **participation** in the **distribution of the residual value** of the company upon its dissolution; after the company is liquidated or wound up and all the debts are paid the shareholders will receive the balance in accordance with their shareholding.

- (2) The Company must not make an offer to the public of any of its securities and an issued share must not be transferred to any other person other than-
  - (a) the company, or a related person;
  - (b) a shareholder of the company, or a person related to a shareholder of the company;
  - (c) a personal representative of the shareholder or the shareholder's estate;
  - (d) a beneficiary of the shareholder's estate; or
  - (e) another person approved by the company before the transfer is effected.

**Article 2.1 (2)** prevents the company from making an offer of securities to the public. This is one of the things that make the company a private company. The underlined italics is what has been amended. In the event of a shareholder dispute there is definitely some contention in the way this has been worded.

- (3) The pre-emptive right of the Company's shareholders to be offered and to subscribe for additional shares, as set
  - (a) out in section 39, is not limited, negated or restricted in any manner contemplated in section 39 (3), or subject to any conditions contemplated in that section.

**Article 2.1 (3)** deals with the pre-emptive rights contained in s 39 which prevents dilution of shares after a share issue or rights issue to existing shareholders, in other words after the share issue the percentage holdings of shareholders should be exactly the same if all shareholders take up their rights, however there may be situations where some of the shareholders can't take up their rights and in this situation the shareholding percentages would change.

- (4) There is a restriction on the transferability of shares and the directors may in their absolute discretion and without assigning any reason, decline to register any transfer of any shares to a person of whom they do not approve.

**Article 2.1 (4)** deals with the restriction on the transferability of shares. The act calls for a restriction on transferability of shares but does not specify what the restriction should be. We have inserted our own restriction which hands over the total control of the transfer to the directors. The directors have the power to block any transfer. Read this together with 2.1 (2).

- (5) This Memorandum of Incorporation does not limit or restrict the authority of the Company's Board of Directors to; –
- (a) authorise the company to issue secured or unsecured debt instruments, as set out in section 43 (2); or
  - (b) grant special privileges associated with any debt instruments to be issued by the company, as set out in section 43 (3);

**Article 2.1 (5) (a) & (b)** deals with the right of the Directors to issue unsecured debt instruments as set out in s 43(2) or to grant any special privileges that are associated with these debt instruments as set out in s 43(3). An example of a debt instrument may be a Debenture.

- (c) authorise the Company to provide financial assistance to any person in relation to the subscription of any option or securities of the Company or a related or inter-related company, as set out in section 44;

**Article 2.1 (5)(c)** deals with the director's authority to grant financial assistance to any person in relation to a subscription of securities of a company or to a ***related or interrelated company*** as set out in s 44. It should be noted that there are a number of conditions required. I.e. a special resolution has to cover the situation within the last two years which must be for a specific recipient or generally for a category of potential recipients, for example like workers. It is also imperative that immediately after providing the financial assistance the company must satisfy the ***solvency and liquidity test*** and the board must satisfy itself that the company does in fact satisfy this test and the terms of the financial assistance must be fair and reasonable to the company.

- (d) approve the issuing of any authorised shares of the Company as capitalisation shares, as set out in section 47 (1); or
- (e) resolve to permit shareholders to elect to receive a cash payment in lieu of a capitalisation share, as set out in section 47 (1).

**Article 2.1.(5) (d) & (e)** deals with the Board's authority to issue capitalisation shares as set out in s 47 or to allow the shareholders to receive a cash payment in lieu of capitalising shares. Capitalisation shares are shares that have been created of a book entry from accumulated profits to share capital. In effect a transfer from accumulated profit to share capital. Bear in mind the definition of ***Contributed Tax Capital*** in terms of the income tax act.

## **2.2 Registration of beneficial interests**

The authority of the Company's Board of Directors to allow the Company's issued securities to be held by and registered in the name of one person for the beneficial interest of another person, as set out in section 56 (1), is not limited or restricted by this Memorandum of Incorporation.

**Article 2.2 S 56(1)** allows the company to register securities in the name of one person for the beneficial interest of another person. There are a whole lot of other conditions

which relate to public companies and regulated companies that we are not going to deal with in this explanation.

### **Article 3 - Shareholders and Meetings**

#### **3.1 Shareholders' right to information**

Every person who has a beneficial interest in any of the Company's securities has the rights to access information set out in section 26 (1).

**Article 3.1** says that any person who owns shares in a company or has a beneficial interest in a company (this will include the so- called nominee) has the right to access information as set out in s 26(1). This will include the companies MOI and rules, records of directors, reports to AGM's and annual financial statements, notices and minutes of AGM's and the security register. They will not be entitled to see the minutes of Directors or to see the books of account.

#### **3.2 Shareholders' authority to act**

- (1) If, at any time, there is only one shareholder of the company, the authority of that shareholder to act without notice or compliance with any other internal formalities, as set out in section 57 (2), is not limited or restricted by this Memorandum of Incorporation.
- (2) If, at any time, every shareholder of the Company is also a director of the Company, as contemplated in section 57 (4), the authority of the shareholders to act without notice or compliance with any other internal formalities, as set out in that section is not limited or restricted by this Memorandum of Incorporation.

**Article 3.2 (1) & (2).** If there is only one shareholder in a company then in terms of s 57(2) that shareholder may exercise any voting rights on any matter at any time without notice or compliance with any other formalities. This section also says that s 59 - 65 do not apply. These sections deal with the **record date** and **shareholder meetings**.

Subsection (2) deals with the section where every shareholder is also a director of a company that any matter referred to the board may be decided by the shareholders. There are certain formalities that will have to be complied with.

### **3.3 Shareholder representation by proxies**

- (1) This Memorandum of Incorporation does not limit, restrict or vary the right of a shareholder of the Company; –
  - (a) to appoint 2 or more persons concurrently as proxies, as set out in section 58 (3)(a); or
  - (b) to delegate the proxy's powers to another person, as set out in section 58 (3)(b).
- (2) The requirement that a shareholder must deliver to the Company a copy of the instrument appointing a proxy before that proxy may exercise the shareholder's rights at a shareholders meeting, as set out in section 58 (3)(c) is not varied by this Memorandum of Incorporation.
- (3) The authority of a shareholder's proxy to decide without direction from the shareholder whether to exercise, or abstain from exercising, any voting right of the shareholder, as set out in section 58 (7) is not limited or restricted by this Memorandum of Incorporation.

### **3.4 Record date for exercise of shareholder rights**

If, at any time, the Company's Board of Directors fails to determine a record date, as contemplated in section 59, the record date for the relevant matter is as determined in accordance with section 59 (3).

**Article 3.4.** The record date is the date that the board decides to determine which shareholders are entitled to receive notices or get paid out a dividend etc. This is very unlikely to happen in a smaller company, however if no record date is determined by the directors it is the latest date by which the shareholders are required to give notice or the date of the action or event in any other case.

### **3.5 Shareholders meetings**

- (1) The Company is not required to hold any shareholders meetings other than those specifically required by the Companies Act, 2008.
- (2) The right of shareholders to requisition a meeting, as set out in section 61 (3), may be exercised by the holders of at least 10% of the voting rights entitled to be exercised in relation to the matter to be considered at the meeting.

- (3) The authority of the Company's Board of Directors to determine the location of any shareholders meeting, and the authority of the Company to hold any such meeting in the Republic or in any foreign country, as set out in section 61 (9) is not limited or restricted by this Memorandum of Incorporation.
- (4) The minimum number of days for the Company to deliver a notice of a shareholders meeting to the shareholders, is as provided for in section 62 (1).
- (5) The authority of the Company to conduct a meeting entirely by electronic communication, or to provide for participation in a meeting by electronic communication, as set out in section 63 is not limited or restricted by this Memorandum of Incorporation.
- (6) The quorum requirement for a shareholders meeting to begin, or for a matter to be considered is as set out in section 64 (1) without variation.
- (7) The time periods allowed in section 64 (4) and (5) apply to the Company without variation.
- (8) The authority of a meeting to continue to consider a matter, as set out in section 64 (9) is not limited or restricted by this Memorandum of Incorporation.
- (9) The maximum period allowable for an adjournment of a shareholders meeting is as set out in section 64 (13), without variation.

### **3.6 Shareholders resolutions**

- (1) For an ordinary resolution to be adopted at a shareholders meeting, it must be supported by the holders of greater than 50% of the voting rights exercised on the resolution, as provided in section 65 (7).
- (2) For a special resolution to be adopted at a shareholders meeting, it must be supported by the holders of at least 75% of the voting rights exercised on the resolution, as provided in section 65 (9).
- (3) A special resolution adopted at a shareholders meeting is not required for a matter to be determined by the Company, except those matters set out in section 65 (11), or elsewhere in the Act.

## **Article 4 - Directors and Officers**

### **4.1 Composition of the Board of Directors**

- (1) The Board of Directors of the Company comprises the number of directors and alternate directors as reflected in the Companies Register of Directors and reflected on file at the CIPC. All directors are to be elected by the holders of the company's securities as contemplated in section 68.
- (2) The manner of electing directors of the Company is as set out in section 68 (2), and each elected director of the Company serves for an indefinite term, as contemplated in section 68 (1).

### **4.2 Authority of the Board of Directors**

- (1) The authority of the Company's Board of Directors to manage and direct the business and affairs of the Company, as set out in section 66 (1) is not limited or restricted by this Memorandum of Incorporation.

- (2) If, at any time, the Company has only one director, as contemplated in section 57 (3), the authority of that director to act without notice or compliance with any other internal formalities, as set out in that section is not limited or restricted by this Memorandum of Incorporation.

#### **4.3 Directors' Meetings**

- (1) The right of the Company's directors to requisition a meeting of the Board, as set out in section 73 (1), may be exercised by at least 25% of the directors.
- (2) This memorandum of Incorporation does not limit or restrict the authority of the Company's Board of Directors to; –
  - (a) conduct a meeting entirely by electronic communication, or to provide for participation in a meeting by electronic communication, as set out in section 73 (3); or
  - (b) determine the manner and form of providing notice of its meetings, as set out in section 73 (4); or
  - (c) proceed with a meeting despite a failure or defect in giving notice of the meeting, as set out in section 73 (5); or
  - (d) consider a matter other than at a meeting as set out in section 74.

#### **4.4 Directors' compensation and financial assistance**

This Memorandum of Incorporation does not limit the authority of the Company to; –

- (a) pay remuneration to the Company's directors, in accordance with a special resolution approved by the Company's shareholders within the previous two years, as set out in section 66 (9) and (10);
- (b) advance expenses to a director, or indemnify a director, in respect of the defense of legal proceedings, as set out in section 78 (3);
- (c) Indemnify a director in respect of liability, as set out in section 78 (5); or
- (d) purchase insurance to protect the company, or a director, as set out in section 78 (6).

## **7 THE AUDITOR SITUATION AND THE NEW COMPANY'S ACT**

### **7.1 INTRODUCTION**

The old articles i.e. table B indicates that an auditor must be appointed. The articles do not say anything about doing an audit because it was compulsory in terms of the old companies act anyway.

The New Companies Act creates a whole new situation in regard to the audit requirement. It uses a system of public interest points which is specified in the Act and the Regulations and if the company has more than 100 points it has to do a Review and if it has to do more than 350 points it has to do an Audit. The majority of companies however fall below 100 and therefore they are not required to do a review or an audit. In all likelihood banks have granted company loans and at the very minimum will probably want a review. In certain instances, they may also specify an audit which means that the audit or review becomes voluntary.

The problem with this situation is that the transitional arrangements in Schedule 5 of the new act allows the old Act or the old MOI (i.e. the old Memo of Incorporation and the old Articles of Association) to apply for the first two years. After the two years have passed everything reverts to the new Act. If a company has not changed the old MOI then it has to do an audit within the first 2 years because the old Table B specifies that the company will have to have auditors and by reference to the old act will therefore require an audit. After the 2 years is up if there is still no change to the MOI then all conflicts with the new act are void and the company can then carry out the terms of the new act. See Schedule 5 clause 4.4.

Most Company Secretarial practitioners were not aware of this complication until SAICA sent out a notification explaining the law. The problem is that the notification was sent out about 10 days before the end of February 2012 which caused a huge volume of special resolutions submitted to the CIPC as many companies wanted to change the audit requirements to a review or no audit.

### **7.2 SAICA NOTIFICATION**

“Table B of the Articles states the following:

- right to transfer shares are restricted
- all companies to hold an Annual General Meeting
- all companies must appoint an auditor

All three of these requirements have been significantly changed in the Companies Act, 2008, as per our [Communiqué](#), dated 1 December 2011.

If you have not amended your company's MOI, the company will still require an audit for their year-end, even if they do not qualify for an audit under the Companies Act, 2008, as their MOI will still be a valid document requiring the company to have an audit.

To amend your MOI before your year-end, companies have to follow the following process:

1. Approve a special resolution removing the requirement for audit and any additional changes. Companies could utilize the following provisions, unless their articles expressly prohibit such practices:

- a. The special resolution can be approved by electronic means (Section 60)
- b. The notice period for a shareholders' meetings can be waived (Section 62(2A))

Complete form [CoR 15.2](#) - Notice of Amendment of Memorandum of Incorporation

Attach copy of special resolution amending the MOI to Form CoR15.2  
Ensure date for amendment is approved before your year-end date, (e.g. 28 February 2012) and ensure the Notice is also filed prior to the year-end date. The Notice should be sent by Registered mail or ensure the CIPC stamp on date of filing (if it is filed at a later date, the later date will be the effective date).”

As we know by now there are a number of uncertainties in regard to the MOI and in regard to the audit, but the time has come for us to make the necessary changes so that we can comply as best as is possible with the requirements of the new act. It was however unfortunate that the timing was out which caused an avalanche in the processing of special resolutions.

### ***7.3 SPECIAL RESOLUTION REQUIRED***

1. A review of the financial statements is required but the client does not wish to change the MOI at this stage.

Owing to the complexity and all the different alternatives of the alterable provisions you may have a situation where the client wants a review instead of

an audit simply because of costs but at this point it is still too early for the client to make the necessary changes to the MOI.

What you can do is pass a special resolution to the effect that the shareholders want a review or no audit. It would be best to change the MOI and submit it to the CIPC even if you are out of time as below.

2. Where you are going to make a change to the standard short form MOI OR Long form MOI.

If you go through the short form MOI you will note that nothing is said about audit or review. I have also looked through the long form and nothing is said about audit. There is no reason to have anything in the new MOI as the requirement for audit or review is governed by the act and the regulations. We have however noted that in some of the MOI's attorneys are in fact dealing with the audit, within the MOI which then makes the MOI unique. See the examples below.

*Audit Clause 1 – The Company shall prepare annual financial statements in accordance with the Act and Regulations and shall only to the extent required by the Act and the Regulations have those annual financial statements audited or reviewed.*

*Audit Clause 2 - The shareholders may by ordinary shareholders resolution elect to have an audit in the event that the company is not required to do an audit in terms of the Act or the Regulations.*

Table B does not specifically say that an audit will be done because it assumes that because all companies have to do an audit under the old act, it is not very specific, it however does say that an auditor will need to be appointed and this kind of makes the wording of the special resolution a little difficult in the event that you have not changed the old MOI.

3. Where the audit requirement is to be retained and the company still has an old MOI nothing needs to be done.

Where the old MOI is in existence which is table B in a smaller company situation an audit is required. Owing to the transitional arrangements in the 2008 act where there is a conflict between the old and new act the old MOI

prevails. This means that all companies with an old MOI require to be audited if their yearend falls within two years from the 1<sup>st</sup> May 2011.

4. If the client wishes to comply with the letter of the law and they wish to dispense with the audit or have a review because the public interest scores falls below the required limits then the following is the procedure;

It is necessary to change the existing old MOI to take out the requirement of an audit by completing a form COR 15.2 and filing the special resolution. It's important to include the fact that notice is to be waived owing to the timing if applicable.

The wording for the special resolution should be as follows. Change or modify to suit your own requirements.

**“PREAMBLE:**

The Company has not changed its MOI (i.e. the old memorandum of incorporation and articles of association) which was created under the old Companies Act 1973. As we are still in the transitional period of two years from 1st May 2011, the provisions of the old act apply and require that the company's Annual Financial Statements be audited. The transitional arrangements in the new 2008 Companies Act provide that where the old MOI is still in existence the terms in that old MOI take precedence over any conflicts between the old and new act, therefore an audit of the Financial Statements is required.

In terms of the Companies Act 2008, as amended and the Regulations the company's Annual Financial Statements are required to be reviewed and not audited.

It is resolved;

That the following article 95 is to be added to the MOI with immediate effect;

95. The company shall prepare Annual Financial Statements in accordance with the Companies Act 2008 and the Regulations and shall only to the extent required by the 2008 Act or the Regulations have those annual Financial Statements audited or reviewed.

All existing clauses in the existing MOI and sections to the Company's Act 1973 referring to the fact that an audit is to be undertaken are to have no force or affect.”

95 should be the next available article in the Table B.

**7.4 REGISTERING NON AUDITOR**

The CIPC will not register an accounting officer. This registration must take place in house. I.e. appoint the accountant in your own records and don't advise the CIPC. Please see the letter below

**RE: Amendment to Company Information**

**Company Number: 2012/063121/07**

**Company Name: MY-CHINA DISCOUNT STORE**

We have received a COR44 (Notice of change of company officials) from you dated 25/07/2012.

The COR44 was not approved for the following reasons:

\* Kindly note that Accounting Officer register at SARS, we only appoint auditors

Yours truly

*Astria Ludin*

**Commissioner: CIPC**

DMA DJO

## 8 SHAREHOLDERS AGREEMENT

### 8.1 GENERAL POINTS

The New Company's Act recognises a shareholder's agreement. We would need to look at s 15(7) which basically says that shareholders may enter into agreement with one another. The shareholders agreement may cover any matters "*relating to the company*", however this is a little vague and can cover a very wide area.

It is important to note that the ***company is not party to a shareholder's agreement*** in terms of s 15(7), but there is nothing to prevent the company from being a party to the agreement,

There are some **advantages** to shareholder's agreements and these are that they are **private**, therefore the public cannot inspect the contents of a shareholder's agreement, and therefore they are secret.

The shareholders agreement is also binding in terms of the normal law of contract. S 15(6) governs only the legal status of the MOI and the rules and this does not extend to the shareholders agreement.

There are also some **disadvantages**; those shareholders who are party to the agreement are bound by the terms. In many situations new shareholders coming into the company who have not signed to the effect that they are bound by the agreement are not bound. There is no facility in the act to alter a shareholder's agreement; the individual parties have got to all agree with any change to the shareholders agreement. In other words, if a shareholder's agreement is amended, all the parties, that is all the shareholders have to agree with it if they are to be bound. Could some rules be created forcing all shareholders to sign the shareholders agreement?

A shareholder's agreement is useful in practice but must be consistent with the companies act and the MOI. Where there are provisions in the shareholders' agreement which are not consistent with the MOI or with the act, these are void and therefor unenforceable. It is also important to understand that the ***Act and the MOI takes preference over the shareholder's agreement.***

In the past, there were clauses in the shareholder's agreement that made the shareholders ***agreement prevail in the event of an inconsistency.*** This does not apply anymore. There is a major difference between a shareholder's agreement under the old act and that of the new act. Under the old act the shareholders agreement added to the various provisions of the articles, in other words the terms of the shareholders agreements could enhance what the articles said.

The company was also a party to the shareholder agreement which could contain provisions contrary to the articles and these contrary provisions would prevail.

Under the new act there is a policy shift in the way shareholders agreements work which could have an adverse effect on the impact and value of a shareholder's agreement.

In the past shareholder's agreements dealt with minority protection and various voting rights were built into shareholder's agreement but this no longer applies.

S 65(11) defines all the special resolutions that a company has to pass but the MOI can add other situations where a special resolution is required.

A shareholder's agreement **cannot alter the effect of the alterable provisions** in a MOI. Where an alterable provision has been changed by a MOI the shareholder's agreement must be consistent with those provisions. This in fact makes the constitutional documents more complex.

The anti-avoidance provisions of the act may have an effect on shareholders' agreements. The shareholders agreement cannot defeat or reduce the effect of a prohibition by an unalterable provision of the act.

Voting agreements may also be supported if they are not used to change the effect of alterable or any unalterable provisions but may very well prevail in most instances.

### **8.2 TRANSITIONAL ARRANGEMENTS**

The transitional arrangements are set out in s 15(7) and basically for 2 years from inception of the act the shareholders agreements will take preference over the act even if there are provisions that are inconsistent with the act. After the two years the inconsistent provisions of a shareholder's agreement will be void.

### **8.3 POINTS TO BE TAKEN INTO ACCOUNT WHEN DRAFTING SHAREHOLDERS AGREEMENTS**

Carl Stein in his book *The New Companies Act Unlocked* talks about what the drafter of shareholder's agreements should consider on page 76. It's important to go through these points some of which are **S46 - distributions, anti-dilution clauses** and **pre-emptive rights**. Many corporate governance issues that used to be in the shareholders agreement must now be handled in the MOI.



## 9 SPECIAL RESOLUTIONS

### 9.1 INTRODUCTION

The **share capital maintenance** routines have changed from one of tracking the number of shares in issue by the CIPC to placing more emphasis on changes to the MOI and keeping these changes up to date. The structure of the share capital must be kept up to date in the MOI. The CIPC does not need to know about shares in issue. It is very important that the registered office has all the necessary registers available for inspection and that this is up to date.

Under the old act, we produced a set of forms and selected Table A or B and made changes to the articles required. In smaller companies, it was rare to make changes to the Articles as mostly table B was used. Now with the emphasis on the MOI and the one size fits all approach we need to make sure it is in harmony with the new act and we need to run the process of change very professionally. I can't tell you how many times where interested parties on inspecting a register of special resolutions can't get it or it is not correct which makes it very embarrassing for the Secretarial Practitioner.

Changes to the MOI require a special resolution and the submission of Form CoR 15.2. There are other transactions or events that also require a special resolution. ***Not all special resolutions need to be filed with the CIPC.***

There are 2 kinds of resolution an **ordinary resolution** and a **special resolution**. A resolution is a decision to be taken by the company at a meeting of shareholders, which is called with proper notice and then voted upon at the meeting in terms of the law and the MOI.

