

# **Tutorial Letter 201/2/2016**

**Company Law**

**LML4806**

**Semester 2**

**Department of Mercantile Law**

**IMPORTANT INFORMATION:**

This tutorial letter contains important information  
about your module.

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Dear Student

## 1. FEEDBACK ON ASSIGNMENT 01

Several important consequences flow from the existence of a group, even though the law does not recognise a separate legal personality for the group. The consequences are as follows:

- In terms of section 48(2) of the Companies Act 71 of 2008 (hereafter referred to as “the Act”) a subsidiary may acquire shares in its holding company, provided that the acquisition does not amount to more than 10 per cent, in aggregate, of the number of any issued shares of the holding company. Furthermore, the 10 per cent cap applies to all the subsidiaries taken together. The voting rights attached to these shares cannot be exercised as long as they are held by the subsidiary of the holding company and as long as the latter is regarded as the subsidiary of the holding company.
- In terms of section 76 of the Act, a director must not use his or her position as a director, or any information obtained in his or her capacity as a director, to gain an advantage either for himself or herself or for another person other than the company or a wholly owned subsidiary of the company. In addition, a director of a company is prohibited from using that information to cause harm to the company or its subsidiary.
- The definition of an employee share scheme as it appears in terms of section 95 of the Act refers to a scheme established by a company, by means of a trust or otherwise, for the purpose of offering participation therein solely to employees and officers of the company or of a subsidiary of the company. In this way, an employee of one company in the group is treated as being an employee of the holding company or another subsidiary company, that is, as an employee of the group.
- Section 112 (Proposals to dispose of all or greater part of assets or undertaking) and section 113 (Proposals for amalgamation or merger) of the Act do not apply to a proposal to dispose of all or the greater part of the assets or undertaking of a company if that disposal would constitute a transaction between a wholly owned subsidiary and its holding company, or between or among two or more wholly owned subsidiaries of the same holding company, or between a wholly owned subsidiary of a holding company on

the one hand and its holding company and one or more wholly owned subsidiaries of that holding company on the other hand.

- Financial assistance for the purpose of, or in connection with, the purchase of securities or the subscription of an option or securities in terms of section 44 of the Act includes the shares or securities issued or to be issued by the company or a related or an inter-related company.
- Financial assistance in terms of section 45 of the Act not only applies to directors, but also to the granting of financial assistance by way of loans or guarantees within the group. Generally speaking, a special resolution of shareholders is required before a company can provide financial assistance to any other company in the same group.

**See your Module Online Letter at learning unit 7, paragraph 7.7, and your prescribed textbook at paragraph 3.3.**

## **2. FEEDBACK ON ASSIGNMENT 02**

In terms of section 76 of the Act, a director owes a fiduciary duty to the company and must act with a certain degree of care, skill and diligence. The fiduciary duty of a director entails that a director must perform his or her functions in good faith, for a proper purpose, and in the best interests of the company. Acting in contravention of this duty attracts liability to the director in terms of section 77 of the Act.

In *CyberScene Ltd v iKiosk Internet and Information (Pty) Ltd* 2000 (3) SA 806 (C) it was held that a director acts in breach of his or her fiduciary duty to the company if he or she sabotages the company's contractual opportunities for his or her own advantage, or if he or she uses confidential information to advance the interests of a rival concern or his or her own business to the prejudice of the interests of the company.

In *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 it was stated that a director has a duty not to misappropriate corporate opportunities and a duty not to compete improperly with the company by becoming a director of or holding another office in a rival concern. Furthermore, it was held that where one man stands to another in a position of confidence

involving a duty to protect the interest of that other, he is not allowed to make a secret profit at the other's expense or to place himself in a position where his interests conflict with his duty.

When applying the aforementioned principles to the facts, it is clear that Johan has breached his fiduciary duty in terms of section 76 of the Act, by appropriating an opportunity intended for Cellular Computers (Pty) Ltd for himself. Moreover, Johan breached his fiduciary duty by using the position of a director, or information obtained while acting in the capacity of a director, to gain an advantage for himself or another person and to knowingly cause harm to the company.

**See your Module Online Letter at learning unit 3, paragraph 3.2, and your prescribed textbook at paragraph 6.3.**

### **3. OCTOBER/NOVEMBER 2015 EXAMINATION**

In order to help you with your preparation for the examination, we provide you with examples of the types of questions that you may expect in the examination paper. Note that these questions are merely examples of how questions may be asked in the examination paper. We do not imply that we will ask these questions in the examination paper. Feedback is also provided in this tutorial letter. The questions below were taken from the October/November 2015 examination paper.

#### **QUESTION 1**

- 1.1 Briefly discuss the main similarities and differences between a shareholders' meeting and an annual general meeting with reference to public and private companies. **(5)**
- 1.2 Briefly discuss the differences between an ordinary resolution and a special resolution. **(5)**
- 1.3 What does the solvency and liquidity test in terms of the Companies Act 71 of 2008 entail? Give two examples of circumstances when this test should be applied. **(5)**
- 1.4 Discuss the meaning of the following types of directors:
  - 1.4.1 *ex officio* director **(1)**
  - 1.4.2 alternate director **(2)**
  - 1.4.3 temporary director **(2)**

- 1.5 Name two instances when a person would be ineligible to be appointed as a director and three instances when a person would be disqualified from being appointed as a director.