Directors can also have a meeting and pass a director's resolution. The shareholders or the directors resolve that something is to be carried out on a decision that is to be taken. An ordinary resolution requires a vote of more than 50% to pass and a special resolution requires a vote of 75% as a rule but in certain instances this can be modified by the MOI. I.e. 65% for the special resolution and 60% for the ordinary resolution.

Directors can take resolutions that they are authorised to make in regard to management decisions and resolutions they are entitled to make in terms of the act and the MOI. They would need to refer certain decisions back to the shareholders where they are not authorised to make those decisions in terms of the act and the MOI.

### 9.2 DEFINITION OF SPECIAL RESOLUTION

**The definition of a special resolution is a resolution adopted by the shareholders with the support of at least 75% of the voting rights exercised or a different percentage as indicated**

in s 65 (10) of the companies act by the MOI. The MOI may have a differing percentage but not lower than 65% for a special resolution.

S65 (8) deals with an ordinary resolution which means a resolution adopted with the support of more than 50% of the voting rights exercised. Such percentage may also be adjusted higher (not more than 60%, but not lower than 50%) by the MOI except for the removal of a director which remains at 50% – see s 71.

### **9.3 RESOLUTIONS OTHER THAN AT A MEETING**

A special resolution is to be taken at a shareholders meeting. There is a further interesting development in that a special resolution need not be adopted at a meeting. S60 deals with how such resolutions may be approved in writing without having a meeting. Now if you look at the electronic aspects of the New Act this method of passing resolutions is going to make the job much easier. Company secretaries then have to look at proper electronic filing systems to back up what has occurred.

In terms of s60 (1) (a) a resolution may be voted on where it is submitted for consideration to the shareholders entitled to exercise voting rights, in relation to that resolution, and (b) voted on in writing by shareholders entitled to within 20 business days after the resolution was submitted to them. This applies to both an **ordinary resolution** and a **special resolution**, and if adopted by making use of this method has the same effect as having been approved by voting at a meeting. **When using this method be weary of the numbers involved.**

The Act stipulates that any business that is to be conducted in terms of the act or the MOI at an annual general meeting may not be conducted in this manner. A proper meeting has to take place.

The election of director can be conducted using this method but can't be removed using this method.

### **9.4 SPECIAL RESOLUTION REQUIRED FOR SPECIFIED PURPOSES**

S 65 (11) deals with all the cases where a special resolution is required. We will not deal with all of them in these notes. I have explained some of the subsections below.

- a. Refers to the **amendment of a company's MOI** to the extent required by s16(1)(c) and 36(2)(a). S16(1)(c) says that a company's MOI may be amended at any time if a special resolution to amend it is proposed.

S36(2) deals with the authorization and the classification of shares and indicates what the directors may do subject to exceptions in the MOI. If there are any changes to the MOI then a special resolution is required and the amendment notice CoR 15.2 must be filed with the CIPC.

- b. S65(11) (b) deals with the **ratification of a consolidated revision of the MOI** as specified in Section 18(1)(b) which basically deals with the authenticity of the consolidated version. It is good idea when doing a consolidated version of a MOI that it is ratified by special resolution. If there is a dispute and the consolidation is not passed by special resolution then the unconsolidated resolution will take preference. In certain cases, the CIPC will send out a notice requesting a consolidation of the MOI.
  
- c. S65(11) (c) requires a special resolution to **ratify actions by the company if the directors act in excess of their authority** as indicated in s20 (2) which basically deals with certain limitations that the directors may have. A special resolution can ratify these acts of the directors. An example of this is if the directors did not have authority to issue shares, the issue of shares in excess of their authority may stand provided a special resolution is passed to this effect. A special resolution cannot ratify anything in conflict with the companies act.

S65 (11) details other situations where special resolutions are required which I am not going to detail here, please refer directly to Section 65(11).

There are also other special resolutions required not mentioned in this section. E.g. for Directors remuneration see s66 (8) and (9) which requires a special resolution to be approved for the remuneration to directors.

### **9.5 SPECIAL RESOLUTION IN SECTION 65(11) – FUNDAMENTAL TRANSACTION**

This section deals with the required special resolution to approve any proposed **fundamental transaction** to the extent required by Part A of Chapter 5.

We need to look at s 112 which deals with the proposal to dispose of all or the greater part of the assets of an undertaking. Where the disposal is not pursuant to a business rescue plan or between companies within the same group, wholly owned subsidiary and holding company and various other combinations a company may not dispose of all or the greater parts of its assets or undertaking unless this disposal has been approved by a special resolution of the shareholders in accordance with s 115 and the company has satisfied all other requirements as set out in s 115 to the extent those requirements are applicable to such a disposal of that company.

There are also some requirements in regard to the notice of a shareholders meeting to consider. A resolution to approve a disposal must be delivered within the prescribed time and in the prescribed manner to each shareholder of the company and this will be subject to s62 which deals with all the notice requirements of the meeting. The notice must include or will be accompanied by a written summary of the precise terms of the transactions or series of transaction to be considered at the meeting.

Any part of an undertaking or assets of a company to be disposed of must be fairly valued as calculated in the prescribed manner as at the date of the proposal which must be determined in the prescribed manner.

A resolution as specified above is effective only to the extent that it authorises a specific transaction.

We now need to look at some of the requirements for the approval of this transaction in terms of s 115. Ss 1 says that despite the provisions of s 65 the provision of the Company's MOI or any resolution adopted by the board or holders of its securities to the contrary a company may not dispose of, or give effect to an agreement or series of agreements to dispose of all, or the greater parts of its assets or undertaking, implement an amalgamation or merger, or implement a scheme of arrangement unless the disposal etc. has been approved in terms of this section or is subject to an approved business rescue plan.

Ss 1(b) deals with the situation where the takeover amalgamation etc. needs to be handled by the takeover regulations panel where a compliance certificate is to be issued.

Ss 115 (2) deals with the fact that the transaction must be approved by special resolution and at least 25% of all voting rights on the matter or any higher if the MOI says so. Part B deals with the situation where the shareholders are a holding company and may indicate the major portion of the holding company assets have been disposed of. Where there is opposition to the transaction of at least 15% then the company has to apply to court to get the court to review the transaction in accordance with ss 7.

### **9.6 SOME REQUIREMENTS OF A SPECIAL RESOLUTION**

Who can propose a special resolution? In terms of s 65(3) **any two shareholders** of a company may propose a resolution concerning any matter in respect of which they are each entitled to exercise voting rights and when proposing a resolution may require that the resolution be submitted to shareholders for consideration at a meeting, either at the next shareholders meeting or by written vote in terms of s 60.

The board or any other person specified in the MOI may call a shareholders meeting at any time. If there is a written request and a signed demand for such meeting the directors must call a meeting. Please refer to s 61(3) for regulations in regard to a demand for a shareholders meeting.

In terms of s65 (4) a proposed resolution must be expressed with **sufficient clarity and specificity** and be accompanied by sufficient information or explanatory material to enable a shareholder entitled to vote to participate in a meeting and to influence the outcome of the vote of the resolution.

In terms of s65 (5) at any time before the start of a meeting a shareholder or director who believes that the form of the resolution does not satisfy the requirements of sub-section (4) **may seek leave to apply to a court** for an order restraining the company from putting the proposed resolution to the vote until the requirements of sub-section (4) are satisfied. The court order may also require the company or the shareholders proposed resolution as the case may be to take appropriate steps to alter the resolution so that it satisfies the requirements of sub-section (4) and to compensate the applicant for costs of the proceedings if successful.

Once the resolution has been approved it cannot be challenged or set aside under subsection 4.

### **9.7 NOTICE OF SHAREHOLDERS MEETINGS**

S 62 deals with the notice of shareholder's meetings. Essentially this section says that 15 business days' notice is necessary for calling a shareholders meeting in the case of a *public company* or a **non-profit company** that has voting members, or ten business days in any other case, therefore a profit company will require ten business days in order to call a shareholders meeting.

A company's MOI may provide for a longer or shorter minimum notice period for the calling of a shareholders meeting.

A company may call a **meeting with less notice** than is required by the MOI but such meeting may only proceed if every person who is entitled to exercise voting rights in respect of any item on the meeting agenda is present and votes to **waive** the required minimum notice of the meeting.

A notice of a shareholder meeting **must be in writing** and must include the date, time and place for the meeting and the record date for the meeting. Please see s 59 for details of the record date which is the date for determination of which shareholders have rights. The general purpose of the meeting and any specific purpose must be specified. A copy of the proposed

resolution for which the company has received notice and which is to be considered at the meeting and a notice of the percentage of voting rights that will be required for that resolution to be adopted. In the case of an AGM, the annual financial statements to be presented or a summarized form must be sent to shareholders and directors for obtaining the complete copy of the annual financial statements must be provided. There must be a reasonably prominent statement that a shareholder entitled to attend and vote at the meeting is entitled to appoint a proxy to attend or participate in and vote at the meeting in the place of the shareholder or two or proxy's if the MOI so permits. A proxy need not also be a shareholder of the company.

Section 63(1) requires that meeting participants provide **satisfactory identification**.

If there is a **material defect** in the giving of the **notice** of the shareholders meeting the meeting may proceed, subject to Section 62(5) only if every person who is entitled to exercise voting rights in respect of any item on the meeting agenda is present at the meeting and votes to approve the ratification of the defective notice.

Sub Section 5 deals with the **defective notice**, if a material defect in the form or manner giving notice of a meeting only to one or more particular matters of agenda for the meeting, any such matter may be severed from the agenda and the notice remains valid with respect to any remaining matters on the agenda, and the meeting may proceed to consider a severed matter if the defective notice in respect of that matter has been ratified in terms of 4 (d). The problem in reading this Act is that there is no 4 d because it has been substituted, so there might be something wrong with this.

Sub Section 6 says that any material defect in the form or manner of giving notice of a shareholder's meeting or an accidental or inadvertent failure in the delivery of the notice to any particular shareholder to whom it is addressed does not invalidate any such action at the meeting.

Sub section (7) says a shareholder who is present at the meeting, either in person or by proxy is regarded as having received or waived notice of the meeting, if at least the required minimum notice was given. A shareholder who is present has a right to allege a material defect in the form of notice for a particular item on the agenda for the meeting and participate in the determination as whether to waive the requirements for notice if less than the required minimum notice was given or to ratify a defective notice.

## 10 DRAFTING RESOLUTIONS OR MINUTES

The term resolutions should only be used in regard to a proposed motion that has been carried after a vote at either a Directors or a Shareholders meeting.

The wording for resolutions should be carefully drafted in unambiguous language so that there are no possible misunderstandings which may result in a fight in the future.

### **10.1 REQUIREMENTS OF A WELL DRAFTED RESOLUTION ARE AS FOLLOWS:**

1. It should be lucidly worded all necessary verbiage being excluded.
2. It should avoid ambiguity or possible misunderstanding.
3. It should be worded positively i.e. should not be framed as a negative as the same result can be achieved by simply voting again.
4. It should consist of a single sentence though it may well contain one or more qualifying clauses and may also contain one or more co-ordinate clauses joined together by and;
5. If the subject matter involves a resolution or several paths, it is generally preferable to frame two or more separate resolutions.
6. Each resolution should commence with the word **that**.

Each motion must be capable of being voted on either as a **yes** or a **no**.

Where an act is not only agreed upon at a meeting but is effectively performed at the meeting for example such as the election of a director it is necessary to state at the meeting both the resolved part and that it is done.

***It was RESOLVED that Mr. A Smit be and he is hereby elected as a Director of the company.***

### **10.2 MINUTES**

Minutes may be defined as the official record of the proceedings and business transacted in a meeting and may be divided into two categories namely;

- a. Minutes of narration; and
- b. Minutes of resolution.

Minutes of narration give a simple statement of matters dealt with at the meeting for which there is no formal resolution, for example;

***the chairman declared the meeting duly constituted and the minutes of a meeting of the board held on the 5<sup>th</sup> January 2015 were read and signed by the chairman as a correct record.***

Minutes of a resolution record only the resolutions passed and are pre-fixed by the word resolved;

***Resolved That***

***Mr. Dhlamini be, and he is hereby appointed as assistant secretary to the company with effect from the 1<sup>st</sup> February 2015.***

## 11 SHARE CAPITAL

### 11.1 INTRODUCTION TO SHARE CAPITAL

Share capital forms a major part of the structure of the company. S1 of the act defines securities which includes share debentures and other instruments. We will deal fully with shares later on in these notes.

The word capital is an economic concept that is used to connote those man-made resources that are utilised in the process of production. In the accounting sense **Capital** or **Equity** consists of the excess of assets over liabilities in a business. In company law the word is used mostly to connote the **share capital** of a company.

Under the old Act the then CIPRO was most concerned with the **authorised** and **issued** share capital of a company. Each time there was a change in the authorised or new shares were issued various forms (CM15) had to be submitted together with a special resolution to CIPRO. We called this the **share capital maintenance regime**. The concern was that companies had to retain their share capital.

The explanatory memorandum that came with the new act talks about the Capital Maintenance Regime being based on **solvency and liquidity** and the abolishment of the concept of par value shares and nominal value.

The Sections 35 to 42 have a far greater flexibility in determining a company's share structure, then the 1973 Act:

1. The new act abolishes most of the rigid share capital requirements of the 1972 Act; and
2. Enables the board of directors to determine the composition of a companies authorised and issued shares.

***The reason for this is to enable smaller companies to have very similar characteristics to those of a close corporation.***

In Section 1 the definition of **securities** says any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company. The new act talks of securities which includes shares. In this document we use the word shares as everyone understands this terminology.

## **11.2 NOTIBLE DIFFERENCES BETWEEN THE ACTS**

Under the Old Act a company could have either shares of a **par value** or **no par value**, but not both. Par Value shares are where a value is allocated to the authorised share, we call this nominal value or par value. A **no par value share** is a share where a value is established on the issue of the share and every time there is a new share issue the value could be different. We will talk about this later on. Under the old Act a company could not have both as they had to select one. There were very few companies that had no par value shares, in fact I never ever came across one.

In Company Law there were strict requirements in regards to share capital. Many of these requirements have been removed in the new Act. The maintenance of share capital was very important because once the share capital in a company has been lost the company is insolvent. If the accumulated losses of a company have wiped out all the profits then share capital is lost.

Under the old Act what usually happened in regard to a company and for that matter in a close corporation is that share or members capital was established at a nominal value and 100 shares were issued at R1 each making the share capital R100. The balance of the capital that the business required to start or to operate were supplied by way of shareholder loans under various terms and conditions. The problem with this is that as soon as the shareholders, and one would assume that these shareholders were in control of the business saw that things were not going according to plan as they controlled everything, they would whip out the loan account to the detriment of creditors. However, if the money went in as share capital it would have been much harder for the company to make a repayment of share capital as there are all kinds of rules which we will deal with later.

The new Act does away with the **share capital maintenance regime** and brings in a new concept of **solvency and liquidity**. However, under the new Act one could still establish a company with a small share capital which could be shares of no-par value together with loan accounts and what would stop the shareholders or directors from taking the capital (loans) before creditors are paid? Yes, there are other laws that may be applicable like the insolvency law, but certainly a repayment of a shareholder's loan is not a distribution so the chances are that the company can get away with it.

The New Act allows very flexible arrangements for the control of shares with the total control of the issue of shares being in the hands of the directors unless the MOI provides differently.

Just a word of caution...because the CIPC is not interested in the maintenance of share capital, this does not mean that this aspect should be neglected. In fact, it does mean that company secretaries must take more care and make sure that their record keeping on shares is perfect.

### **11.3 THE LEGAL NATURE OF SHARES**

S 35 deals with the legal nature of company shares and requirements to have shareholders.

- Shares are moveable property and transferable.
- All shares (new company) must have **no par value**.
- All shares in a pre-existing company may be **par value**, and is allowed
- A company cannot issue shares to itself.
- Authorised shares have no rights until they are issued.
- Shares re-acquired or bought back have the same rights as authorised shares.
- Shares in a pre-existing company have exactly the same rights as they had before the effective date.

S 36 deals with all the classes of shares, the rights, and the limitations etc. All of these must be set out in the MOI. The MOI should dictate what the directors are allowed to do or what they cannot do, and of course the MOI can only be changed by special resolution.

For example, if the MOI allows, the directors may increase or decrease the number of authorized shares of any class, reclassify or classify any shares. They may determine the preference rights limitations or other terms of shares in any class that are not issued.

### **11.4 TERMS USED IN REGARD TO SHARE CAPITAL**

#### 1. Par Value Shares

These shares are allocated a value, normally R1 and they retain their value irrespective of what happens in the company. The new company's act does not allow new par value shares to be created or par value shares to be authorised. See Regulation 31. Where shares are taken up by shareholders for more than the par value the excess of the funds received goes to a **share premium** account.

#### 2. No Par Value Shares

An authorised No Par Value Share has no allocated value. When the shares are issued the directors determine the value of the shares and the funds are credited to a **stated capital**

**account.** This means that each share issue in the company can be at a different value. Under the old act the stated capital will be the same total as the share capital plus the share premium.

### 3. Authorised Capital

The authorised capital is essentially the number of shares of a particular share class that the company may issue to shareholders. As a rule, one cannot issue more shares than the number stated as authorised share capital. The authorised share capital has to be specified in the MOI. This will include the types of share, what rights, preferences and limitations are attached to each share etc.

**Regulation 31(2)** provides that a pre-existing company cannot authorise any new par value shares or shares that have a nominal value. If there are any shares of par value with no shares in issue these shares may not be used and would need to be converted in terms of Regulation 31(3) by completing form CoR 31 and submitting a director's resolution.

### 4. Issued Capital

This means shares that have been issued and held by shareholders. The issued shares may constitute a portion or the whole of the authorised share capital but cannot exceed it. The number of shares a shareholder holds to the total shares is the percentage of the company that he owns.

### 5. Unissued Shares

This represents the shares that have not being issued, the number of authorised shares minus the issued shares would be the unissued shares. If the issued shares are equal to the authorised shares then the company has to authorise new shares before any new issues can be made.

### 6. Classes of Shares

As a rule, all shares are equal within the same class. Where shares have different rights, preferences and limitations these are split into different classes. A company can have multiple classes of shares. Shares with different classes may have a different dividend participation on liquidation and also the ability to convert from one class to another class when certain events happen. A company virtually has an unlimited freedom to create any capital structure it requires.

The MOI must set out with respect to each class of share.

- a. A distinguishing designation for that class; and
- b. The preferences, rights, limitations and other terms associated with that class, unless these will be determined later by the board.

The capital of a company may consist of one type of share like an ordinary share or of several classes of shares, each with different rights.

## **11.5 TYPES OF SHARES**

### **1. Unclassified shares**

There is a new concept introduced by the companies Act called **unclassified company shares** which must be stipulated in the MOI – Section 36(3)(c). The purpose of having unclassified shares is to allow the directors to set up the requirements of the company when they wish to raise more share capital, without having to go to shareholders. As a rule, it is very unlikely that smaller owner managed companies will ever make use of unclassified shares as they would quite easily be able to pass a special resolution to make the necessary changes to the MOI. Large companies may need to make changes quickly if they come across an opportunity like an acquisition and they have to change share capital and raise cash quickly or to issue shares for an acquisition. If they have to go to shareholders, they may lose out on the opportunity because of the time it takes.

In this case please note the following; the authorisation and classification of shares, the change of rights and preference rights etc. must be set out in a company's MOI;

- a. These rights may only be changed by an amendment of the MOI by special resolution of the shareholders; or
- b. By the Board of Directors unless the company prohibits or restricts the board from doing so, except to the extent that the MOI does not allow it, the Companies Board may increase or decrease the number of authorised shares of any class of shares or re-classify any shares that have been authorised but not issued.

If a Board acts in terms of its authority, the company must file a notice of amendment of its MOI by using a form CoR 15.2 setting out the changes effected by the Board together with the director's resolutions.

This is a very interesting point as we are now seeing that if the Directors have the authority which has been given to them by the MOI, they can change the share capital by filing an appropriate Directors Resolution and the necessary paperwork to the CIPC. When we discuss the MOI in more detail, we will go through some of these clauses.

### **2. Ordinary shares.**

Ordinary shares are the usual type of shares in virtually all companies and are in fact the equity or ownership shares of the company. The holders of these shares are the ones who

take the **risk** with the capital they have contributed and are entitled to the profits of the company. In the event of winding up of the company these shareholders receive the surplus on the distribution of assets after all claims have been paid in respect of creditors and the liability for preference shares.

Ordinary shares while ranking equally may be set up in such a way that participation in profits and voting rights might be different. We have all come across the situation of A-class, B-class etc. and what is quite common is another class called N-class. The N-class share is a device that has been adopted to prevent the threat of take overs and enables control to be held by a small number of shareholders. This device is often used to keep control in a family business.

For example, let us assume that a company has 200 000 ordinary shares of R1 each and each share has one voting right, it then issues another 300 000 shares of R1 each which we call N-class ordinary shares and these shares carry a voting right of one vote for every 10 shares issued instead of 1 vote per share. The purpose of this is that the company wishes to raise more capital and could even be trading on the stock exchange and the founding shareholders wish to retain control. In this example the voting rights are 200 000 voting rights which the founders hold. Outsiders who have subscribed for shares and invested money only hold 30 000 voting rights, so in fact the founding members have control of this company as indicated in the table below.

<u>Investors</u>	<u>Cash Invested</u>	<u>Voting rights</u>	<u>Percentage control</u>
<b>Founding members</b> 200,000	R200,000	200,000	87%
<b>New investors</b> 300,000	R300,000	30,000	13%

Of course, these rights in regard to the N shares must be set up clearly in the MOI. Provided the shares are set out in the MOI the company is completely free to create such categories of shares and to attach such rights to each category as it deems fit.

### 3. Preference Shares

Preference shares are used to raise additional capital for a company and could have many rules as to how they are to be paid back or retained. They may be viewed as a loan. As a rule, preference shareholders do not take part in the active management of a company. Preference shares can also be converted into other classes of shares as well as ordinary shares.

There are different kinds of preference shares which could be **accumulative, non-cumulative, participating** and or **redeemable**. They are all alike in that their dividend distribution must take place before any other profits of the company takes places.

Holders of cumulative preference shares are entitled to a dividend each year before the holders of ordinary shares get their dividends. If a company is unable to make this payment then they will be paid first out of the next year's profits. Cumulative means the dividends accumulate until they are paid out.

Where the shares are non-cumulative, if a dividend is not paid there is no right to have arrears made good in the following year.

There are all kinds of terms and conditions that go with preference shares. If you have an interest in these shares, please look at examples on the web. Most of the banks have issued preference shares in the past.

#### 4. Redeemable Preference shares

Another type of preference shares are redeemable, this means that the company can repay those shares based on the terms and conditions when they were issued. It might be that originally the preference shares were issued at a very high rate of interest so therefore it would be in the interest of the company to redeem these and then issue a new set of redeemable preference shares at a lower rate. All the terms and conditions must be contained in the MOI.

### 11.6 THE ISSUING OF SHARES

The issue of shares does come with some complications in a number of instances.

#### WHERE SHAREHOLDER APPROVAL IS REQUIRED

In terms of Section 41 in certain instances it is necessary for shareholders to approve a share issue where the shares or securities or options or rights are issued to a **director**, a **future director**, a **prescribed officer**, a **future prescribed officer** or to a **person related or interrelated to the company**, or to a **director or prescribed officer of the company to any nominee of such person**.

Shareholder approval will not however be required if such issue is under an agreement underwriting the shares, if it is in the exercise of a pre-empted right to be offered and to subscribe to shares as contemplated in Section 39;

- Is in proportion to the existing holdings and on the same terms and conditions as have been offered to all the shareholders of the company or to all the shareholders of the class or classes of shares being issued.

- Pursuant to an employee share scheme that satisfies the requirements of Section 97 or pursuant to an offer to the public as defined in Section 95(1)(h) read with Section 96.

### **11.7 DIRECTORS EXCEEDING THEIR AUTHORITY IN A SHARE ISSUE**

S 38 (2) deals with the situation where the directors exceed their authority to issue shares. An unauthorized share issue transaction is to be reversed if the transaction is not ratified by the shareholders. In terms of S 38(1) the Board may resolve to issue any shares at any time but only within the classes and to the extent that the shares have been authorised or are in terms of the Company's MOI. Such share issues are to be in accordance with s 36.

If the shares have not been authorised in accordance with s 36 or are in excess of the number of authorised shares of any particular class, the issuance of these shares may be retroactively authorised in accordance with s 36 within 60 business days after the date on which the shares were issued. If a special resolution to sort out the unauthorized issue, is not adopted when put to the vote at a general meeting, the share issue is a **nullity** to the extent that it exceeds any authorization. Also see s 200(2) in this regard.

In terms of s 38(d) the Company must return to any person the fair value of the consideration received by the company, together with interest in accordance with the prescribed rate of the Interest Act.

### **11.8 CAPITALIZATION ISSUE**

Where a company has retained a large part of its profits for whatever reasons they may decide to transfer some of these profits into share capital. The directors may decide to capitalise a whole or part of these reserves by putting an entry through the books reducing reserves and crediting the share capital. This they do by issuing new fully paid ordinary shares in the company. In past years this was done to try and avoid dividend tax. There was a transfer from reserves and later these shares were bought back by the company, this then would be a dividend in the hands of the shareholder and the company would have to pay the necessary dividend tax. In many instances the capitalisation was a scheme to avoid dividend tax.

A capitalization issue does not in any way increase the capital resources of the company because there is no movement in cash.

We need to look at this in regard to tax and what we call **contributed tax capital**, something that will be dealt with later.

Where there is a cash payment made to shareholders in lieu of the capitalization i.e. the issue of the share certificates to the shareholders then the board has to carry out a **solvency and liquidity** test as this will fall within the definition of a **distribution**.

## 12 SHARE CERTIFICATES

### 12.1 CERTIFICATED OR UNCERTIFICATED

Any securities issued by a company are either certificated or uncertificated.

In Section 49(2), the certificated security means that it is a security or share that is evidence by certificate whereas an uncertificated security are defined as securities that are not evidenced by a certificate or a written instrument and these are transferable by entry without a written instrument. Securities can only be traded on the JSE if they are uncertificated. Section 49(3)(a) specifies that the rights and obligations of security holders are not different according to whether they are certificated or uncertificated except where it expressly provides otherwise.

### 12.2 SECURITIES REGISTER

A profit company is required to maintain a security register. (Section 24(4)(a)). The register must reflect the current holders of shares and securities.

In South Africa there is an extensive use of a nominee system and the beneficial holder of the rights pertaining to the securities must be given to the company in question. The total number of securities held in uncertificated form must also be entered in a securities register.

Secretarial practitioners that handle smaller companies do not deal with uncertificated shares.

Strait Ltd is licensed to carry out all the uncertificated transactions for the JSE.

If the directors have the authority, they can allot shares. There is no longer any need to file something like a CM15 which you had to do under the old act. If the directors have the authority there is no need for a special resolution in order to issue shares. It is imperative that the share records of a company are kept up to date. Where it is necessary to increase the authorised share capital this is in affect a change to the MOI and requires a special resolution or directors' resolution where the directors have the authority. If the company still has par value shares then the procedure to convert to no par value shares in terms of Regulation 31 must be carried out.

Regulation 32 deals with the requirements of the securities register. One of the requirements are that an email and cell number of the shareholder should be entered. I don't believe that its right as anyone has right of access and it's a question of privacy.

### 12.3 SHARE CERTIFICATES

S 51(1) c of the act provides that a securities certificate is **proof that the named holder owns the security**. Although a share certificate is transferable it is **not fully negotiable** and the true owner can reclaim his shares.

There are strict requirements as to what is contained on a share certificate. i.e.

- Name of company
- Serial number
- Name of registered holder
- The number and class of shares
- Any restriction on the transfer
- Require 2 signatures secretary or/and director and if not available someone appointed by the director

#### **12.4 APPROVAL OF THE ISSUE**

Under the old Act approval for the issue of shares were **generally granted to Directors** in the situation of larger companies. In terms of the new Act the board may resolve to issue shares but only within the classes and to the extent that the shares have been authorised by or in terms of the company's MOI. It is not necessary for shareholders to approve the issue of shares; it is really a question of what the MOI says.

If a company issues shares that have not been authorised or in excess of the number of authorised shares of any particular class the issuance of those shares maybe retroactively authorised in accordance with the companies MOI within 60 days. If the shareholders do not approve this then the transaction must be reversed and the share issue becomes a nullity.

#### **12.5 ISSUE OR ALLOTMENT OF SHARES**

On the issue or allotment of shares the money paid by the new shareholder is paid into the company and credited to the share capital and or share premium account. In the instance of an issue the directors place the value on the shares. The issue of shares is a risky area as minority or outside shareholders percentage holding may be reduced. One also needs to be aware of this where there is a capitalisation issue. Please refer to the section on pre-emption rights.

#### **12.6 TRANSFER OF SHARES**

Shares may be transferred from one shareholder to another person or company on the payment of an agreed price from the new shareholder to the old shareholder. The money paid does not go into the company but is paid by the new shareholder to the old shareholder. The determination of this price is between the new and old shareholder. On the JSE the market sets the price.

A transfer consists of a series of steps;

1. An agreement to transfer

2. The execution of the deed of transfer
3. The registration of the transfer

Full title to the shares i.e. all rights and duties of the member as embodied in the MOI is conferred only by the registration of transfer in the share register. One also needs to take into account the conditions as set out in the MOI and the company must be fully aware of pre-emptive rights.

### **12.7 PRE-EMPTIVE RIGHTS**

Various subsections deal with the pre-emptive rights situation in that before shares are offered generally, the existing shareholders should have the right to take them up thereby retaining their shareholding percentage.

If we look at the short form MOI CoR 15.1A a standard clause 2.1(3) deals with the pre-emptive rights and refers to s 32 of the act.

The important thing to note is that after a share issue the ratio of shareholdings remain in the same proportion to what they were before the issue. It may be that one of the shareholders declines to take up the shares offered and in this situation the ratio of his shares held will reduce after the issue has taken place.

It is really a good idea to build all the rules on pre-emption into the MOI or the rules.

### **12.8 CONSIDERATION FOR SHARES**

S 40 deals with the consideration for shares.

- a. In terms of Section 40 the board of a company may issue authorised shares only for **adequate consideration** to the company as determined by the board;
- b. In terms of conversion rights associated with previously issued securities of the company;
- c. As a capitalization issue as contemplated in Section 47.

Basically, this is the same in the old and new act. When shares were issued under the old Act it generally was a par value share, the nominal amount plus the excess of the value of the share going to the **share premium account**. The directors used to set the share premium value under the old act. Now it is still up to the directors to set the consideration and s 40 (1) (a) talks about adequate consideration which must be determined by the board.

The adequacy of the issue price cannot be challenged on any other basis than in terms of s 36 which deals with standards of director's conduct, read with s 77 (2) which deals with in what circumstances the directors can be held liable.

S 41 deals with situations requiring shareholder approval for the issue of shares and these would be to a director, future director, prescribed officer or future prescribed officer of the company a person related or inter-related to the company or to a director or prescribed officer of the company or a nominee of a person contemplated in paragraph (a) or (b). In these instances, a special resolution is required.

Sub-section 5 deals with the situation when a director can be held liable in certain events if the actual law was not complied with.

### **12.9 SECURITIES TRANSFER TAX**

Share transfer tax was what we used to call it. We now call it securities transfer tax. A tax Of .025% has to be paid on various share transactions.

Securities transfer tax is regulated by the Securities Transfer Act No 25 of 2007 as amended and the Securities Tax Administration Act, No 26 of 2007 as amended.

S1 of the Securities Transfer Act says, security means any share or depository receipt in a company or a member's interest in a close corporation, but the definition excludes the debt portion in respect of a share linked to a debenture.

Transfer includes; -

- Transfer
- Sale
- Assignment
- Cession
- Disposal in any other manner
- Cancellation
- Redemption of that security
- **But does not include**
- Any event that does not result in a change of beneficial ownership
- Any issue of a security
- A cancellation or redemption of a security if the company is being wound up, liquidated or deregister

There are a number of exemptions for more complicated types of transactions which you need to take advice on.

## 13 REGULATION 31 CONVERSION OF PAR VALUE SHARES

### 13.1 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.

### 13.2 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.

### **13.3 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.

### **13.4 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.

### **13.5 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 authorized 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.

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

### **13.6 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. One could also do it by allotting additional shares at no value but this certainly does not make any sense. 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.

### **13.7 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.

### **13.8 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	<u>R200,000</u>	

After the transaction it could be as follows

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

However, we could make it look like this;

Share capital NPV	R10,000	10,000 No Par value shares of R1 each
Share capital PV	R90,000	90,000 par value shares of R1 each transfer to share premium.
Share premium	R100,000	
Total Share Capital	R200,000	

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

## 14 SHARE CAPITAL QUESTIONS

**Q. What happens to the share premium account, once you convert your par value shares to no par value shares?**

A. The directors can transfer this to the stated share capital account or they can retain it as share premium as it's much easier to pay back share premium than to buy back shares owing to the additional compliance required.

**Q. With reference to the value of shares being transferred. How does market related value play in this and the SARS requirements?**

A. As a rule market value is determined by an agreement between a buyer and a seller. If the buyer and seller agree on a price that is the market value and the price of securities transfer tax.

**Q. If shares are issued at say R1 per share, can the purchase price for the shares be different i.e. higher?**

A. The price of a share or the market value of a share relates to the value of the company. If the company makes profits and the assets grow then the value of the shares goes up. By the same token if the company loses money the share price would go down. Any excess of shares over the par value will go into share premium on allotment and into share capital account on NPV shares.

**Q. Is it possible to pay different shareholders of the same class dividends that are not in proportion to one another? Can this be achieved by altering the MOI, or is there a way around it?**

A. This can't be done in respect of the same class of shares as the number of shares held to the total indicates the percentage holding. The MOI says that profits are to be distributed on this basis of this percentage holding. If for some reason the directors want a disproportionate payment of dividends then different share classes must be set up. One could then have preference shares with its own unique class of shares.

**Q. It seems there is some confusion on old and new company share knowledge. You need a good understanding of the old companies act on share capital to really follow or understand the new companies act. i.e. what PV, NPV Share Premiums and the basic capital concepts. Perhaps lecture on this later on.**

This is true. To really understand the concept of share capital one needs to have a good basic understanding of the accounting principles of share capital. The new companies act does not deal with the basics of share capital but assumes the accounting principles of share capital apply and only really replaces a restriction on having par value shares. There are in fact no definitions of what share capital really is in the act.

**Q. Can you issue shares to different people at different values - 1 share for R100 and 1 share for R1000?**

A. There is really nothing to say that you can't. The only reason that this should not be done is how would you justify this to the person who is paying more. Shares are always issued

based on the value of the share. In the listed environment this value is determined by agreement between a buyer and a seller on the stock exchange.

**Q. For new companies being formed, can the share capital be reflected as R0 in the financial statements?**

A. Only if the company is dormant and does not have a bank account and all it has is **authorised share capital**. However, when a share is issued a value must be assigned to that share so that a share capital account can be opened in the books of the company and shown on the balance sheet. Remember shares are issued to determine the percentage of ownership in the company and who controls the company. Despite the fact that the shares are **no par value** an amount must be assigned to a share when business starts as you can't have a zero-value share. It could be 1c or R1 or any amount determined by the directors based on the capital needs of the company. As the company grows and makes profit the value of the shares will grow and new issues of shares will always be at a higher value.

**Q. Please advise on the following;**

**How do you go about issuing various different classes of shares, in particular from a CIPC perspective (completing the CoR15.1 form)? For example, we want to issue**

**Type A no par value ordinary shares, these shares are only entitled to voting rights, with no participation in any dividends and**

**Type B, C, D, no par value ordinary shares, these shares are only entitled to participate in dividends, with no voting rights.**

A. Summarise the different share classes on the front page of the form CoR 15.1 and indicate the different share classes in the actual MOI. One can set this up as a schedule to the MOI where all the rights and limitations are specified.

**Q. What happens to Cumulative Fixed Rate Shares?**

A. These are preference shares where in a particular year the agreed dividend is not paid. These dividends are accumulated and paid when the company is in a position to do so.

**Q. Please can you explain why they say that a preferential share is equity and debt... why would you want to subscribe for these shares and not ordinary shares?**

A. Larger companies who require project finance for large projects take money from investors to finance those projects. In order to encourage investors, they offer a good rate of return which is very secure and is at a fixed rate. In many instances this is more like debt financing and investors never have ownership of the company. There are many large companies with preference shares.

**Q. What could one do in a case where there were no proper records kept and resolutions were not updated. When you are now trying to update share registers and there is missing information. What do we as Company Secretaries need to do in such cases?**

A. In this case the only valid evidence that you have is the CIPC listing of who the directors are. If possible, I would obtain an affidavit signed by each of them as to who the shareholders are. If there are existing shareholders that you know about include them in the affidavit. If all the parties agree then reconstruct the company secretarial records to the

current situation. In regard to share capital there may be movement of share capital paid into the company. The directors should know who the shareholders are. If it's a pre-existing company there is a record of the issued shares at the CIPC.

**Q. On transfer of shares the Capital Gain or Loss is determined on the original base cost and proceeds from the sale value. Question - is the transfer value also not subject to being determined in relation to market value for income tax purposes as STT constantly refers to market related value which the share transfer value is not always.**

A. What you have said above is true, however the transfer value is in fact what a buyer is prepared to accept for the shares owned and what a seller has agreed to pay. In effect this is the market price of the shares. Once the market price is determined the capital gain or loss and the SST can be determined.

**Q. Is the Securities Transfer Tax payable by the shareholder selling?**

A. The STT is payable by the buyer,

**Q. What document of evidence is required when transferring shares from one shareholder to another? What restricts director's transferring shares of shareholders? In the old act this was governed by the CM42. If two directors sign the share certificate this does not prove that the shareholder gave authority?**

A. There is no reason why you can't use the old CM42 as the transfer deed. In our systems we have converted this form into a **transfer deed** which must be signed by the transferor (seller) and the transferee (buyer). Directors should never sign the share certificate unless they have an agreement in place or the transfer deed is properly signed. In law the transfer becomes effective when the transaction is entered into the share register.

**Q. Can an incorporated company have different classes of shares?**

A. There is no reason as to why it should not. They must be defined in the MOI.

**Q. Once the CIPC have approved the conversion of par value shares to no par value shares, does a new share certificate need to be issued to the shareholder?**

A. There must definitely be new share certificates issued. I would recommend that they are issued with the same share certificate number so that they can be traced back to the old class. I would recommend doing this when all the paper work has been produced so that the share certificates can be signed at the same time as the resolutions. Remember this is a formality that the CIPC must eventually approve.

**Q. I had a case where a company was incorporated on 20 April and the shares certificates were only issued on 30 May. Is this wrong? What about the period where no shares were issued?**

A. I assume that this was a company that was incorporated. The first thing here is that there are in fact incorporators who are the equivalent of directors. From a practical point this may very well happen often. There is also no reason to backdate the issue of the share certificates. As this situation has a gap I don't think anything turns on it.

**Q. How do you convert ordinary shares to preference shares or can you?**

A. Preference shares are normally issued by agreement; the terms can even be contained in the MOI. There may be an option to convert them into ordinary shares. If there is agreement up front as to how then there is no issue with this. If there is no agreement up front I don't

see why this can't be done by special resolution taking into account the pre-emption rights as specified in the act.

**Q. Is it fine to only furnish clients with share certificates and meeting minutes allocating shares to shareholders? They can then sign the templates to confirm shareholding status. Or must a share register and any other documents accompany this?**

A. If one is using an electronic system then all the paperwork including the registers are produced at the same time. The shareholding really only comes into effect when all the paperwork is signed and the share register is updated. It is not necessary to give the new shareholders the register unless they request it. The registers should always be available at the registered office for inspection by anyone.

**Q. Is it possible to change the MOI once the Shareholders have changed an old Company to a standard MOI as per the new Companies Act and realised it is not appropriate?**

A. Yes, the shareholders can change an MOI as many times as they like provided they carry out the compliance procedures and pay the CIPC fee. A special resolution is required.

**Q. I registered an incorporated company. During the process I completed the long form MOI, but did not make provision for any restrictions?**

A. It is not necessary to have restrictions as the act and the MOI will determine the rules.

**Q. What is the Serial Number on the share certificate?**

A. It is the unique number that is used to keep track of each share certificate. With NPV shares on the Shares Certificates you need to insert a value on the Share Cert the Shareholders to advise value

**Q. I have read/heard somewhere some time ago that when it comes to transferring or selling your shares, there could be potential technical issues when the shares are not fully paid up. Is it a potential pitfall if the shares are not paid up?**

A. All shares in RSA must in fact be paid up. The law does not allow non-paid up shares. Shares should not be issued unless they are paid up.

**Q. When transferring 'No Par Value' shares of an existing company, does the company need to be valued by the Auditors to determine the value of the Shares? Or how is the value of the No Par Value shares determined?**

A. The rules are the same for a par value share. If the buyer and the seller want to determine a proper value then the auditor can value the shares as a guide, but as a rule is not necessary. The price is in effect an agreed price between the buyer and seller. If we were to compare the PV to NPV situation on an allotment it would be as follows  $NPV = PV + \text{Share premium}$

**Q. So in essence the value of the NPV shares should equal the shareholders' investment in the company i.e. loan accounts.**

A. Not necessarily. It should be remembered that Shareholders loans are in affect a liability and can be repaid.

**Q. Can a subdivision of shares still be done under the new Act?**

A. Yes, it can, subject to the various technicalities.

**Q. So if I register a new company for a client, Can I be the incorporator and sign all the original documentation and as soon as the company is registered do a CoR39?**

A. Yes you can.

**Q. According to a lawyer, who is an expert in Co Law, a company MUST have a class of ordinary shares (general) before other classes with more specific rights may be created. I don't agree with this. What is your opinion?**

A. The ordinary class are in effect the owners of the company so it is necessary to have them. Where different rights are required then we can have different classes of shares.

**Q. Can you not have ordinary PV shares and once you increase the share capital the additional shares are then issued as a new Share Class and have 2 classes of Shares?**

A. You can do this but the MOI must differentiate the new class and the rights and in the long run this becomes messy. If money above par is paid this will go into the share premium account. Share Premium belongs to all the shareholders in equal shares.

**Q. As a standard I issue e.g. 100 ordinary no par value shares at an issue price of R1.00 or such issue price as the board determines.**

A. This is correct right at the start of operations. Once the company starts to build operations the price should reflect the value of the shares then it would be the stated share capital.

**Q. What is the transfer date where you have a Share Sale Agreement that stipulates a current effective date but everything is subject to suspensive conditions that needs to be complied with at a future date? Do you perhaps consider the effective date as the transfer date for accounting purposes and only transfer the shares when the suspensive conditions have been complied with?**

A. When the suspensive conditions have been met that is the time to do the paper work with everything dated at the effective date.

**Q. In the event where there was no proper record keeping regarding shareholding and issued shares, how does one go about establishing who the actual shareholders are or were?**

A. This is difficult. Its best to get a resolution where everyone agrees. The directors should know this.

**Q. Does it become a litigation matter or is there another way to resolve this?**

Whichever way it goes it has to be based on facts that everyone agrees to.

## 15 BENEFICIAL INTEREST IN SECURITIES

In South Africa there has been a long-standing business practice to register a share where one person holds the shares for the benefit of another person whose name was not entered into the share register. It was a method used to get around the group areas act where certain members of society were not allowed to own property in certain areas.

The new act defines this as a relationship between the **registered holder of a security** and the **holder of the beneficial interest in the security**.

Essentially let's say Mr. A wants to buy a building but he does not want to disclose this. He puts up the money and puts everything in the name of Mr. B. The building is registered in the name of a company and Mr. B is entered into the share register. A and B enter into an agreement to regulate their arrangement.

In terms of Section 57(1) a shareholder means the holder of a share issued by a company and who is entered as such in the **certificated** or **uncertificated** securities register as the case may be. A registered shareholder or the equivalent of a member under the 1973 Act **holder** is not defined. The distinction in the old Act between the shareholder and the member has been replaced by the distinction between the holder of a beneficial interest and a shareholder as defined in Section 1.

Section 56(1) allows this practice except to the extent that a company's MOI provides otherwise. A company's issued securities may be held by one person for the beneficial interest of another person. The Act retains the right that a company must respect the rights of the shareholder, the owner of a registered security to exercise votes. It is therefore necessary to regulate this relationship.

Beneficial interest when used in relation to a company's securities means the right or entitlement of a person, or ownership, agreement, relationship or otherwise a loan or together with another person to;

- a. Receive or participate in any distribution;
- b. Exercise or cause to be exercised in the ordinary course or all of the rights attaching to a company security, or
- c. Dispose or direct the disposition of a company securities of any part of a distribution in respect thereof.

Section 56(2) increases the range of persons who have a beneficial interest in a security issued by a public company even further. For the purpose of this discussion we are not going

to go into detail, just be aware that you need to look at this section if you are handling the affairs of a public company.

### **15.1 Disclosure Requirements**

S 56 applies to all types of profit companies or a public company.

The person who is registered as the holder of a security in a public company and is not the holder of the beneficial interest in the securities the registered holder must disclose the identity of the person on whose behalf the security is held. The number and class of securities held for each such person with the beneficial interest and the extent of each such beneficial interest must be disclosed to the company in writing within five (5) days after the end of every month during which a change has occurred of such information.

If the company knows who or has reasonable cause to believe that securities are held by one person for the beneficial interest of another person, the company may request in writing to either of those persons to confirm or deny that fact and provide the necessary particulars. Such information must be provided by no later than 10 business days after receipt of the notice.

S 56(5) and S 56(6) apply to every type of company including private companies.

S56(9) provides that the holder of a beneficial interest in a share may only vote to the extent that;

- (a) The beneficial interest includes the right to vote on the matter
- (b) The person holds a proxy appointment in respect to that matter from the registered holder of those securities or the person's name is on the company's register of disclosures.

The beneficial holder of a security may demand a proxy appointment in certain instances.

Where you come across these kinds of arrangements it's in the interests of all concerned to have a proper agreement.

The problem with this kind of situation is that the holder of the beneficial interest in the shares wants to hide his or her holding so the chances are that they are not going to comply with these provisions.

## 16 DIFFERENT TYPES OF COMPANIES

### 16.1 PROFIT COMPANIES

A profit company is a private company if it is not state owned and its MOI prohibits the offer of securities to the public and restricts the transferability of its shares. This is in terms of s 1 read together with s 8(3)(b).

The core characteristic is that the shares or securities may not be offered to the public and there is a restriction on the transferability of shares. Essentially this is the fundamental difference between a private company and a public company.

A private company under the new 2008 Act is very close to a private company under the 1973 Act except that the restriction of 50 shareholders in a private company has now been abolished. This is the interest of flexibility in an organization and the fact that the number of shareholders really does not bear any correlation as to the true nature and size of the company.

The restriction on the transferability of the shares has now being widened in the new Act.

A profit company's main goal is for financial gain for its shareholders.

The accountability of the company really depends on its size and one has to look at the regulations as to when a company requires an audit or needs to appoint a secretary.

### 16.2 NON PROFIT COMPANIES

#### 16.2.1 INTRODUCTION

A nonprofit company under the act is the equivalent of an “**association**” **not for gain** referred to as a Section 21 company under the old Act. Fundamentally the principals are the same except in two aspects:

- A nonprofit company may have members and;
- A nonprofit company is not a public company as it was under the old Act. It is now a unique company.

Nonprofit companies or NPC's are governed mainly by s 10 and Schedule 1 of the new Act. One of the stated purposes is to provide for formation, operation and accountability of nonprofit companies in a manner to design, promote, support and enhance the capacity of nonprofit companies to perform their functions.

#### 16.2.2 DEFINITION OF NONPROFIT COMPANY

An NPC's MOI must set out at least one object of the company which must be either a “**public benefit**” object or an object relating to one or more cultural or social activities or communal or group interest and;

The property of the company must not be distributable to its incorporators, members, directors, officers or persons related to any of them except to the extent provided by item 1(3) (see s 1). The NPC must apply all of its assets and income however derived to advance its stated objects as set out in the MOI.

#### 16.2.3 THE MOI AND NAME OF AN NPC

A non-profit company's name must end with the expression **NPC**.

The NPC'S MOI must be consistent with the principles as set out in Item 1(2) to (9) and must differ from that of a profit company, state at least one object and does not have any shares.

Regulation 15(1) provides for 3 standard MOI's for NPC's, namely a short form or a long form for an NPC with and without members.

The transitional arrangements provide that every pre-existing NPC or old Section 21 company is deemed to have amended its MOI at the 1<sup>st</sup> May 2011 to expressly state that it is a nonprofit company and to have changed its name with the expression NPC.

#### 16.2.4 MEMBERSHIP OF A NONPROFIT COMPANY

An NPC may have members but this is not a necessity. A member of an NPC is a person who holds membership in and specified rights in respect of that NPC as set out in Schedule 1. The Incorporators of an NPC are its first members if its MOI provides for the NPC to have members. It is most important that the MOI sets out the fact that there must be members. Where the MOI provides for the NPC to have members there can only be two classes of members namely members with voting rights and non-voting right members.

- If an NPC MOI provides for members its MOI must not restrict or regulate or provide for any restriction or regulation of that membership in a manner that it may amount to unfair discrimination in terms of **Section 9 of the constitution**.
- The MOI must not presume the membership of any person, deem a person to be a member or provide for the member to automatic or ex-officio membership of any person, except for lifetime membership awarded to a person for services

to the company or to its or to its public benefit objects as it is set out in its MOI, and with that person's consent.

- The MOI must set out the **qualifications for membership**, the process for applying for membership, any initial or periodic cost of membership, the rights and obligations (if any) of memberships in any class and the grounds in which membership will be suspended or lost.

**Juristic persons** including profit companies may be members of an NPC if it's MOI so allows. As a rule, each voting member has one vote and each member's vote is equal to each other member unless the MOI provides otherwise. The MOI can provide for certain members to have different or leader voting rights than others. Where an NPC has members then it must produce a register of membership.

An **incorporator** or member or director must not be paid directly or indirectly or receives any portion of its income or take transfer of any of its assets regardless of how the income or assets was derived except;

- a. As reasonable remuneration where goods are delivered or services are rendered.
- b. Reimbursement for cost may be made.
- c. As a payment of an amount due and payable by the NPC in terms of a bona fide agreement between the NPC and that person or another.
- d. As payment in respect of any rights of that person to that extent that such rights are ministered by the NPC in order to advance the stated object of the NPC or;
- e. In respect of legal obligation binding on a non-profit company.

#### 16.2.5 DIRECTORS OF A NON-PROFIT COMPANY.

An NPC must have a board of directors which must comprise of at least three directors. The incorporators are the first directors of the NPC.

If there are **no members** the MOI must set out the basis on which its Directors are appointed via the Board or other persons. If the NPC has members the MOI must set out the basis on which its members choose its Directors. If any Directors are to be elected by the voting members its MOI must provide one third of them to be elected each year.

Unlike a profit company an NPC is **prohibited from providing a loan**, securing a debt obligation or otherwise providing direct or indirect financial assistance to a Director of an NPC

or a related or interrelated company or to a person related to any such director other than in certain limited instances as indicated below;

- Is in the ordinary course of the NPC's business or fair value;
- Constitutes an accountable advance to meet legal expenses in relation to a matter concerning the NPC or to meet anticipated expenses to be incurred by the person on that NPC's behalf;
- To defray the person's expenses for removal at the NPC's request or;
- Is in terms of an employee benefit scheme generally available or to a specific class of employees.

If an NPC has no voting members the board of that NPC may amend its MOI by special resolution as defined in Section 1 proposed by its board.

#### 16.2.6 PROVISIONS OF THE ACT NOT APPLICABLE TO NPC

All provisions apply to an NPC subject to the limitations alterations or extensions as set out in Section 10 and Schedule 1.

The provisions that apply is Part D of Section 2 Capitalization of profit companies and Part E of Chapter 2 of Securities and registration transfer and remuneration and election of Directors in terms of Section 68 parts B and D of Chapter 3 of Secretarial and Audit Committees unless the NPC voluntary elects to appoint a company secretary or audit committee and in Section 42 or unless the Minister prescribes a category of nonprofit companies that must have their AFS audited in terms of the regulations in terms of Section 30(7). The whole of Chapter 4 Public Offerings of Securities, the whole of securities the whole of Chapter 5 of Take over and fundamental transactions, except to the extent as contemplated in Item 2 of Schedule 1(46)(d) and 152(3)(c). Rights of shareholders of business rescue plan except if the NPC is a shareholder of a profit company that is engaged in business rescue proceedings and Section 164 descending shareholders appraisal rights unless the NPC is a shareholder of a profit company.

Ss 58 to 68 Shareholder and meeting resolutions read with the changes required by the contents, only apply to NPC'S which has voting members and when applied as a subject to the provisions of Item 4 of Schedule 1. If there is a conflict between a provision of Item 4 of schedule 1 and any provision of Sections 58 to 65 the former prevails.

#### 16.2.7 ASSETS AND BUSINESS OPERATIONS OF AN NPC

As long as the assets and income however derived apply to advance the NPC's stated object as set out in its MOI an NPC may acquire and hold securities issued by a profit company or

directly or indirectly alone or with any other person carry on any business trade undertaking consistent and or auxiliary to any stated object.

#### 16.2.8 INCOME TAX

Section 10 of the Income Tax Act grants a number of exemptions from income tax to so called benefit organizations. This act contains strict requirements for eligibility for the exemptions including requirements for approval of a public benefit organization under Section 330(3)(b). Compliance with some of these requirements will probably necessitate the amendment of certain provisions of an NPC's MOI.

#### 16.2.9 FUNDAMENTAL TRANSACTIONS INVOLVING AN NPC

An NPC may not convert to a profit company and is also prohibited from amalgamating or merging with a profit company.

An NPC may dispose of any part of its assets or undertaking or business to a profit company provided that it does so at a fair value. If the value is less than fair this must be in accordance with the ordinary course of the NPC's activities.

If an NPC has voting members, any proposal to dispose of all or greater parts of the assets or undertaking or to amalgamate or merge with another NPC must be submitted to voting members for approval in a manner comparable to that required of a profit company in accordance with ss 112 and 113 respectively. In this event ss 115 and 116 must apply.

#### 16.2.10 EXTERNAL NONPROFIT COMPANIES

An external company must within 20 days after it first begins to conduct nonprofit activities in the Republic register with the commissioner as an external NPC. If within the jurisdiction in which it was incorporated it means legislative or definitional requirements that are comparable to those of a nonprofit company incorporated.

#### 16.2.11 INCORPORATION AND DISSOLUTION OF A NON PROFIT COMPANY.

An NPC is incorporated in the same way as a profit company except that an organ of state, juristic person or a minimum of three persons acting in concert are required to incorporate the NPC.

On winding up no member, director etc. is entitled to any part of its net value, after all its liabilities have been satisfied

An NPC'S entire value must be distributed to one or more nonprofit companies registered external nonprofit company activities in the Republic, voluntary association or nonprofit trust having similar objects as determined in terms of the NPC's MOI or by its members or Directors at or immediately before the time of its dissolution.

If the members fail to make this transfer then it can be determined by the court. The commission may apply to the court on behalf of the NPC for such determination.

### **16.3 DOMESTICATED COMPANIES**

A domesticated company is defined as a foreign company whose registration has been transferred to the Republic in terms of s 13(5) to 13(11). The Act makes provision for the fact that when the transfer takes place the company exists as a company in terms of this Act as if it had been originally incorporated under the Act.

In terms of s 13 (6) there are some severe restrictions which would prevent a foreign company from registering in the Republic.

- a. The law of the foreign country must permit such a transfer, and the company in question must have complied with all the requirements of the transfer.
- b. The transfer must be approved by its shareholders in accordance with the law of its jurisdiction in which it is registered, if that law imposes such a requirement, or by the equivalent of a special resolution in terms of this act if the law of the jurisdiction of which it is registered does not require such shareholder approval.
- c. The whole or greater portion of its assets and undertaking are within the Republic other than any assets and undertaking of any subsidiary that is incorporated outside the Republic.
- d. The majority of its shareholders are residents of the Republic.
- e. The majority of its directors are citizens of the Republic.
- f. If immediately following the transfer or registration it will satisfy the solvency and liquidity test and no longer be registered in another jurisdiction.

The application to transfer must be accompanied by a copy of a shareholder's approval referred in b above together with satisfactory evidence that it satisfies the remainder of the requirements.

Section 13(7) contains additional restrictions

- If there are **bearer shares** held by the company i.e. ownership resides with the holder of the share the company may not transfer its registration.
- If it is in liquidation.
- If its property has been placed under a receivership or management by court or otherwise.

- If there are any plans that are similar to a business rescue or there is some kind of compromise or arrangements with creditors.
- If an application has been made to court in any jurisdiction and has not been disposed of.
- If the company is in liquidation or declared insolvent or there is a compromise arrangement between it and creditors or a receiver has been appointed to administer its properties.

Once the required registration details have been taken care of in terms of s 13 the CIPC must issue a registration certificate. The CIPC must also sign a unique registration number to the company and must be entered into the company register. Regulation 17 sets out the requirements for domestication of foreign companies including the documentation that must accompany any application under s 13(5).

Regulation 17(13) permits a foreign company to apply to the tribunal to review a conditional registration or refusal of registration by the CIPC.

The registration of a domesticated company in terms of terms of s 13(5) to (9)

- Does not establish a new juristic person, or prejudice or affect the identity of a juristic person constituted by that domesticated company or its continuity as a juristic person.
- Prejudice the rights of any person or affect the property rights, liabilities or obligations of that juristic person.
- Or render ineffective legal proceedings by that jurisdiction by that person.

## **16.4 EXTERNAL COMPANIES**

### 16.4.1 INTRODUCTION

External companies are governed by s 23 which sets out certain disclosure and filing requirements for any foreign company that carries on business or non-profit activities in the Republic. This is so that these companies can be identified and traced for the purpose of legal proceedings and also enables the CIPC to monitor their activities. There are very few provisions of the Act that apply to external companies as most have been abolished. In particular most of the accountability obligations of external companies have been abolished. It is most surprising that there are no financial reporting obligations, it is not necessary to prepare financial statements or to have any financial statements audited or independently reviewed.

#### 16.4.2 FOREIGN COMPANY DEFINITION

A **foreign company** is defined as an entity incorporated outside the Republic irrespective of whether it is a profit or a nonprofit company or whether it is carrying on business or nonprofit activities as the case may be within the Republic.

#### 16.4.3 EXTERNAL COMPANY DEFINITION

An **external company** is defined as a foreign company which **is carrying on business or nonprofit activities** as the case may be in the Republic subject to s 23(2). In fact, the remaining Act does not apply to foreign companies which are not external companies at all except in two respects;

- A foreign company may transfer its registration to the Republic and if it does it becomes a domesticated company; and
- Chapter 4 of the Act which governs public offerings of securities to a foreign company whose securities are offered to the public within the Republic.

Neither a foreign company nor an external company is a company as defined in Section 1, and this then means that external companies are only bound by the provisions as affected by the new Act in terms of external companies.

#### 16.4.4 THE MEANING OF CARRYING ON BUSINESS OR NONPROFIT ACTIVITIES

1. The old definition of external company was defined as a company incorporated outside South Africa which had an established business. The new definition has a much broader scope which means more foreign companies will now have to register as external companies.

S's 23(2) and 2A set out the meaning of carrying on business or Nonprofit activities. The carrying on of business or nonprofit activities is if a Foreign company is party to one or more employment contracts in South Africa and this is the situation no matter what the employee's duties may entail.

2. The company has engaged in a course of activities within the last six months that would give the idea that the company intended to establish a place of business and continually engage in business or nonprofit activities.

If, however in terms of this s 23(A) the foreign company has engaged in one or more of the following activities it does not mean that it is carrying on of business or nonprofit activities.

- a. Holding a meeting of a shareholders or board in the Republic, or otherwise conducting any of the company's affairs in the Republic.
- b. Establishing or maintaining any bank or other financial accounts.
- c. Establishing or maintaining offices or agencies within the Republic for the transfer exchange or registration of its own securities.
- d. Creating or acquiring any debts within in the Republic or any mortgages or security interest in any property within the Republic.
- e. Securing or collecting any debt or enforcing any mortgage or security interest within the Republic or acquiring any interest in any property within the Republic.

I.e. A foreign company must have conducted business or non-profit activities over and above any of these activities over a period of at least six months in order to satisfy the continually engaged in business or non-profit activities test.

#### 16.4.5 REGISTRATION AND OTHER FILING AND DISCLOSURE OBLIGATIONS

An external company must register with the CIPC on form CoR 20.1 within 20 business days after its first day he conducts business or nonprofit activities as the case may be in Republic of South Africa.

An external company must register as either;

- An external nonprofit company if within the jurisdiction in which it was incorporated, it meets legislative or definitional requirements that are comparable to the legislative or definition of a nonprofit company incorporated under the Act or;
- An external profit company in any other case.

Each external company must at least contain one office in Republic and must register its principle office, if it has more than one office by providing the required information and filing its registration in terms of s 23(1). Notice of any change of registered office will also be filed. Regulation 21 contains the filing requirements where there has been a change of registered office of external companies.

The CIPC must assign a unique registration number to each external company that has registered and maintain a register of external companies and enter the prescribed information concerning each external company in the register.

Once this date has been entered in the register a registration certificate to the external company in the form of CoR 20.2 must be issued.

A registered external company is defined as an external company that has registered its office as required by s 23 and has been assigned a registration number in terms of Section 23.

If an external company has failed to register in terms of s 23(1) it will receive a compliance notice from the CIPC requiring it to register within 20 business days, or if it fails to register in such time to cease carrying on its business activities in the Republic of South Africa.

Every external company must file an annual return CoR 30.3 within 30 business days after the anniversary date on which it was registered. Failure by an external company to file an annual return for two or more years in succession may result in that external company being de-registered by the CIPC.

In terms of s 32(1), contravention of which is an offence provides that an external company must provide its full registered name or registration number to any person on demand and not mistake its name or registration number in a manner likely to mislead or deceive a person.

An external company being a foreign company doing business in South Africa is not obliged to prepare or lodge financial statements in terms of the Act, however they may be required to prepare financials for the purposes of SARS. They would also need to lodge the necessary annual return.

#### 16.4.6 TRANSITIONAL ARRANGEMENTS

External companies which are registered as such in terms of the 1973 Act are expressly excluded from the definition of a company in terms of s 1. They are also not pre-existing companies. The transitional arrangement provides for the continued existence as a company of all pre-existing companies. If an external company was registered as such on the 1<sup>st</sup> May 2011 they continue to be registered as an external company in terms of the Act.

## 17 REMOVAL OF DIRECTORS

### 17.1 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.

## **17.2 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.

## 18 DISTRIBUTIONS

### 18.1 INTRODUCTION

As we have already mentioned the new Act does away with the **share capital maintenance** rule and focusses on the **solvency and liquidity test**. Over the years and certainly during the course of the old companies Act, distributions were related to the legal system in place. **Creditors and minority shareholders required protection** in the event that a distribution was made which was prejudicial to their interests. It was because of this that distributions had to be carefully regulated.

Under the old Act dividends could not be paid out of capital, a company could not acquire its own shares, a company could not generally provide capital for financial assistance for the acquisition of its own shares or shares in its holding company.

In 1999 this changed. With all the above items being allowed subject to the rules that were put in place. The liquidity and solvency test and a special resolution was required before a company could make a distribution.

It was really the total share capital of the company that shareholders put up for risk, and once this capital was lost and liabilities exceeded the assets then the company was insolvent. The only thing that a shareholder could lose was their share capital. There were no rights for creditors to obtain their losses from shareholders. If the strong regulations of corporate governance were not in place then creditors would sustain even bigger losses.

The share capital maintenance rule required a company to consistently maintain the level of funding contributed by its shareholders.

The problem with the share capital maintenance rule is that it certainly did not work in the case of many smaller companies because the funds of small companies were supplied by way of shareholder loan accounts. Shares were created with a nominal value of say R100 or R1,000 on the share capital account. The balance of the funding was provided by shareholders loans. When the shareholders who were directors saw that things were not going according to plan, they would pull out their loan funding to the detriment of creditors who had no say or control over the company. The shareholders loan was ranked the same as other creditor's funds. This situation was often subject to this abuse. In fact, when banks lend companies money, they may very well insist on a subordination of the shareholders loans, which will allow the banks to get out their money before the shareholders can withdraw their loans.

I cannot see that this is going to change with the new Companies Act as by doing away with the share capital maintenance regime and having the solvency and liquidity test the refund of

a shareholder's loan is still not in fact a distribution, but a repayment of a loan. Of course, there could be other remedies that creditors might have in terms of the insolvency laws. So, the new Companies Act in doing away with share capital maintenance and introducing the solvency and liquidity test will help in certain instances prevent these situations preventing minority shareholders and creditors being prejudiced in certain circumstances, but certainly not in all cases.

Owing to the fact that the share capital maintenance regime has been dropped it is not necessary anymore to keep the CIPC informed of the movement of share capital the way we use to do in the past (remember the dreaded CM15 form) as they are no longer interested in keeping these records. This means that share issues and buybacks now do not have to be reported to the CIPC. This also means that it is exceedingly important for companies to make sure that the share capital records are perfect from an audit and inspection point of view and it is for this reason that we have to keep good records of share capital. As company secretarial practitioners you do not want the secretarial records to become the center of a dispute in a legal action.

The notion of share capital from a company law perspective basically ceases to exist but of course will continue to exist from an accounting point of view. The standards for share capital are based on common practice as the company's act says very little about the housekeeping and maintenance of shares.

The new Companies Act follows a similar approach to the 1999 company law changes. Section 48 deals specifically with the acquisition by a company of its shares and Section 46 deals with other distributions. The definition of distribution in Section 1 of the Act includes a transfer of the consideration for the acquisition by the company of its shares or shares in any company in its group.

The Act provides that all shares of a class must be treated equally, unless the MOI provides otherwise. It also provides that the MOI may entitle the shareholders to distributions calculated in specific ways and may provide for preferences as to distributions or liquidation rights in respect of different classes of shares.

One also needs to look at the liability of directors in s 77 which would make a director responsible for any loss incurred. Please see Section 77 (3) (e) (vi).

### **18.2 DEFINITION OF A DISTRIBUTION**

In terms of the definition of distribution the following items would be included as part of a distribution;

- Money or property
- The occurrence of an obligation
- The forgiveness or waiver of any obligation.

Where there is a distribution which is part and parcel of a **liquidation dividend** this would not be included in the definition of a distribution.

The inclusions in a distribution would be;

- A payment of dividends
- Payment in lieu of capitalising of shares
- Buy back of shares
- Buy back of another company's shares in the group.
- Inter group share transfer. I.e. this is a share transaction between companies that belong to the same group.

It is interesting to note that there is **no definition of dividend** in the companies Act and we need to look at the meaning in terms of accounting principles.

If the MOI allows the board the company may pay out shareholders a cash payment as an alternative to a **capitalization issue of shares**. In this case the payment will qualify as a distribution.

Companies in terms of the Act may issue redeemable shares and the redemption thereof requires compliance with the distribution and acquisition provisions of Sections 46 and 48. The **redemption of preference shares** falls outside the buyback provisions of the act, however the provisions in regard to solvency and liquidity must be applied.

### **18.3 AUTHORISATION OF A DISTRIBUTION**

A distribution must be authorized by a company's directors. The actual distribution must be in terms of an existing obligation of the company or of a court order – See Section 46.

**46. Distributions must be authorised by board.**—(1) A company must not make any proposed distribution unless—

(a) the distribution—

(i) is pursuant to an existing legal obligation of the company, or a court order; or

(ii) the board of the company, by resolution, has authorised the distribution;

(b) it **reasonably appears** that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution; and

(c) the board of the company, by resolution, has acknowledged that it has applied the solvency and liquidity test, as set out in section 4, and reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.

(2) When the board of a company has adopted a resolution contemplated in subsection (1) (c), the relevant distribution must be fully carried out, subject only to subsection (3).

(3) If the distribution contemplated in a particular board resolution, court order or existing legal obligation has not been completed within 120 business days after the board made the acknowledgement required by subsection (1)(c), or after a fresh acknowledgement being made in terms of this subsection, as the case may be—

(a) the board must reconsider the solvency and liquidity test with respect to the 25 remaining distribution to be made pursuant to the original resolution, order or obligation; and

(b) despite any law, order or agreement to the contrary, the company must not proceed with or continue with any such distribution unless the board adopts a further resolution as contemplated in subsection (1)(c).

It appears that no shareholders' approval is required for distribution and according to Cassim in Contemporary Company Law it appears that the MOI cannot validly impose any prohibitions, conditions or requirements relating to the distribution. This means that any provisions in the MOI that prohibits certain distributions or acquisitions altogether or permit them only if certain conditions are met are not valid. According to Cassim this is borne out of reading section (15)(2)(a)(ii) of the Act and the definition of alterable provision in s 1 of the Act. If one examines s 46 it appears not to be an alterable provision, there is nothing in s 46 that may negate, restrict, limit, qualify, extend or otherwise alter in substance or in effect anything in a company's MOI. It is unlikely that the legislature had this intention so it should be amended.

***There however is an opposing view.***

The definition of distribution includes a distribution to “*one or more*” of the shareholders and s 47 governs the requirements of the value of the distribution and does not require the distribution to be at a uniform rate of all shares of the same class. However, it appears that class rights must be respected at all times and the directors do not have the power to discriminate amongst shareholders of the same class when it comes to the distribution of dividends.

## 19 SOLVENCY AND LIQUIDITY

### 19.1 INTRODUCTION

Whenever a company does a distribution it is actually critical for the company to comply with the solvency and liquidity laws as this is a high-risk area for the directors and the company. If the correct procedures are not carried out there are going to be numerous claims and the directors can in fact be sued. This could very well be an issue for the accounting firm that does the company secretarial work if the directors do not comply with the legislation. The company may not even know about the legislation and make a distribution without the proper procedures, which could make them personally liable if something goes wrong.

In the previous section we discussed distributions. Where a distribution is carried out the directors must perform a **solvency and liquidity test** and where the director's lack the knowledge of what is required the accounting firm must be in a position to guide them or undertake the work on their behalf.

### 19.2 THE SOLVENCY AND LIQUIDITY TEST

**4. Solvency and liquidity test.**—(1) For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of company at that time—

- (a) the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and  
[Para. (a) substituted by s. 2 (a) of Act No. 3 of 2011.]
  - (b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of—
    - (i) 12 months after the date on which the test is considered; or
    - (ii) in the case of a distribution contemplated in paragraph (a) of the definition of “distribution” in section 1, 12 months following that distribution.
- (2) For the purposes contemplated in subsection (1)—
- (a) any financial information to be considered concerning the company must be based on—
    - (i) accounting records that satisfy the requirements of section 28; and
    - (ii) financial statements that satisfy the requirements of section 29;
  - (b) subject to paragraph (c), the board or any other person applying the solvency and liquidity test to a company—

- (i) must consider a fair valuation of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities, irrespective of whether or not arising as a result of the proposed distribution, or otherwise; and
- (ii) may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances; and
- (c) unless the Memorandum of Incorporation of the company provides otherwise, when applying the test in respect of a distribution contemplated in paragraph (a) of the definition of "distribution" in section 1, a person is not to include as a liability any amount that would be required, if the company were to be liquidated at the time of the distribution, to satisfy the preferential rights upon liquidation of shareholders whose preferential rights upon liquidation are superior to the preferential rights upon liquidation of those receiving the distribution.

[Para. (c) substituted by s. 2 (b) of Act No. 3 of 2011.]

The solvency test is at a point in time, in fact after the distribution is made, and the liquidity test must be completed for a period of 12 months following the distribution which is a prediction of the company's cash flows over the ensuing 12-month period. The 12-month period in Section 4(1)(b) is also new. It gives Directors more certainty when applying the solvency and the liquidity test. It is also designed to protect creditors and make sure that the company survives after the distribution. The Directors must make a prediction of the company's cash flow for the period of twelve months into the future. This predication can be based on trading conditions in previous years. As we know this is quite a complicated exercise and should be conducted properly with all the necessary accountant's skill. Accfin has a software program called **Cash Flow Forecaster** which will help with this exercise. <https://www.accfinssoftware.com/cash-flow-forecaster.html>

Section 4 (1) requires an arithmetical calculation. Section 4 (2) contains some vital rules as to the method of making this calculation. All financial information concerning the company must be considered and must be based on the **Accounting Records and Financial Statements**. In making this determination 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 and may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances. This gives the Board some degree of flexibility into determining the value of assets or liabilities.

This in fact **creates a severe difficulty** in that none of the financial records are forward looking but are based on the historical records of the company. In order to do this properly it's just not good enough to look at the historical books. The directors must look at the future budgets and

cash flows and funding plans that reflect the future forecasts of the business. The directors must view very carefully their capital expenditure budgets required. If this is not done then how can the liquidity test be carried out properly?

At this stage there are no standards to govern how these tests should be done, therefore the board would need to apply a high degree of skill in carrying out these tests and in the situation of private companies the directors will be leaning on their accounting firm's skill if they even realise what the risks are. Surely this is an opportunity for the accounting firm but could also be a huge risk.

In order to safeguard the creditors of the company before the company can make any distribution as defined, the board of directors must apply the **solvency and the liquidity test** and **acknowledge by way of Directors Resolution** that it has **reasonably concluded** that the company will satisfy the solvency and liquidity test immediately after the distribution is made. These two aspects of the solvency and liquidity tests and the acknowledgement must be met whether a distribution is pursuant to a **board resolution** or an **existing obligation** or **a court order**.

The solvency and liquidity test are very important and there are seven instances where the directors have to ensure that the solvency and liquidity tests are carried out: -

- S44 – financial assistance and
- S45 – loan to directors, prescribed officers or related and inter-related companies.
- S47 - capitalisation shares with a cash alternative
- S48 – buyback of shares
- S113 – amalgamation and mergers
- foreign transfers to register a company in South Africa
- distributions mostly dividends

In terms of the solvency test the **assets must be fairly valued** and the assets must be valued at a **specific point in time just** after the distribution has taken place. This means that the assets can be revalued over and above what the balance sheet says. Properties held can be looked at, at their current market value and intangible assets undervalued on the balance sheet can be brought in at their fair value.

Failure by Director to comply with these tests could render the director personally liable under s 77 (2) for any loss sustained by the company and could render that director liable to be placed under probation.

The board must **acknowledge** that it has applied the solvency and liquidity test and must have reasonably concluded that the company will satisfy it. They acknowledge this by passing a director's resolution to this effect.

The liquidity test is met ***“if it reasonably appears that the company will satisfy the solvency and liquidity test, and the board has acknowledged that it had applied the solvency and liquidity test”***

### **19.3 120 DAY RULE**

There is a time limit for the solvency and distribution test to take place.

S 46

(3) If the distribution contemplated in a particular board resolution, court order or existing legal obligation has not been completed within 120 business days after the board made the acknowledgement required by subsection (1) (c), or after a fresh acknowledgement being made in terms of this subsection, as the case may be—

(a) the board must reconsider the solvency and liquidity test with respect to the remaining distribution to be made pursuant to the original resolution, order or obligation; and

(b) despite any law, order or agreement to the contrary, the company must not proceed with or continue with any such distribution unless the board adopts a further resolution as contemplated in subsection (1) (c).

In the event that the full distribution does not take place within 120 days the board of directors have to carry out a solvency and liquidity test again as well as acknowledge that they can proceed and complete a distribution. In other words, if 120 days has expired and the distribution has not been completed in full then the test has to be completed again before the distribution can be continued.

Once the acknowledgement has taken place periodic testing must take place if the company intends proceeding with the distribution.

### **19.4 THE INCURRENCE OF A DEBT**

If the distribution takes the form of a debt or other obligation the requirements of this section apply when the board takes the decision to take on the debt. The time when the solvency and the liquidity test is satisfied is generally immediately after completing the proposed distribution. However, there is an exception and this is in regard to the incurrence of a debt in which case the timing must be when the board resolves to incur the debt. The company must satisfy the test when the board resolution is done unless the board resolution provides otherwise.

S 46 (4) says;-

(4) If a distribution takes the form of the incurrence of a debt or other obligation by the company, as contemplated in paragraph (b) of the definition of “distribution” set out in section 1, the requirements of this section—

(a) apply at the time that the board resolves that the company may incur that debt or

obligation; and

(b) do not apply to any subsequent action of the company in satisfaction of that debt or obligation, except to the extent that the resolution, or the terms and conditions of the debt or obligation, provide otherwise.

## 20 BUYBACK OF SHARES

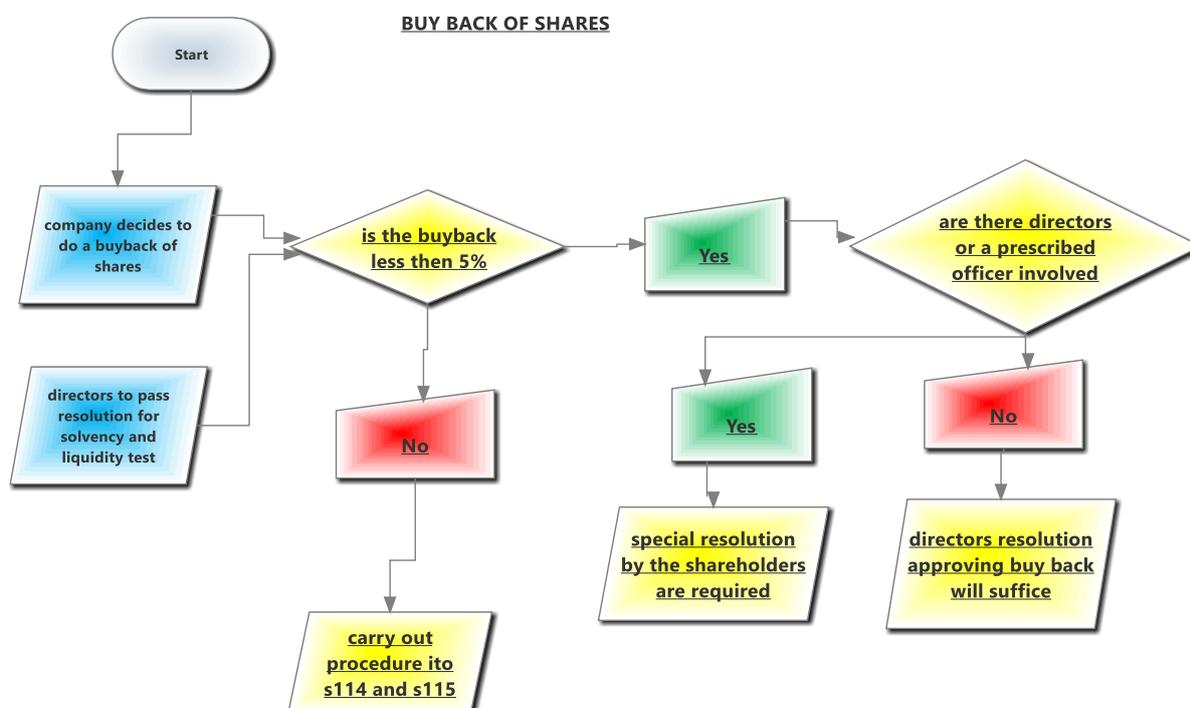
### 20.1 INTRODUCTION

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.

### 20.2 DECISION CHART ON BUYBACK OF SHARES



### 20.3 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;”

#### **20.4 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)

### **20.5 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.

### **20.6 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 or 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.

## **20.7 RESOLUTIONS THAT ARE REQUIRED**

### **DIRECTORS RESOLUTION WHERE THE BUYBACK OF SHARES IS NOT FROM DIRECTORS AND IS LESS THAN 5%**

**ABC COMPANY PTY LTD**

**NOTICE OF DIRECTORS MEETING**

**TO BE HELD AT JOHANESSBURG DATE 15 MAY 2019 TIME 1400**

Notice is hereby given that a meeting of directors will be held at the registered office of the company situated at xxxxxxx, xxxxxx xxx, to pass the resolutions indicated below.

#### **REASONS FOR THE DIRECTORS RESOLUTION**

1. In terms of Section 48 of the Companies Act 2008 the directors have decided to repurchase shares from certain shareholders by way of a cash payment. The re-acquisition of the shares constitutes less than 5% of the share capital of the company and no shares are being re-acquired from directors. The shareholders who are to be repaid are reflected in the schedule attached amounting to R200,000 of par value shares at R1 each. This payment is to reduce the Share Capital account as well as the Contributed Tax Capital Account. Together with this payment each shareholder will receive a further payment of 50c per share being their share of the Share Premium account which will reduce the Share Premium account by R50,000 as well as the Contributed Tax Capital Account. These payments are scheduled to take place on the 31<sup>st</sup> May 2019.
2. In terms of Section 46 of the Companies Act 2008 the directors have reviewed the latest set of management accounts at the 31<sup>st</sup> May 2019 which has established the solvency and liquidity of the company. The directors have also prepared a detailed cash projection which is attached to this resolution for the 12-month period ending 31 May 2019 which establishes that after the distribution of the share capital and share premium as reflected in resolution Number 1 the company will not have any liquidity problems and will meet all its financial commitments for the ensuing 12 months.

***On the date of the proposed transaction the directors will ensure the following in terms of Section 46 of the Companies Act; -***

1. That the Share Capital and reserves of the Company are adequate for ordinary business purposes for a period of 12 (twelve) months after the date of the repurchase;

2. That the working capital of the Company is adequate for ordinary business purposes for a period of 12 (twelve) months after the payment date; and;
3. Having applied the solvency and liquidity test as set out in Section 4 of the Companies Act, that the Company will satisfy the solvency and liquidity test immediately after completing the proposed repurchase.

### **RESOLUTION TO BE PASSED**

1. That the Directors hereby approve, subject to the Memorandum of Incorporation and the Companies Act a re-acquisition of shares in terms of S48 of the Companies Act, being 5% of the shares in the company amounting to a repayment of R200,000 to the shareholders in the attached schedule. This payment, to be debited to the Share Capital Account and the Contributed Tax Capital account is to be reduced accordingly.
2. That each shareholder who is being repaid share capital will receive a further payment of 50c per share being their share of the share premium account which will reduce the share premium account by R50,000 as well as the Contributed Tax Capital account.

**Signed by a Director**

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**ABC COMPANY PTY LTD**

**MINUTES OF DIRECTORS MEETING**

**HELD AT JOHANESSBURG DATE 15 MAY 2019 TIME 1400**

**Resolved that;**

1. the Directors hereby approve, subject to the Memorandum of Incorporation and the Companies Act a re-acquisition of shares in terms of S48 of the Companies Act, being 5% of the shares in the company amounting to a repayment of R200,000 to the shareholders in the attached schedule. This payment, to be debited to the Share Capital Account and the Contributed Tax Capital account is to be reduced accordingly.
2. each shareholder who is being repaid Share Capital will receive a further payment of 50c per share being their share of the share premium account which will reduce the share premium account by R50,000 as well as the Contributed Tax Capital account.

**SIGNED AS A CORRECT RECORD BY THE DIRECTORS**

Director A \_\_\_\_\_

Director B \_\_\_\_\_

20.7.1 RESOLUTION WHERE THE BUYBACK IS FROM DIRECTORS AND OR IS ABOVE  
5%

**ABC COMPANY PTY LTD**

**NOTICE OF 0SHAREHOLDERS MEETING**

**TO BE HELD AT JOHANESSBURG DATE 15 MAY 2019 TIME 1400**

Notice is hereby given that a meeting of shareholders will be held at the registered office of the company situated at xxxxxxx, xxxxxx xxx, to pass the special resolutions indicated below.

**REASON FOR THE SPECIAL RESOLUTION**

The directors of the company have decided to re-acquire 25% of the share capital of the company. Some of the shares acquired will be from directors of the company. In terms of Section 48 (8) of the companies act this transaction has to be approved in terms of Section 114 of the Companies Act as it's viewed as a ***scheme of arrangement*** in terms of the provisions. In order to ratify this re-acquisition a special resolution has to be approved in terms of Section 115 of the Companies Act.

In terms of Section 46 of the Companies Act the directors have reviewed the latest set of management accounts at the 31<sup>st</sup> May 2018 which has established the solvency and liquidity of the company. The directors have also prepared a detailed cash projection which is attached to this resolution for the 12-month period ending 31 May 2019 which establishes that after the distribution of the share capital and share premium as reflected in the resolution the company will not have any liquidity problems and will meet all its financial commitments.

In view of the small size of the transaction and the material cost involved in appointing an **Independent Expert** in terms of s 114 the Directors require the shareholders to each sign a waiver for the appointment of the Independent Expert and to approve by way of special resolution the reacquisition of the shares.

***On the date of the proposed transaction the directors will ensure the following in terms of Section 46 of the Companies Act; -***

1. That the share capital and reserves of the Company are adequate for ordinary business purposes for a period of 12 (twelve) months after the date of the repurchase;
2. That the working capital of the Company is adequate for ordinary business purposes for a period of 12 (twelve) months after payment date; and;
3. Having applied the solvency and liquidity test as set out in Section 4 of the Companies Act, that the Company will satisfy the solvency and liquidity test immediately after completing the proposed repurchase.

***As specified in Section 115 a copy of Section 115 and Section 64 of the Companies Act is attached to this notice for your attention, as well as the waiver which you must sign.***

**SPECIAL RESOLUTION TO BE CONSIDERED**

***To consider and, if deemed fit, to pass, with or without modification, the following special resolution:***

1. Resolved that the Company hereby approves, subject to the Memorandum of Incorporation and the Companies Act a re-acquisition in terms of S48 of the Companies Act, of 25% of the shares of the company amounting to a repayment of R100,000 to the shareholders in the attached schedule. This payment to be debited to Share Capital and the Contributed Tax Capital account is to be reduced by R100,000
2. Resolved that each shareholder who is being repaid Share Capital will receive a further payment of 50c per share being their share of the share premium account which will reduce the share premium account by R50,000 and reduce the Contributed Tax Capital account is to be reduced by R50000.
3. Resolved that owing to the small size of the transaction and the cost involved in appointing an Independent Expert that 100% of the shareholders approve the waiver of the appointment of the Independent Expert in terms of Section 114 of the companies act.

**ABC COMPANY PTY LTD**

**MINUTES OF SHAREHOLDERS MEETING**

**HELD AT JOHANESSBURG DATE 15 MAY 2916 TIME 1400**

**Resolved by special resolution that;**

1. the Company hereby approves, subject to the Memorandum of Incorporation and the Companies Act a re-acquisition in terms of S48 of the Companies Act, of 25% of the shares of the company amounting to a repayment of R100,000 to the shareholders in the attached schedule. This payment to be debited to Share Capital and the Contributed Tax Capital account is to be reduced by R100,000.
2. each shareholder who is being repaid Share Capital will receive a further payment of 50c per share being their share of the share premium account which will reduce the share premium account by R50,000 an reduce the Contributed Tax Capital account by R50,000.
3. owing to the small size of the transaction and the cost involved in appointing an Independent Expert in terms of Section 114 of the companies act, that 100% of the shareholders approve the waiver of the appointment of the Independent Expert.

**SIGNED AS A CORRECT RECORD**

**CHAIRMAN**

\_\_\_\_\_



In the above examples its important that each shareholder signs the waiver. Where the notice for the meeting is waived each shareholder must approve the waiver.

## **20.8 CONCLUSION**

The problem with the above is that all the compliance issues may easily fit into both a larger or smaller company except that I don't believe that a smaller company can afford to go the route of appointing an independent expert.

We need to ask the question what the position is with a company where there is one director and one shareholder and they decide to do a buy back. Is it then necessary for the company to retain this **independent expert** at a huge cost in order to comply with a section of the act that is not really applicable to a smaller company?

I would suggest that in a case like this the shareholders sign a resolution to the effect that it is not necessary to get an independent expert owing to the huge costs involved and as long as all the shareholders sign together with a waiver it should be sufficient. The problem with this is that after a distribution the company goes insolvent and creditors lose money then the directors could become liable.

Another issue is that if the private company is a **regulated** company then they have to make the application for a compliance certificate or an exemption from the Take-over Regulation Panel and it looks like if not regulated then on a strict reading of the act in terms of s114 they have to appoint the independent expert. Can the tribunal grant an exemption to the company?

## **20.9 CONTROVERSIAL ASPECTS OF BUYBACKS AND CONVERSION OF SHARE CAPITAL**

### **QUESTION**

A small company that is **not regulated** performs a buyback of shares of 10% of the shares in the company.

This transaction now falls within the ambit of S114(2) because it is more than 5%.

In this situation an independent expert needs to be appointed to do a report. Is this really necessary for a smaller company? Can a waiver be signed?

### **ANSWER**

The question specifically looks at a company that is **not regulated**, however if it was regulated then one could make application to the TRP and ask for an exemption which would mean that the company does not have to comply with the provisions of S114 as it is exempted. Of course, one must do the solvency and liquidity test and the necessary special resolutions.

In the case above because the company is not regulated and the share buyback is more than 10% S114 kicks in. The conditions of S114 and S115 have to be complied with. The real bad part of this means that the company even if it is a smaller company has to appoint an independent expert to do a report. For the smaller company this seems to be ridiculous as the costs would not warrant the production of the report.

One of the views is that S114 only applies if the buyback is more than 10% of the share capital and is bought back from directors. This interpretation is based on the word “**and**” between s48 (8) (a) and (b). In this instance the onerous provisions of appointing an independent expert to produce a report may be ignored.

In the event that you wish to adopt the literal interpretation and you are a small company you may ignore the provisions but it will be necessary to do a waiver. The risk with this is that if any party is disgruntled it could pose a problem in the future in that the transaction could be set aside.

## 21 CONTRIBUTED TAX CAPITAL – CTC

### 21.1 INTRODUCTION

For the first time we are seeing that it is necessary to make two disciplines merge into one in the accountant's office. Secretarial practitioners now need to venture into the area of tax because of relatively new legislation. In my view Company Secretarial Practitioners need to know about **CONTRIBUTED TAX CAPITAL (CTC)**.

#### *The Tax and Secretarial functions merge.*

Although the definition of **CONTRIBUTED TAX CAPITAL (CTC)** is really a **tax concept** and has nothing to do with company law it is really only the company secretary or the secretarial practitioner that has the necessary records to record and calculate CTC. We have been doing share buy backs and other share transactions without really understanding the tax consequences of keeping proper records of CTC. The record keeping is normally handled by the secretarial department but only from a company secretarial point of view without understanding the tax consequences. The time has come for tax people and secretarial people to work together to come up with the required information thus reducing risk that companies face from SARS. It is now obligatory to have this information on tap for the purposes of completing the ITR14 tax return.

Any **repayment of CONTRIBUTED TAX CAPITAL (CTC)** to a shareholder is not a dividend.

CTC is a tax concept only. From a practical point of view the CTC may be the same as the share capital of a company and may very well be the case where smaller companies are concerned.

In terms of the Income Tax Act there are four parts to the definition of CTC.

### 21.2 PART 1 – NON RESIDENT COMPANY

If a non-resident company becomes a resident company in RSA (this could be a foreign company becoming domesticated) on or after the 1<sup>st</sup> of January 2011 it's contributed tax capital will be calculated as follows;

The **market value** of all shares on the day before  
the company becomes resident

RX

Plus the consideration for new shares issued

RY

**Total CTC**

**RX+RY=CTC**

All the reserves realised and unrealised of the company immediately before it becomes resident in South Africa is effectively the starting point for CTC for income tax purposes and any repayment of these reserves is not a dividend.

A non-resident company can become a tax resident by moving its place of effective management to South Africa. This happens when one or more Directors manage the company from premises in South Africa.

### **21.3 PART 2 – OTHER COMPANIES**

**Untainted share capital** plus the **share premium** or **stated capital** immediately before the 1<sup>st</sup> January 2011

XXX

Plus, consideration received or accrued for share capital

XXX

**Total CTC**

**XXX**

**Untainted share capital** is pure share capital where money was paid into the company for shares that were issued. This could be share capital and share premium if the company is a pre-existing company (incorporated prior to 1 April 2011). **Tainted share capital** is where the share capital arose by way of a capitalisation issue. This is where shares are issued to shareholders which are supported by a transfer from reserves (accumulated profits) to share capital. If these reserves had been distributed to shareholders, they would have constituted a dividend.

In order to calculate the CTC one should be able to do a reconciliation between the share capital and the CTC.

If a **convertible share** is converted to another class then the CTC balance rolls over to the new class.

### **21.4 PART 3 – REDUCTION OF CONTRIBUTED TAX CAPITAL**

Section 46 of the Companies Act deals with this and there are some formalities that need to be complied with for a buyback in terms of the companies act. The directors must determine what CTC is to be transferred to shareholders; they must actually calculate the amounts. The safest thing to do when a share buyback takes place besides doing the normal company law formalities is to take care of CTC calculation and to include the details of the CTC calculation in the resolutions.

Where money is transferred to a shareholder out of share capital the CTC amount must be reduced. The repayment to the shareholder must be after 1 January 2011. The payment to

the holder of the share does not have to be the registered holder. It can be the person entitled to the dividend on the share.

In regard to the repayment a formality must be involved. The directors must determine the amount of CTC to be transferred. Refer to s 46 of the companies act. The board must authorise the transfer by way of resolution.

### **EXAMPLE 1**

Let us say a company has a share capital of R100,000 plus a share premium of R900,000 and retained income of R2 million. The directors resolve that they are going to pay an amount of R800,000 to shareholders. The CTC of this company is R1,000,000. If nothing is said the full amount of the R800,000 distributed to shareholders is a dividend and is subject to the dividend withholding tax. In this case the CTC remains the same.

Let's say that the directors resolve that of the R800,000, R300,000 is to be paid out of share premium and R500,000 out of reserves or retained income. This means that R300,000 is a reduction of CTC and is not a dividend and R500,000 is a dividend and is subject to the dividend withholding tax.

### **EXAMPLE 2**

The share capital of the company is R50,000 being 1000 ordinary shares of R50 each and it has a retained income of R60,000 making the total share capital and reserves R110,000.

The company decides to buy back 10% of the shares by making a payment of R25,000 to shareholders. In this example because the company has determined that they are only buying back 10% this would make a buy-back to shareholders of R5,000 which is a capital reduction and a reduction of the balance of CTC. The balance of the payment of R20,000 has to come out of retained income and is therefore a dividend.

### **21.5 POINT 4 – PROVISIO**

Basically the proviso to the definition says that a shareholder cannot receive a distribution in a different proportion to the shares they hold for a particular class of shares. If they receive a higher amount to the proportion of the shares they hold then this will be classified as a dividend. It's best to explain this by way of example.

### **EXAMPLE 1**

Let us say a company has a R100 worth of shares and the share premium is now R9,900 making the total share capital R10,000.

One of the shareholders, a 50% shareholder gets R6,000 as a distribution. As the shareholder is only a 50% shareholder they would only be entitled to R5,000 of the share capital and share premium, therefore R1,000 of the repayment is a dividend. Later on the same company wishes to pay R6,000 to B who is now the only shareholder. As the CTC is R5000 one can only reduce the CTC by R5000, therefore R1000 is a dividend. This is for the purposes of illustration only as there are various company issues here in that a company cannot have no share capital. The above situation could be that the share premium could be repaid and the shares could be left intact.

### **EXAMPLE 2**

A shareholder owns 10,000 ordinary shares in a company which amounts to 20% of the company. These shares have a cost of R100,000. The company buys back the shares for R450,000. What would the journal entry be for this transaction? The balance on the CTC account before the transaction is R1 million rand.

As only 20% of the shareholding is to be paid back only R200,000 will be a capital reduction reducing the CTC balance of R1million to R800,000. The balance of the distribution R250,000 will be a dividend.

This is in line with the proviso of the definition.

### **CAPITALISATION ISSUE**

Where shares are transferred from accumulated reserves or any other reserves this is called a capitalisation issue. This is not a dividend and therefore is not taxable as a dividend. The shares are received by the shareholder for nothing. Capitalisation issues do not form part of CTC. Any payment above the value of the transfer is a dividend

## 22 S44 FINANCIAL ASSISTANCE TO ACQUIRE SHARES AND THE LENDING OF MONEY

### 22.1 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.]

## **22.2 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.

## 23 S45 - LOANS OR OTHER FINANCIAL ASSISTANCE TO DIRECTORS

### 23.1 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.

### 23.2 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.

### **23.3 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.

### **23.4 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.

## 24 RELATED AND INTER RELATED PERSONS

### 24.1 INTRODUCTION

The term **related or interrelated person** is widely used around the world including on the JSE and there is a whole chapter provided in the listing requirements devoted to transactions between **related parties**.

As a company secretarial practitioner this is something you need to know as the term related person appears in the companies Act 80 times. These terms have been included in the Companies Act to increase transparency and improve the standards of corporate governance. These terms are used in the context of safeguarding minority shareholders against the majority of shareholders or directors taking unfair advantage of these relationships.

Where two parties transact the transaction may be between 2 people who are related which may be to the detriment of minority shareholders. E.g. where a loan is made to a director. In terms of s 45 a special resolution is required. What is the position if the loan is made to another person who has a relationship with the director!

It may also be that related or interrelated parties act independently or at arm's length and the act empowers the court, the takeover regulation panel or the Companies Tribunal from exempting such parties from the provisions of the act.

### 24.2 THE LAW

Three relationships are defined namely between or amongst two or more:

1. natural persons.
2. juristic persons.
3. Natural and juristic persons

Section 1 of the Act contains the following definitions:

**"related"**, when used in respect of two persons, means persons who are connected to one another in any manner contemplated in section 2 (1) (a) to (c);

**"inter-related"**, when used in respect of three or more persons, means persons who are related to one another in a linked series of relationships, such that two of the persons are related in a manner contemplated in section 2 (1), and one of them is related to the third in any such manner, and so forth in an unbroken series;

#### **2. Related and inter-related persons, and control.—**

(1) For all purposes of this Act—

- (a) an individual is related to another individual if they—
- (i) are married, or live together in a relationship similar to a marriage; or
  - (ii) are separated by no more than two degrees of **natural or adopted** consanguinity or affinity;

(b) an individual is related to a juristic person if the individual directly or indirectly controls the juristic person, as determined in accordance with subsection (2); and

(c) a juristic person is related to another juristic person if—

(i) either of them directly or indirectly controls the other, or the business of the other, as determined in accordance with subsection (2);

(ii) either is a subsidiary of the other; or

(iii) a person directly or indirectly controls each of them, or the business of each of them, as determined in accordance with subsection (2).

(2) For the purpose of subsection (1), a person controls a juristic person, or its business, if—

(a) in the case of a juristic person that is a company—

(i) that juristic person is a subsidiary of that first person, as determined in accordance with section 3 (1) (a); or

(ii) that first person together with any related or inter-related person, is—  
(aa) directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with securities of that company, whether pursuant to a shareholder agreement or otherwise; or  
(bb) has the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board;

(b) in the case of a juristic person that is a close corporation, that first person owns the majority of the members' interest, or controls directly, or has the right to control, the majority of members' votes in the close corporation;

(c) in the case of a juristic person that is a trust, that first person has the ability to control the majority of the votes of the trustees or to appoint the majority of the trustees, or to appoint or change the majority of the beneficiaries of the trust; or

(d) that first person has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary commercial practice, would be able to exercise an element of control referred to in paragraph (a), (b) or (c).

(3) With respect to any particular matter arising in terms of this Act, a court, the Companies Tribunal or the Panel may exempt any person from the application of a provision of this Act that would apply to that person because of a relationship contemplated in subsection (1) if the person can show that, in respect of that particular matter, there is sufficient evidence to conclude that the person acts independently of any related or inter-related person.

### **3. Subsidiary relationships.—**

(1) A company is—

(a) a subsidiary of another juristic person if that juristic person, one or more other subsidiaries of that juristic person, or one or more nominees of that juristic person or any of its subsidiaries, alone or in any combination—

(i) is or are directly or indirectly able to exercise, or control the exercise of, a majority of the general voting rights associated with issued securities of that company, whether pursuant to a shareholder agreement or otherwise; or

(ii) has or have the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board; or

(b) a wholly-owned subsidiary of another juristic person if all of the general voting rights associated with issued securities of the company are held or controlled, alone or in any combination, by persons contemplated in paragraph (a).

(2) For the purpose of determining whether a person controls all or a majority of the general voting rights associated with issued securities of a company—

(a) voting rights that are exercisable only in certain circumstances are to be taken into account only—

(i) when those circumstances have arisen, and for so long as they continue; or

(ii) when those circumstances are under the control of the person holding the voting rights;

(b) voting rights that are exercisable only on the instructions or with the consent or concurrence of another person are to be treated as being held by a nominee for that other person; and

(c) voting rights held by—

(i) a person as nominee for another person are to be treated as held by that other person; or

(ii) a person in a fiduciary capacity are to be treated as held by the beneficiary of those voting rights.

(3) For the purposes of subsection (2), “hold”, or any derivative of it, refers to the registered or direct or indirect beneficial holder of securities conferring a right to vote.

**Related** – when used in respect of 2 or more persons who are connected to one another in the manner contemplated in s 2(1) (a) (b) and (c).

**Inter-related** - when used in respect of three or more person mean persons who are related to one another in a linked series of relationships such that two of the persons are related in a manner as defined in 2(1) and one of them is related to the third in any such matter and so forth in an unbroken series.

**relationship** includes the connection existing between any two or more persons who are related or inter related as determined in a in terms of 2.

Where 2 persons are related s 2(1) (a) (b) and (c).

Note the word persons includes juristic person.

S 2 provides that for the purposes of the Act any two natural persons are related to one another if they are married or live together in a relationship similar to a marriage or separated by more than two degrees of **natural or adopted consanguinity** or **affinity**. This includes children, grandchildren, parents, grandparents, siblings and in-laws including grandparents in law.

S 2 (1) (b) provides that a natural person is related to a juristic person if the natural person directly or indirectly controls the juristic person as determined in accordance with s 2 (2)

Section 2 (1) (c) provides that for all purposes of the Act two juristic persons are related to one another if;

1. Either of them directly or indirectly controls the other, or the business of the other as determined in accordance with s 2(2) or
2. Either is a subsidiary of the other, or;
3. A person directly or indirectly controls each of them or the business of each of them as determined in accordance with s 2.2.

This includes a holding company and its direct and indirect subsidiaries as well as fellow subsidiaries of a common controlling shareholder irrespective of whether the controlling shareholder is a natural or juristic person.

### **24.3 THE MEANING OF CONTROL OF A JURISTIC PERSON**

The word control is capable of numerous meanings. The words ‘control of a company’ is defined in s 2 (2) (a)

For the purposes of s 2(1) a person (first person) controls a company or its business;

1. if that company is a subsidiary of the first person as determined in terms of s 3(1)(a). This means the subsidiary by definition is always related to its holding company and vice versa.
2. The first person together with any related or inter-related person is directly or indirectly able to exercise or control the majority of the voting rights associated with securities of that company whether pursuant to a shareholder agreement or otherwise or

Has the right to appoint or elect or control the appointment or election of directors of that company who controls a majority of the votes at a board meeting.

Control at board level is something that is tested by the majority of the votes that the directors control. There is a common law duty that whichever way director’s vote they must carry out their fiduciary duty which is a common law principle. A Close Corporation and Trust are included in these definitions and it is just a question of control.

S 2(2)(d) is a catch all and takes the meaning of control even further.

#### **24.4 APPLICATION FOR EXEMPTION**

In terms of Section 2(3) one can ask for exemption for the various related parties if they act independently, this exemption can be made by an application to Court, The Company Tribunal or the Take-Over Regulation panel which may exempt any person from the application of the abovementioned provisions. The application must show that there is sufficient evidence to conclude that the person acts independently of any ***related*** or ***inter-related person***.

## 25 WHEN IS A PRIVATE COMPANY REGULATED?

### 25.1 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.**

### 25.2 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;

### **25.3 APPROVAL OF A FUNDAMENTAL TRANSACTION**

The Act has simplified the common approval procedure for all three fundamental transactions. This is found in s 115. Where a shareholder opposes any one of these transactions, the shareholders have what we call an appraisal right in terms of s 164.

When any of these transactions are preformed both s 115 and s 164 must accompany the notice given to shareholders.

A special resolution is required for a fundamental transaction to be approved. However, a court approval will be required if 15% of the voting rights requires the company to seek court approval. The court is required to review the resolution and not the transaction unless it is manifestly unfair to a group of shareholders and is tainted with a conflict of interest.

### **25.4 THE TAKEOVER REGULATION PANEL**

The law in regard to the **Takeover Regulation Panel** (TRP) and all the situations requiring involvement from the panel is highly complex and in the case of private companies somewhat of a surprise. It is not the intention to deal with the Takeover Regulation Panel in detail but to deal only with the situation where private companies fall within the scope of the TRP regulations. Where a private company is defined as **regulated** and has an **affected transaction** the compliance required is onerous and costly.

One needs to ask the question in regard to this part of the law - was it really necessary to apply this complex and costly compliance to the smaller company as one of the reasons given for the new company's act was to make the administration burden easier and quicker? The TRP charges R3420 per hour for work done.

For more information on the Takeover Regulation Panel refer to their website [www.trpanel.co.za](http://www.trpanel.co.za)

“The Companies Act 71 of 2008 (the Act) which became effective on 1 May 2011 brings about new changes in the regulation of mergers and takeovers of companies. The Act created the Takeover Regulation Panel (TRP) in terms of section 196 to replace the Securities Regulation Panel (the SRP) which was established in accordance with Chapter XVA of the Companies Act No. 61 of 1973.”

**“The TRP will perform the same functions as those which were performed by the SRP. In terms of section 201 of the Act, the TRP is responsible to:**

- Regulate affected transactions and offers (as defined in the Act);
- Investigate complaints with respect to affected transactions and offers;
- Apply for a court order to wind up a company in appropriate circumstances;
- Consult with the Minister in respect of additions, deletions or amendments to the Takeover Regulations.”

S 119 deals with the purpose of the take-over regulation panel and one of the things that they must do is to ***not consider the commercial advantages or disadvantages of any transaction or proposed transaction***. They have to ensure the integrity of the marketplace and fairness to the holders of the securities of regulated companies. They must ensure that all the holders of the shares get all the necessary information to allow them to make a fair and informed decision. They must ensure that the shareholders of regulated companies have adequate time to obtain the necessary advice with respect to offers. The take-over regulation panel must prevent actions by a regulated company designed to impede or frustrate or defeat an offer or the making of a fair and informed decision by the holders of that company’s securities.

### **25.5 AFFECTED TRANSACTION**

S 117 to s 127 and the takeover regulations do not apply unless a transaction is an **affected transaction** or an **offer** as defined in s 117.

S 117(1)(c) is the cornerstone definition of the takeover regime. It provides that an **affective transaction** means;

1. A transaction or series of transactions amounting to the ***disposal of all or the greater part of the assets or undertaking*** of a “regulated company” as contemplated in s 112, other than in an approved business rescue plan – see s 118(3); This disposal

refers to the assets only. The assets must exclude liabilities and must be greater than 50% of the assets of the company which must be fairly valued;

2. An **amalgamation or merger** as contemplated in s 113, if it involves at least one regulated company i.e. subject to s 118(3);
3. A **scheme of arrangement** between a regulated company and its shareholders as contemplated in s 114 i.e. subject to s 118(3). A re-acquisition of shares or buyback is included in a scheme of arrangement if more than 5% of the shares are repurchased.

## **25.6 BUYBACK OF SHARES**

Many smaller companies do a buyback of shares instead of paying a dividend for obvious reasons. In the case of the buyback of shares that constitutes more than 5% of a share capital class this falls within the definition s 48 (8) (b) of an affected transaction and s 114 and s 115 kick in with full TRP compliance being necessary where the company is regulated, despite the size of the company. The Companies Act 2008 does not differentiate between large and small companies as far as s 114 is concerned. On the face of it, it seems that even small companies have to comply with expensive administration in that they have to appoint an **independent expert**.

S 48 (8) (b) says that subject to the requirements of s 114 and s 115, if considered alone or together in a series of buy back transactions which amount to more than 5% of any particular class of share capital then this transaction has to be conducted in terms of s 114 and s 115. This means that it falls within the definition of an **affected transaction**, which also means that if it is a private company the private company, could very well become classified as a **regulated company**.

## **25.7 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:

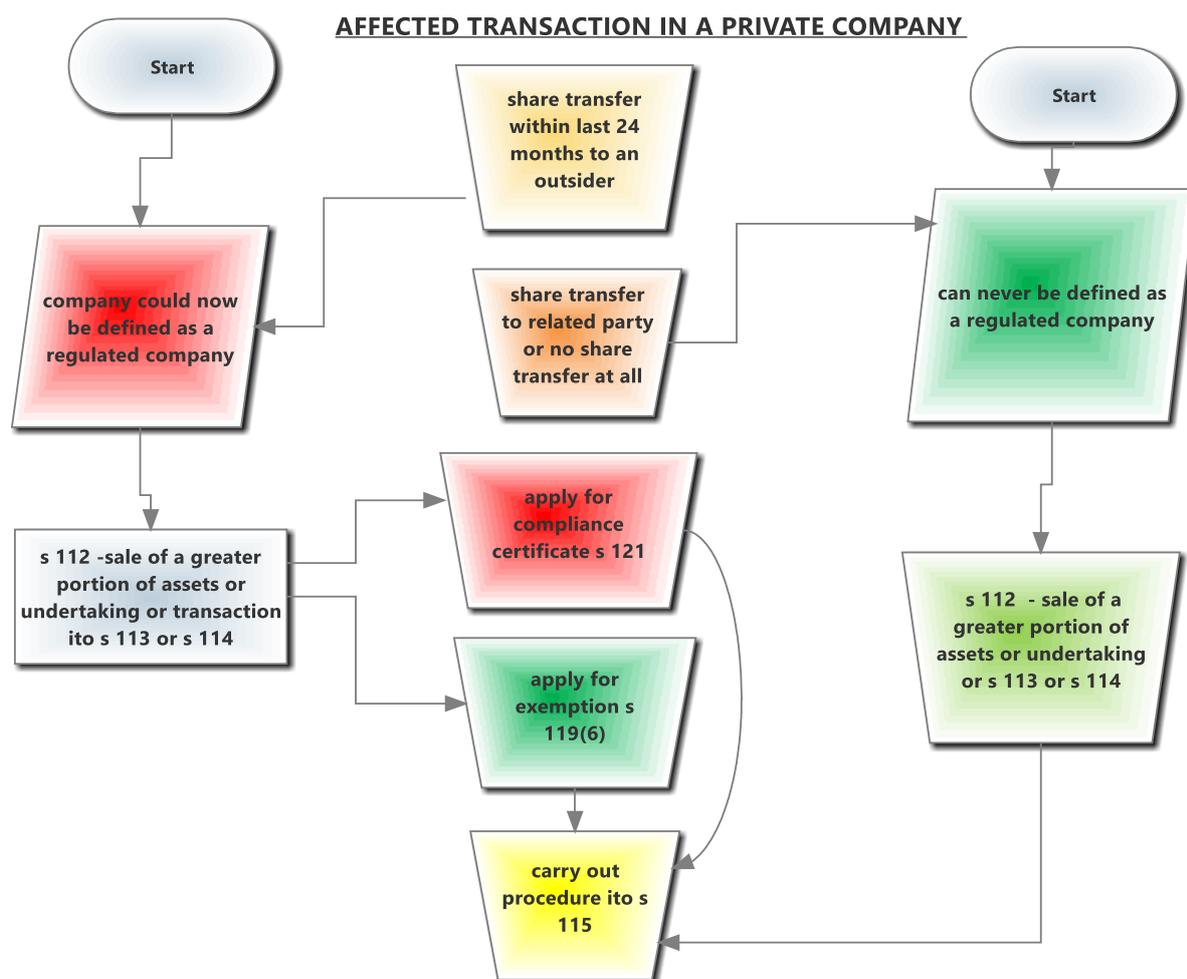
- a. A public company;
- b. A state owned company;
- c. A private company only if the MOI expressly provides that the company and its securities are subject to Part B, Part C of the Takeover Regulations and if more than the prescribed percentage currently (10%) of its issued securities have been transferred (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.

## 25.8 DECISION CHART



## 25.9 REPORTING OR APPROVAL REQUIREMENTS

S 121 clearly and directly applies the takeover provisions of the Act to affected transactions and offers by providing that any person making an offer;

1. Must comply with all the reporting or approval requirements as set out in Part B and Part C of the Takeover Regulations (except to the extent that the panel has exempted them from any requirement); and
2. Must not give effect to an affected transaction unless the panel has issued a compliance certificate with respect to the transaction (or granted an exemption for the transaction).

The question that arises in this situation is what happens if a private company falls within the definition of a regulated company and does not make the necessary application to the TRP because of ignorance! What now! In terms of s 121 (b) any person making an offer or proposal cannot give effect to the transaction unless the TRP issues a compliance certificate or an exemption. There could be dire consequences if compliance has not taken place and parties

wish to get out of their obligations. This area poses a grave potential risk for secretarial practitioners and company secretaries who do not advise companies correctly.

### **25.10 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.

### **25.11 CONCLUSION**

I believe that in the light of all the rules around private companies this has to be overkill and places a huge burden of administration not only for companies but for the regulators. A better solution needs to be found.

Perhaps what should happen is that provided all the existing shareholders of the private company agree in the abovementioned situation, they should sign a particular document or form to the effect that no shareholder is prejudiced by the affected transaction. There should be no cost or perhaps only a nominal cost associated with this filing. Once the form is filed then automatic exemption is granted to the private company and no time need be spent on the matter by the TRP.

## 26 TRP GUIDELINES

There are some guidelines and regulations published on the TRP site, [www.trpanel.co.za](http://www.trpanel.co.za).

### **26.1 PRIVATE COMPANY STARTUPS**

There is a guideline that deals with the exemption of shelf companies in certain circumstances that says the following;

The Panel hereby publishes a Guideline that:

2.1 Notwithstanding that a percentage exceeding 10% of the issued securities is being disposed of by the incorporator and is transferred to the user in an initial transaction, the Panel does not regard such initial transaction as categorizing such private company, for purposes of that initial transaction alone, as a regulated company in terms of section 118.1 of the Act, on the basis that no shares had been transferred within the period of 24 months immediately before the date of such initial transaction. Accordingly, the Panel will not insist on compliance with the Takeover Regulations in respect of the initial transactions taking into consideration the purpose and objects of the Takeover Regulations.

2.2 However, thereafter for at least 24 months following such initial transaction such private company will, in terms of section 118.1(c) (i) of the Act, be categorized as a regulated company.

2.3 The Panel recognises that in the initial start-up phase of a private company the burden of compliance with Part B, Part C and the Takeover Regulations may, in many instances be unduly harsh on a private company. Accordingly, the Executive Director may, against submission of an application setting out all relevant facts, in terms of Section 119.6, exempt parties to an affected transaction from the application of Part B, Part C and the Takeover Regulations if he considers an exemption to be 3 reasonable and justifiable in the circumstances having regard to the objects and purposes of Part B, Part C and the Takeover Regulations.

### **26.2 EXEMPTION FOR DEALERS IN SECURITIES**

*(ii) granted an exemption for that transaction.”*

1.3 The Panel recognises that these provisions referred to above may have unintended consequences taking into consideration the purpose and object of the Act and the Regulations. In some instances, it has been interpreted that parties are required to make an offer in compliance with the Act and Part B, Part C and the Takeover Regulations.

1.4 The Panel also recognises that it is not practical, nor in the interests of persons dealing in securities to have to comply with the provisions of Section 121(b)(i), when a person wishing to deal in securities, where a threshold prescribed in Section 122(1) may be breached, is obliged obtain a compliance certificate from the Panel prior to such dealing taking place.

2. The Panel hereby publishes a Guideline that, all transactions undertaken in terms of section 122(1) of the Act, are hereby exempted in terms of Section 119 (6) of the Act, from compliance with the provisions of Section 121(b)(i) of the Act, relating to issuing of a compliance certificate. In granting the exemption, the Panel considered the principles and purpose of the Act, and the Regulations the Panel and is of the view that it is reasonable and justifiable to grant the exemption.

3. However, all acquisitions and disposals in terms of section 122(1) are required to comply with the notification requirements of this section.

### **26.3 EXAMPLE OF A TRANSACTION**

#### **Question**

We have company A (Pty) Ltd which has 4 shareholders each holding 25% of the issued shares of the company. The 4 shareholders are brothers. The company holds a significant portfolio of properties in the retail sector.

Exactly one year ago one of the brothers sells his 25% interest to an unrelated outsider as he wanted to emigrate. The share transfer had the blessing of the remaining 3 brothers at that time and the transaction went through without a problem.

Today A (Pty) Ltd received an offer for selected portions of its property portfolio.

You as the company secretarial practitioner have to advise the directors of the company on how to proceed.

#### **Answer**

The first thing that we need to do is to determine whether this transaction falls within the definition of an **affected transaction** as defined in s 117(c) and in this instance we would need to look at s 112 – proposals to dispose of all or a greater part of assets or undertaking as well

The first thing that we need to determine is that this is not part of a business rescue plan, if it was it would not be an affected transaction. It is also not a transaction between a wholly owned subsidiary and its holding company or between various combinations of wholly owned subsidiaries and holding companies so at this point it may very well fall within the ambit of Section 112 and then s 112 would not apply.

The next thing we need to determine is if this disposal or this offer is **for a greater part of the assets or the undertaking?** We are also told that the value of the offer exceeds the market value of the property. If we look at s 112 (4) it talks about that the assets to be disposed of must be fairly valued as calculated in the prescribed manner as at the date of proposal, which date must be determined in the prescribed manner. .Let us assume that on enquiry we find that the disposal is for 60% of the company's property portfolio. As long as it's more than 50% then it complies with this requirement. This means that it falls within the ambit of Section 112 and is a fundamental transaction. It also means that it falls within the definition of s 117 (c) and is an affected transaction.

The next thing that has to happen is that the proposal or transaction has to then be approved in terms of s 115 by a special resolution of the shareholders. This will require a detailed reading of s 112 and s 115.

S 112 (5) basically says that the resolution by the shareholders must be specific and not be a generalised solution.

We now need to look at the requirements of Section 115 which deals with the issue of the Takeover Regulations panel issuing a compliance certificate, if it is a **regulated company**.

We have to determine if this transaction falls within the definition of a **regulated company**. If we look at the definition as contained in Section 118(1) we have been told that there is a share transaction to an outsider (please refer to the definition of related and inter-related) within the last 24 months. This means that this private company falls within the parameters of the definition of a regulated company.

Now because it is an affected transaction and the company is a regulated company the transaction falls within the parameters of Part B and Part C and the Takeover regulations and therefore the takeover regulations apply to the company therefore we have to make an application to the takeover regulation panel in order to get a compliance certificate or an exemption.

Let us assume that the brother who immigrated did not sell his shares but held onto them then the company would not fall within the definition of a regulated company and therefore the various sections and regulations would not apply and no application would have to be made to the takeover regulation panel.

There is however an alternative to obtaining the compliance certificate as in terms of Section 119(6) and application can be made for the exemption of the requirements.

An exemption can be made if no parties are affected or prejudiced by this transaction. The way to do this is for the shareholders to pass a special resolution which they must all sign to the effect that there has been no reasonable potential of the affected transactions prejudicing the interest of any existing holder of the regulated company's securities. This is itself should be enough.

If the transaction was not considered to be of a material nature and then one could make the application on the basis that the cost of the compliance is disproportionate relative to the value of the affected transaction.

If the company is to apply for exemption then they are to write to the takeover regulation panel detailing the transaction putting in all the various notices and the resolutions passed by the shareholders requesting that the panel grant an exemption.

The panel will consider the application, grant the exemption if they deem fit and charge the company. For a simple exemption this is going to cost the company at the rate of R3,420 per hour and will probably in all likelihood take one hour.



of the transaction has been made timeously, and we/I am satisfied with all the disclosures made to me in terms of the transaction;

3.3 We/ I hereby irrevocably consent to the Company and all the parties to the transaction being exempted from the provisions of the Act and the Regulations by the Takeover Regulation Panel from compliance with all the relevant provisions of the Act and the Regulations.

SIGNED ON XXXXXXXXXXXX AT XXXXXX

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For and on behalf of

Authorised signatory

## 27 APPRAISAL RIGHTS AND MINORITY SHAREHOLDERS

### 27.1 INTRODUCTION

In the researching of the new Companies Act the Government wanted to have a remedy to prevent the **locking in of minority shareholders** in inefficient companies. So, one of the sections, s 164 allows a shareholder provided certain conditions are met of finding a way out. There are quite a number of issues with the appraisal procedure. It in fact applies to all size companies, listed as well as smaller companies. So, it's imperative as company secretarial practitioners that we know about appraisal rights. If you don't know this then how can you advise your clients properly?

We have discussed **pre-emption rights**. This is where a minority shareholder does not get on with all the other shareholders and the minority has to find a mechanism to be bought out. This situation is in fact extremely complicated and one has to tread very carefully when dealing with the situation. The details or the way out of this situation should be built into the MOI or the rules or a shareholder's agreement. This situation is where there are issues in the company between the shareholders and a settlement has to be negotiated. There could also be some in-fighting which impedes the growth and the future of the company which forces the minority to seek an exit.

The problem with being a minority shareholder is that the only way a minority can get rid of their shares is to sell them to the majority and in this situation the majority calls the tune. In other instances, the minority can perhaps be bought over by another minority shareholder where they can come to an agreement.

The appraisal rights section is fundamentally different from any method before or from methods contained in the MOI. Appraisal rights come into play when **fundamental transactions** are carried out causing the appraisal remedy to be triggered;

#### **Section 112, Section 113 or Section 114 or**

If there is **a special resolution** that alters the MOI and **alters the rights of any class** of the company's shares in any manner which is materially averse to the rights or interest of the minority shareholders.

The above four events will trigger a Section 164 appraisal rights action if the minority shareholder wishes to do so. The appraisal rights action is a **no-fault action** and can

be executed by a minority shareholder where they are unhappy to stay in the company when the above events are triggered. Directors who are pursuing a fundamental transaction need to be aware of appraisal rights because it can affect their cash flow dramatically and cause the whole transaction to fail.

First **before** we get into the appraisal remedy let's talk about fundamental transactions and in fact what they are.

### **27.2 TRANSFERABILITY AND PRE-EMPTION RIGHTS**

It should be remembered that the pre-emptive rights in the Companies Act 2008 in itself only deals with the **issue or allotment of shares**, it does not deal with the transferability of shares i.e. when one shareholder transfers shares to another shareholder or to an outsider. This is something that needs to be addressed urgently in your MOI and the rules.

S39(2) deals with pre-emption rights but only for the **subscription or allotment** of shares and basically says that if a private company proposes to issue any of the shares of that private company, each shareholder has a right to take them up before any outsider, provided they take them up in a reasonable time period. This basically means that the voting rights before the subscription of the new shares must be the same as the **voting rights after the subscription** of the new shares, unless a shareholder declines to take up their share of what is offered.

This is all very well, but what happens where there are a number of shareholders in a private company and things turn a bit sour and a particular shareholder who may hold say 25 per cent or 30 per cent wishes to exit and wants to sell shares. Owing to the fact that it is a private company this becomes a very difficult situation and the way the MOI is configured now and the way the Act is configured it is probably possible for the shareholder to go and offer his shares to any outsider or third party who may in fact be a competitor and it may in fact not be in the best interest of the company concerned, unless there is some kind of restriction of transferability clause.

The latest short form MOI now has a clause 2.1 (2) (e) which says that a transfer needs to be approved by the company. The original one did not.

If one looks at the standard Articles of Incorporation used in the old act, table B together with various amendments that lawyers made in regard to the transferability

of the shares where they put in a number of articles preventing a shareholder from basically selling the shares to a third party where the Directors do not approve. It might be that the latest short form MOI addresses this situation.

### **27.3 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—

- (c) 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
- (d) 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;

#### **27.4 APPROVAL OF A FUNDAMENTAL TRANSACTION**

The Act has simplified the common approval procedure for all three fundamental transactions. This is found in s 115. Where a shareholder opposes any one of these transactions, he has what we call an “**appraisal remedy**” in terms of s 164.

When any of these transactions are performed both s 115 and **s 164 must accompany the notice** given to shareholders.

A special resolution is required for a fundamental transaction to be approved. However, a court approval will be required if **15% of the voting rights** requires the company to seek court approval. The court is required to review the resolution and not the transaction unless it is manifestly unfair to a group of shareholders and is tainted with a conflict of interest.

#### **27.5 APPRAISAL REMEDY**

The appraisal rights of dissenting shareholders are relatively new to South Africa. It is currently active in the USA and more recently Canada and New Zealand. It is really not viewed with much success in those jurisdictions. It can best be described as the right of dissenting shareholders who do not approve of certain triggering events to have their shares bought out by the company in cash at a price reflecting fair value. In certain cases, the value can be determined judicially.

The appraisal right is a **no-fault remedy**. “The grant of appraisal rights in these triggering circumstances involves the implicit acknowledgement that such events may

have significant and far-reaching consequences for shareholders. This is because the nature of the company as well as the rights of shareholders could be drastically altered”- Cassim. Appraisal rights allow a minority or dissenting shareholder to opt out of the company if they do not wish to go along with the triggering event which in effect is a minority buy out.

There are 2 very important conflicting values here; -

1. For the company to **change the structure** of the company in order to **create value** by changing shareholders rights in order to adapt to a changing business environment.
2. This may not be in the interests of minorities as they would want to retain their investment and have the same expectations of preserving rights and interests on the same basis in which they invested.

The **majority rules** and the fundamental transaction or change in shareholder rights will go ahead irrespective of what the minority wants. The appraisal remedy is an **exit strategy** for dissenting minorities. This could be great where a minority is locked in and disappointed with the way the company is being run. It gives that minority a chance to receive fair value in cash. It's the **director who drive the transaction** and it may be that they have **other vested interests** or they are looking at their own future which may not be in the interests of the minority. This right allows the minority an opportunity to show their dissent. “The appraisal right may thus be used to challenge the fairness of the price. It also functions as a check on opportunism by directors.” – Cassim. The remedy also serves as a deterrent or a restraint on bad business judgements by the directors.

### **27.6 HOW IT WORKS**

In terms of Section 164(2), if a company calls a shareholders meeting to consider adopting a special resolution to enter into any fundamental transaction as contemplated in Section 112, 113 or 114 or to amend its MOI by altering the **preferences, rights** and **limitations** or other terms of any class of its shares in any manner materially adverse to the rights or interest of holders of that class of shares as contemplated in s 37(8). That notice for the resolution must include a statement informing shareholders of their rights under s 164.

Section 37(8) provides that if a company's MOI has been amended to **materially and adversely** alter the preferences, rights, limitations or other terms of a class of shares, any holder who holds shares of the class effected is entitled to seek relief in terms of Section 164 if that shareholder;

- (a) Notifies the company in advance of the intention to oppose the resolution, amending the MOI;
- (b) Was present at the meeting and voted against the resolution.

The wording of Section 37 (8) is virtually the same as that of Section 115 (8).

There is no guidance as to what **materially** and **adversely** means in this context. Section 163 (the minority oppression action) and its predecessor s 252 of the old act may help because they use similar wording and were also enacted to protect minority shareholders. In fact, both remedies are probably capable of being invoked where s 164(2) read with s 37(8) is applicable.

Under Section 164(2) it is the shareholders rights or interest that must be materially and adversely affected, not the preferences, rights, limitations or other terms of the shares themselves. The wording of Section 37(8) is however to the opposite effect!

*S37(8) If the Memorandum of Incorporation has been amended to materially and adversely alter the preferences, rights, limitations or other terms of a class of shares, any holder of those shares is entitled to seek relief in terms of section 164 if that shareholder-*

*(a) notified the company in advance of the intention to oppose the resolution to amend the Memorandum of Incorporation; and*

*(b) was present at the meeting and voted against that resolution.*

### **27.7 WRITTEN NOTICE**

At any time before such a special resolution referred to in Section 164(2) is to be voted on a dissenting shareholder may give **written notice** to the company objecting to the resolution – Also see Section 115(8)(a). Such notice may be given at the meeting itself as long as it is given before the resolution is put to the vote.

The importance of giving the **notice of objection must not be overlooked** as it is one of the essential pre-requisites for the exercise of an appraisal right. If this notice is not given the appraisal right may be lost. The notice will also give the directors an idea as to where they stand in terms of the transaction that they are doing. If there is

a huge amount of dissent from minorities, that may be a sign for the directors to take note. As dissenting minorities are entitled to **cash for the fair value** of their shares, **cash flow considerations** must be taking into account. It may also be an indication not to proceed with the transaction and the company may revoke the resolution.

If the **company fails to give the shareholders details** of their rights or failed to give notice of the meeting then dissenting shareholders do not have to give notices of objections.

Dissenting rights in the event of a fundamental transaction will apparently not extend to shareholders who are **precluded from voting on the resolution** s 115(4), nor will they extend to shareholders who do not hold any voting rights.

Where such a resolution has been adopted then within 10 business days thereafter the company must send a notice that the resolution has been adopted to each shareholder who gave written notice of objection, and who have not withdrawn that notice or voted in support of the resolution – also see Section(115)(8)(b).

The sections here are Section 164(5) is the main provision. This is reinforced by s 37(8) and s 115(8). Dissenting minority shareholders must comply with each of its requirements, failing which they will automatically lose their appraisal rights.

### **27.8 THE DEMAND**

If the shareholders of the company have adopted the special resolution contemplated in s 164(2) and a shareholder: -

- Sent the company a notice of objection; and
- In the case of an amendment to the companies MOI he or she holds shares of a class that is materially and adversely affected by the amendment;
- And voted against that special resolution; and
- Has complied with all the procedure requirements of s 164.

the shareholder may **demand** that the company pay the shareholder the **fair value** of all the shares of the company held by that minority shareholder. The requirement that a shareholder must have sent a notice of objection to the company does not apply if the company fails to give notice of the meeting or fails to include in that notice a statement of the shareholders rights under s 164.

There **cannot be a partial dissent**. It's either all the shares or no shares.

A demand contemplated in s 164 must be made by written notice which must be delivered by the minority shareholder to the company within 20 business days after receipt of the notice from the company under s 164(4) (notice to dissenting shareholders of the results of the special resolution), or if the shareholder does not receive such a notice within 20 business days, after learning that that resolutions has been adopted. Such written notice **must also be delivered to the takeover regulation panel**, irrespective of whether or not the company is a regulated company. The demand must state the shareholders name and address, the number and class of shares in respect of which the shareholders seeks payment, and the demand for payment or the **fair value** of the shares.

A shareholder who has sent a demand has no further rights in respect of those shares, other than to be paid their fair value; -

- Unless the shareholder withdraws their demand before the company makes an offer or allows an offer made to the company to lapse. See s 164 (11) and (12), or
- The company fails to make an offer in accordance with s 164(11) and the shareholder withdraws the demand;
- Or the company by any subsequent special resolution revokes the adopted special resolution that gave rise to the shareholders rights under s 164. When this happens all the shareholders rights in respect of those shares are re-instated without interruption.

### **27.9 THE OFFER**

Section 164 (11) and (16) provide that within, 5 business days after the latest of the day on which the transaction is approved by the resolution is effective, the last day for receipt of demands, or the day the company receives a demand, the company must send to each shareholder who sent a demand a written offer to pay an amount considered by the Company's Directors to be **fair value** of the relevant shares determined as at the date on which, and time immediately before the Company adopted the resolution, accompanied by a **statement** showing how that value was determined.

Every offer in respect of shares of the same class or series must be made on the same terms. Every offer will ***lapse*** if it has not been accepted within ***30 business days*** after it was made.

Section 164(13) Provides;

If a shareholder accepts an offer from the company under Section 164(11)

- (a) The shareholder must deliver the relevant ***share certificates*** to the Company or its transfer agent or in the case of uncertificated shares take the steps required in terms of Section 53 to direct the transfer of those shares to the Company or its transfer agent; and
- (b) The company must pay the shareholder the agreed amount within 10 business days after the shareholder accepted the offer and delivers the certificates or direct the transfer of uncertificated shares to the company.

There could be dramatic consequences if the company can't pay the fair value of the minority shares. There could be a problem in that the Company is not in a position to pay for the shares and then under s 164(14)(b) and 164(17) the company can apply to court and tell the court they are unable to pay the debts as they fall due for the next twelve months. The court may then make an order that it is just and equitable having regard to the ***Company's financial circumstances***. The court order must also ensure that the person to whom the company owes money in terms of s 164 is paid at the earliest possible date compatible with the Company's other obligations as they fall due and payable.

#### ***27.10 COURT APPLICATION TO DETERMINE FAIR VALUE***

A shareholder who has made a demand also has the right to ***apply to court to determine the fair value of the shares*** that are subject to that demand, and for an order to pay the shareholder the fair value so determined if the company has failed to make an offer to make a payment under s 164(11) or if the company has made an offer that the shareholder considers to be inadequate and that the offer has not lapsed.

In terms of s 164(15) provides in an application to court;

- (a) that all the dissenting shareholders who have not accepted an offer from the company as of the date of the application must be ***joined as parties*** and are bound by the court's decision.

(b) The company must notify each affected dissenting shareholder of the date, place and consequence of the application and of their right to participate in the court proceedings.

(c) and the court

- must determine a fair value of the shares of all the dissenting shareholders. Such fair value must be determined as at the date on which and the time immediately before the special resolution was adopted by the Company.
- The court may determine whether any other person is a dissenting shareholder who should be joined as a party.
- The court in its discretion may allow a reasonable rate of interest of the amount payable to each dissenting shareholder from the date the action is approved by the resolution is effective until the date of payment.
- The court in its discretion may appoint one or more appraisers to assist in determining the fair value of the shares.
- The court may make an appropriate order of costs having any offer made by the company and its final determination of the fair value, and
- the court must make an order requiring
  - o the dissenting shareholders to either withdraw their demands or transfer their shares to the company or its transfer agent who compliance with s 164(13)(a); and
  - o the company to pay the fair value in respect of the shares to each dissenting shareholder who complies with s 164 (13)(a), subject to any conditions the court considers necessary to ensure that the company fulfils its obligations under s 164. NOTE: Remember the exception contemplated in s 164(17) (i.e the company is unable to pay its debts) also applies in this instance.

The Act gives ***no indication of the method to determine fair value***. At any time before the court has made an order the dissenting shareholder may accept the offer made by the Company, in which case that shareholder in the company must comply with the requirements of s 164(13)(a) and (b) - (tender shares and get paid).

The appraisal procedure has an advantage that it does not involve or commit any form of court intervention other than the determination of ***fair value*** of the affective shares.

Section 164(14) (application for fair value) and the limited exception in Section 164(17) which is the Company's ability to pay all its debts.

### **27.11 EXCLUSIONS**

There are a number of things that are excluded.

Any kind of transaction relating to an offer pursuant to **business rescue plan**;

Any kind of deal in regard to appraisal rights does not constitute a distribution by the company or an acquisition of shares by the company within the meaning of s 48, and therefore are **not subject to the provisions of s 48** or the application by the company of the solvency and liquidity test.

S 164 (20) applies to regulated companies only and provides that except to the extent expressly provided in s 164 or to the extent that the takeover regulation panel rules otherwise in a particular case, a payment by a company to shareholders in terms of s 164 does not obligate any person to make a comparable offer under s 125 to any other person.

Shares surrendered in the exercise of appraisal rights become part of the authorised and unissued shares of that class. In other words, these shares are automatically cancelled.

### **27.12 CONCLUSION**

A shareholder may waive their rights under s 164, there is nothing to indicate that they cannot. This is very relevant to a fundamental transaction where the consideration is not cash, such as a share for share exchange. In such a case the shareholder may legitimately agree not to exercise its appraisal rights.

In a fundamental transaction it is permissible for an offeror to make its offer conditional upon all or any of the shareholders not exercising their appraisal rights. It would be expected that such a condition will be frequently imposed where the offer consideration is not cash.

There are flaws in the Appraisal Remedy in that it is very **technical, complex and procedural**. There are mandatory steps required to perfect the procedure. It is unlikely that minority shareholders will be able to adopt the procedure without their lawyers or accountants.

The appraisal remedy ***favours the company more***. If a minority misses a step i.e. does not send a notice, they can lose the remedy, whereas if the company misses a step like fails to make a written offer nothing happens. The shareholder has 30 days to accept an offer before it lapses and it's the shareholder who has to ask for court assistance.

A really ***unfair situation*** is that once the shareholder sends the written demand to the company, they *lose all the rights of their shares* until they are paid the fair value which is only paid at the end of the proceedings if there is a judicial review of fair value.

Another disadvantage to the shareholder is cost. The court has a discretion on this. The ***determination of Fair Value*** is not an exact science and may be substantially lower than what the shareholder thinks.

## 28 ELECTRONIC SIGNATURES

### 28.1 INTRODUCTION

One of the major changes in the new company's act is the ability to do various things electronically. Valid meetings can be held by electronic methods. E.g. Skype Gotowebinar etc. Resolutions and special resolutions can now be taken in writing without it being necessary to actually have a physical meeting. This means that the resolutions can be taken by electronic means. Directors can send out all the documentation and the shareholders can vote on this on an electronic basis provided the requirements of the relevant laws are adhered to.

With an understanding of the requirements of the companies act 2008 and the Electronic Communications and Transaction Act 2002 (ECTA) one can convert many manual procedures to an electronic format.

### 28.2 THE LEGAL POSITION

It's important to understand how the Companies Act 2008 opens the door to do things electronically by referring to the ECTA.

### 28.3 DIGITAL SIGNATURES

Accfin is very proud and excited to introduced digital signatures into its back-office applications. In order to do this, we have partnered with SigniFlow and we are in fact using their SigniFlow product. We have detailed below how this is going to work with our products. SKY will be able to use these products.

#### 1. Description

Signiflow is an electronic signature solution made up of two components:

**Hardware (server):** A secure and certified network-attached appliance that provides electronic signature services to the SigniFlow client software. It stores **encrypted private keys, certificates** and other **signing credentials** belonging to specific users.

**Software (client):** A computer program that uses the **electronic signature services** provided by the SigniFlow server to enable users to electronically sign documents. It can only be used by authorised signers together with the private keys that are securely stored in the server.

In order to send signing requests from the SigniFlow Client to the SigniFlow server, authorised users create a **default signature** in the form of their name or a **graphical image**.

The first time that an Accfin user sends out an e mail to one of their clients with a request to dedicatedly sign a letter approving a tax return or a provisional tax return, or a company secretarial document they will have the opportunity of creating a signature which could be a **font signature** or a **graphical image** of their signature which will be registered against an email address with their own unique password. Once this signature record has been setup by the user it will be available from thereon each time they are requested to sign or approve a document.

After users apply their signature to a document using the SigniFlow client, their signing request is sent to the SigniFlow Server. This request includes a **document hash**, which is a **cryptographic function** that produces a unique string of characters from the document data. This string of characters protects the document from being altered once it has been signed because the string will change if the document data is modified, and if changed the change can be detected.

## 2. Benefits

SkySign which is used Sky in partnership with SigniFlow is an electronic signature solution that helps the users of our back-office products complete the automation of approvals for various actions like tax return approvals moving these approvals to a completely paper-free working environment. It eliminates the need to print, sign and scan documents, as they are signed and transferred electronically from the back-office system to the client and then back to the back-office system after approval has taken place.

This innovative solution offers a unique centralized approach to managing electronic signatures, signatories and private keys. This approach allows you to easily install your own private keys, which is important in the context of South African law.

This unique system enables your organization to:

### **1. Accelerate signature-dependent processes**

Allows your user clients to sign documents remotely at any time, in any location, from any computer or mobile device without printing them first.

Requires no changes to your existing processes, workflows, governance policies and standard operating procedures.

Works with the content authoring applications and file types that you are already using, i.e. your letters converted to PDF files.

Integrates digital signatures into the document sent to your client.

### **2. Reduce operating costs**

Puts you on the path to a rapid ROI by significantly reducing paper-related costs, decreasing document turnaround times, and improving efficiency. Major reduction in follow up calls to your clients.

Installs quickly and easily with minimal operational impact, as its been tightly integrated in the Accfin back office products.

Offers multiple options and flexible licensing based on the number of users who wish to use this option.

### **3. Improve security, control and trust;**

Keeps your sensitive documents within the protected boundaries of your enterprise domain so that they never have to be saved on third-party servers.

Integrates with your enrollment/provisioning methods, leveraging existing user management systems, such as Microsoft Active Directory and other LDAP systems, for control over signer authorizations.

Stores the signing keys in a centralized and secure hardware device, ensuring that any tampering attempt will be immediately detectable.

### **4. Comply with the relevant laws and regulations**

Any time, in any location, from any computer or mobile device. Adheres to industry and governmental regulations including South African common law, the ECT Act, POPI, ESIGN, UETA, EU regulations and VAT law, FDA 21 CFR Part 11, USDA, SOX, and many more.

#### **28.4 Common law**

The South African common law is made up of Roman-Dutch law and past court decisions.

#### **Definition**

The common law definition of a word or term is its plain English meaning. Courts generally use dictionary definitions to determine the plain English meaning of a word or term.

“Signature” means **“the name of a person written with his or her own hand as an authentication of some document or writing”** (Shorter Oxford English dictionary).

The important aspects of this definition are that:

- it must be the **name or mark** of the person signing;
- the person signing must have **applied it themselves**; and
- the person signing must have **intended** it to **authenticate** them.

Our courts used to follow a formalistic approach to signatures where they focused on whether specific factual circumstances existed to decide whether something counted as a signature. Now they follow a functional approach where they focus on the intention

behind the factual circumstances to decide whether the person signing intended something to be their signature.

### **Applies**

South African lawmakers are presumed not to have changed the common law unless they do so explicitly.

Our lawmakers haven't explicitly excluded electronic signatures from the common law of signatures. This means that the common law applies to electronic signatures.

### **Court decisions**

Unfortunately, there are no court decisions about electronic signatures in South Africa. No one has brought a matter involving an electronic signature before a South African judge and had a binding decision made on it, but there are many cases about what form a signature can take. This is useful when considering new forms of signature, like electronic signatures.

### **SigniFlow**

SigniFlow can be used to create electronic signatures that are valid in terms of South African common law.

The electronic signature it creates meets the common law definition of a 'signature', because:

- the person signing's default signature contains their **name**;
- the person signing **applies it themselves** by choosing to apply it to a document; and
- the person signing **intended** it to **authenticate** them because they log into the system using their credentials to authenticate themselves.

The electronic signatures it creates would also be considered signatures in terms of the functional approach, because our courts would focus on the intention behind using SigniFlow to create an electronic signature on a document to decide that the person signing using the electronic signature intended it to be their signature.

### **ECT Act**

The ECT Act (Electronic Communications and Transactions Act 25 of 2002) became law in South Africa on Friday 30 August 2002.

Section 2 of the ECT Act says that "***The objects of this Act are to enable and facilitate electronic communications and transactions in the public interest [...]***"

SigniFlow electronic signatures are an effective way of facilitating electronic communications and transactions.

## Confirms common law

The ECT Act confirms the common law rules regarding signatures.

Section 13(2) of the ECT Act says that “***Subject to subsection (1), an electronic signature is not without legal force and effect merely on the grounds that it is in electronic form.***”

The important aspects of this provision are that:

- electronic signatures are **valid** signatures;
- despite being in **electronic form**.

This provision enables the use of electronic signatures without forcing it. Therefore:

- Signiflow electronic signatures are **valid** signatures;
- despite being in the **electronic form** of electronic signature data associated with an electronic document;

in terms of section 13(2) of the ECT Act.

## Minimalist approach

The ECT Act takes a minimalist approach to electronic signatures. This means that it provides a definition consisting of certain requirements and anything that meets those requirements is an electronic signature. The most important thing about this approach is that it is technology neutral. The ECT Act doesn't contain a list of technologies that count as electronic signatures – it only contains a list of requirements. This is good because it means new electronic signature technologies will automatically become electronic signatures in terms of the ECT Act without the lawmakers having to update the legislation.

Therefore, SigniFlows electronic signatures are electronic signatures in terms of the ECT Act because they meet the requirements in the definition of an electronic signature as we will explain below.

## Signature definition requirements

The ECT Act sets out the requirements for an electronic signature in its definitions.

Section 1 of the ECT Act says that “***“electronic signature” means data attached to, incorporated in, or logically associated with other data and which is intended by the user to serve as a signature;***”

The important aspects of this definition are that:

- an electronic signature must involve **two sets of data**;
- the two sets of data must have a **relationship** where they are “attached to, incorporated in, or logically associated” with each other; and
- the person signing must have had the **intention** that one of the sets of data be their signature.

Section 1 of the ECT Act says that “**“data” means electronic representations of information in any form;**” Therefore, SigniFlow’s signatures are electronic signatures in terms of the ECT Act because:

- they involve **electronic signature data** and **electronic document data**;
- the electronic signature data has a **relationship** with the electronic document data because it is incorporated in it when the person signing applies their signature to the electronic document; and
- there is a strong argument that the person signing had the **intention** that the electronic signature data be their signature, because they logged in with their credentials to authenticate themselves, created their default signature, and chose to apply it to the electronic document.

## Data message restrictions

The ECT Act has certain restrictions that a data message must comply with to be an electronic signature.

Section 13(3) of the ECT Act says that “***Where an electronic signature is required by the parties to an electronic transaction and the parties have not agreed on the type of electronic signature to be used, that requirement is met in relation to a data message if— (a) a method is used to identify the person and to indicate the person’s approval of the information communicated; and (b) having regard to all the relevant circumstances at the time the method was used, the method was as reliable as was appropriate for the purposes for which the information was communicated.***”

The important aspects of this provision are that:

- you cannot use an electronic signature if you have **agreed to use another type** of signature, for example in a contract;
- the electronic signature technology must somehow **authenticate** the signatory and show that they **approved** the signature; and
- this method must be **sufficiently reliable** in the circumstances.

Section 1 of the ECT Act says that “**“data message” means data generated, sent, received or stored by electronic means [...]**”

This definition applies to almost all forms of electronic signature, because they all involve electronic communication of data.

All electronic signatures must comply with these restrictions.

Therefore, SigniFlow electronic signatures comply with the ECT Act's restrictions for data messages to be electronic signatures, because:

- most of the time, the parties will **not have agreed to use** another type of signature;
- SigniFlow makes the person signing log in with their credentials to **authenticate** themselves and shows that they **approved** their signature by recording all the data of how they applied it; and
- this method is **sufficiently reliable** for most circumstances in our opinion, although a court may decide that a more reliable method is required in certain circumstances – but no South African court has made such a decision at this time.

## Signify agreement

Section 13(5) of the ECT Act says that “*Where an electronic signature is not required by the parties to an electronic transaction, an expression of intent or other statement is not without legal force and effect merely on the grounds that— (a) it is in the form of a data message; or (b) it is not evidenced by an electronic signature but is evidenced by other means from which such person's intent or other statement can be inferred.*”

The important aspects of this provision are that:

- where the parties to an electronic transaction have **not agreed** to use an electronic signature;
- an **electronic expression of intention** is valid;
- despite **not being an electronic signature**.

Therefore, SigniFlow's electronic signatures are also **electronic expressions of intention** as well as being electronic signatures, which means that a person can also use them when an expression of intention is sufficient and a signature is not required.

## Advanced electronic signatures

Advanced electronic signatures are legally different from ordinary electronic signatures. They were created by the ECT Act and do not exist in common law.

Section 1 of the ECT Act says that “*“advanced electronic signature” means an electronic signature which results from a process which has been accredited by the Authority as provided for in section 37;*”

The important aspects of this definition are that:

an advanced electronic signature must meet the signature definition requirements of an ordinary electronic signature; and

it must be from a process accredited by the Department of Communications (who is the relevant Authority).

Section 37(1) of the ECT Act says that “***The Accreditation Authority may accredit authentication products and services in support of advanced electronic signatures.***”

The Department of Communications has accredited certain organisations to provide advanced electronic signatures in the form of a digital certificate provider based on a face-to-face authentication service of the person wishing to get the advanced electronic signature.

Section 38(1)(e) of the ECT Act says that “***The Accreditation Authority may not accredit authentication products or services unless the Accreditation Authority is satisfied that an electronic signature to which such authentication products or services relate— [...] is based on the face-to-face identification of the user. [...]***”

These organisations were accredited on the basis of the ECT Act (Electronic Communications and Transactions Act 25 of 2002) Accreditation Regulations, which became law on Wednesday 20 June 2007 in terms of sections 41 and 94 of the ECT Act. (Available at: <http://www.saaa.gov.za/index.php/2013-11-26-14-32-21/2013-12-04-09-54-50/finish/1-policy-and-legislations/7-accreditation-regulation.html>)

Both sections 41 and 94 of the ECT Act empower the Minister of Communications to make these regulations.

Regulation 13 of the ECT Act Accreditation Regulations contains the technical requirements for the certificate service provider to issue a digital certificate that can be used for advanced electronic signatures.

Therefore, SigniFlow lets users install their own private keys in the form of a digital certificate provided by an accredited Certificate Authority, which can then be used to create advanced electronic signatures. This means that a person signing a document could easily get a digital certificate provided by an accredited Certification Authority, install it on the CoSign server, and use it to apply a valid advanced electronic signature.

## **Law requires signature**

You must use an advanced electronic signature when a law requires a signature.

Section 13(1) of the ECT Act says that “***Where the signature of a person is required by law and such law does not specify the type of signature, that requirement in relation to a data message is met only if an advanced electronic signature is used.***”

The important aspects of this provision are that:

- when a **law requires a signature**; and
- a law **doesn't specify** a particular type of signature;
- then you **must use** an advanced electronic signature.

This means that:

- you **need not** use an advanced electronic signature;
- when a **law doesn't require** signature; or
- a law **specifies** a particular type of signature.

Therefore, you can use SigniFlow as an ordinary electronic signature where an ordinary electronic signature is sufficient or as an advanced electronic signature where an advanced electronic signature is required by law. It provides ordinary electronic signatures as is and provides advanced electronic signatures when used together with a digital certificate from an accredited certificate authority.

### **Law specifies type**

The Income Tax Act 58 of 1962 is an example of where a South African law specifies the type of electronic signature you must use.

Section 66(7B) of the Income Tax Act says that “***The Minister may make rules and regulations prescribing the procedures for submitting any return in electronic format and the requirements for an electronic or digital signature contemplated in subsection (7A).***”

The Minister made a rule in terms of this provision that a taxpayer's userID is deemed their electronic signature for the purposes of eFiling. This overrules the provision enabling advanced electronic signatures in terms of the ECT Act and requires a specific type of signature.

Therefore, you cannot use SigniFlow or any other electronic signature solution to sign a document in a scenario like this where the law specifies the type of signature.

### **Counts as law**

The Interpretation Act 33 of 1957 is very old legislation that helps us work out whether something counts as law. We need to work out whether something counts as law to decide whether it is a law that requires signature.

Section 18 of the Interpretation Act says that “***In the interpretation of any Act of Parliament, government notice, government advertisement, ordinance, placat, proclamation, regulation or by-law made under the authority of any law, rule of court, or any enactment having the force of law, which came into operation in the colony of the Cape of Good Hope prior to the thirty-first day of May, 1910, the following expressions shall [...] have the meanings hereby assigned to them [...]***”

We can work out from this very broad provision that law includes both:

- **primary legislation** – like proclamations, ordinances, and Acts; and
- **delegated legislation** – like regulations in terms of promulgated law and forms in regulations.

Therefore, you will need to use SigniFlow with an advanced electronic signature in the form of a digital certificate from an accredited certificate provider when primary or delegated legislation requires a signature.

### **Advanced electronic signature presumption**

The major difference between the legal effect of an advanced electronic signature and an ordinary electronic signature is that there is an evidentiary presumption that applies to advanced electronic signatures and not to ordinary electronic signatures.

Section 13(4) of the ECT Act says that “***Where an advanced electronic signature has been used, such signature is regarded as being a valid electronic signature and to have been applied properly, unless the contrary is proved.***”

The important aspects of this provision are that:

- where a person **signs** something with an **advanced electronic signature**;
- it is deemed to be a **valid electronic signature**; and
- it is deemed to have been **applied properly**;
- unless someone **proves otherwise**.

This is in contrast with where a person signs something with an ordinary electronic signature, because it:

- is **not necessarily** a **valid** electronic signature; and
- has **not necessarily** been **applied properly**;
- but someone can **prove otherwise**.

Therefore, you can choose to use SigniFlow with an advanced electronic signature in the form of a digital certificate from an accredited certificate provider if you want to take advantage of this presumption. Otherwise, you can choose to use SigniFlow as is if you don't want to take advantage of this presumption.

### **Transaction types**

#### **Company administration**

Company administration involves directors and shareholders signing documents necessary to run companies, including board resolutions, shareholders agreements, and share certificates.

Section 6(12)(a) of the Companies Act says that ***“If a provision of this Act requires a document to be signed or initialed- [...] by or on behalf of a person, that signing or initialing may be effected in any manner provided for in the Electronic Communications and Transactions Act; [...]”***

This provision means that you can use an ordinary electronic signature or electronic consent to validly sign any of the documents regulated by the Companies Act.

Therefore, you can use SigniFlow for any company administration documents in South Africa.

### **Other transactions**

Signiflow can be used as an ordinary electronic signature whenever an ordinary electronic signature is sufficient in terms of South African law. It must be used together with a digital certificate provided by an accredited certification authority to create an advanced electronic signature whenever an advanced electronic signature is required in terms of South African law.

Suppliers easily verifiable proof of sign-a-identity, signer intent, and document integrity, which can be validated by anyone using widely available application such as any PDF Reader.

### **28.5 ELECTRONIC RESOLUTIONS**

Section 60 refers to the shareholders having an ability to take various resolutions in writing. The section does not specifically talk about electronic or digital signatures it basically says that a resolution to be taken could be sent to all the shareholders who are entitled to vote and the shareholders have to exercise their vote within 20 business days. If there is sufficient support for the resolution then this resolution will be adopted either as an ordinary resolution or as a special resolution.

It should be born in mind that resolution processed electronically will require a higher vote to pass.

**60. Shareholders acting other than at meeting.**—(1) A resolution that could be voted on at a shareholders meeting may instead be—

(a) submitted for consideration to the shareholders entitled to exercise voting rights in relation to the resolution; and

(b) voted on in writing by shareholders entitled to exercise voting rights in relation to the resolution within 20 business days after the resolution was submitted to them.

(2) A resolution contemplated in subsection (1)—

(a) will have been adopted if it is supported by persons entitled to exercise sufficient voting rights for it to have been adopted as an ordinary or special resolution, as the case may be, at a properly constituted shareholders meeting; and

(b) if adopted, has the same effect as if it had been approved by voting at a meeting.

(3) An election of a director that could be conducted at a shareholders meeting may instead be conducted by written polling of all of the shareholders entitled to exercise voting rights in relation to the election of that director.

(4) Within 10 business days after adopting a resolution, or conducting an election of directors, in terms of this section, the company must deliver a statement describing the results of the vote, consent process, or election to every shareholder who was entitled to vote on or consent to the resolution, or vote in the election of the director, as the case may be.

(5) For greater certainty, any business of a company that is required by this Act or the company's Memorandum of Incorporation to be conducted at an annual general meeting of the company, may not be conducted in the manner contemplated in this section.