(5)

[25]

## QUESTION 2

- 2.1 The following paragraph is an extract from the judgment of Rogers J in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 5 SA (WCC):

“[74] Section 76(4) makes clear that the duty imposed by section 76(3)(b) to act in the best interests of the company is not an objective one, in the sense of entitling a court, if a board decision is challenged, to determine what is objectively speaking in the best interests of the company. What is required is that the directors, having taken reasonably diligent steps to become informed, should subjectively have believed that their decision was in the best interests of the company and this belief must have had a ‘rational basis’”.

Discuss the business judgment test/rule with specific reference to the provisions of section 76(4) of the Companies Act 71 of 2008, the performance or advice of the people and committees which a director is entitled to rely on to make his/her judgement, the effect and general gist of the test, and the arguments for and against the business judgment rule.

(15)

- 2.2 A Ltd holds 51 percent of the shares issued in B (Pty) Ltd. A Ltd also holds 20 percent of the shares issued in C (Pty) Ltd, and 60 percent of the shares issued in D (Pty) Ltd. B (Pty) Ltd holds 20 percent of the shares issued in E (Pty) Ltd. C (Pty) Ltd holds 45 percent of the issued share capital in E (Pty) Ltd. D (Pty) Ltd also holds a 35 percent shareholding in E (Pty) Ltd. Explain whether E (Pty) Ltd is a subsidiary of A Ltd.

(10)

[25]

## QUESTION 3

- 3.1 Carol wants to buy shares in Dakota Hotel Limited. She does not have money available to do so, but she offers to sell some catering equipment she had left over from an unsuccessful business to Dakota Hotel Limited. The company agrees to pay R500 000 for the catering equipment. Carol then uses the money to purchase 10 000 shares in Dakota Hotel Limited.

- 3.1.1 With reference to the relevant case law, advise the board of directors of Dakota Hotel Limited whether or not the purchase of the catering equipment would qualify as *financial assistance* as contemplated in section 44 of the Companies Act 71 of 2008. **(8)**
- 3.1.2 Name four (4) requirements of section 44 of the Companies Act 71 of 2008 that a company must comply with before it will be allowed to provide financial assistance. **(4)**
- 3.1.3 Your friend Jeanette, who is a chartered accountant by profession, has recently been appointed as the company secretary of Stein Holdings Limited, a company listed on the Johannesburg Securities Exchange in the Consumer Services – Retail Sector. This company has many subsidiaries, including Stein Hardware (Pty) Ltd, Stein Investment (Pty) Ltd, Stein International Holdings Ltd, Central Timbers (Pty) Ltd, Green Apple Supermarkets (Pty) Ltd, Becko Foods (Pty) Ltd, and other smaller subsidiaries. Stein Holdings Limited's shareholding and voting power in most of these subsidiary companies is 100 percent. The Stein group operates in the wholesale and retail industries. It is one of the largest retail groups in Africa. Explain to Jeanette how "control" in the context of a group of companies is defined in the Companies Act 71 of 2008. **(3)**
- 3.1.4 The board of directors of Aviation Supplies (Pty) Ltd intends to issue new ordinary shares in order to, among other things, settle the company's existing debt obligations, incentivise employees and raise cash for the expansion of the company's operations. The board anticipates that the shares will be issued to quite a number of people including people who are not currently shareholders of Aviation Supplies (Pty) Limited. The board has heard that the Companies Act 71 of 2008 regards the decision to issue shares as a management decision. However, the board is unsure whether or not they may issue the new ordinary shares without shareholder approval. Upon hearing about the board's intentions, Reona, one of the current shareholders of Aviation Supplies (Pty) Ltd, is concerned that an issue of a large quantity of new ordinary shares will dilute the interests of the present shareholders of the company. Explain fully what is meant by "shareholders pre-emptive rights" and advise Reona on whether the current shareholders of Aviation Supplies (Pty) Ltd have any pre-emptive rights. You should also indicate in your answer the circumstances when shareholders' pre-emptive rights will not apply. **(10)**

**[25]**

## QUESTION 4

- 4.1 Dolphin Hides Ltd is a company trading in the production and distribution of leather products. It owns a production site in Randburg to the value of R100 million and a couple of distribution outlets to the value of R20 million. Due to the 2008 financial crises, the company has not been doing well. In light of this the general meeting adopted a resolution to sell the production site, which is the company's biggest income producing asset.

Maite, Peter and Mike, three of the shareholders of Dolphin Hide Ltd and each having 5 (five) percent of the voting rights, object to the sale of the production site. The objection is raised on the basis that the procedure followed for the sale of the production site, does not comply with the requirements of the Companies Act 71 of 2008. In light of the above mentioned facts, advise the aggrieved shareholders on the following aspects:

- 4.1.1 In terms of the Companies Act 71 of 2008, explain what type of transaction the company wishes to enter into and whether the Take-over Regulations will apply to the transaction. (6)
- 4.1.2 Explain how the objection of Maite, Peter and Mike to the sale of the production site may impact upon the prescribed procedure that should be followed in terms of the Companies Act 71 of 2008. (5)
- 4.2 Suppose Dolphin Hides Ltd is on the brink of financial collapse. The board of directors has adopted a resolution to commence with business rescue proceedings. Mpho, a creditor of Dolphin Hides Ltd feels aggrieved by the decision as his claim will be subjected to a moratorium and he does not approve of the appointed business rescue practitioner. Advise Mpho on the grounds on which the resolution of the directors of Dolphin Hides Ltd to commence with business rescue proceedings and the appointment of the business rescue practitioner can be set aside in terms of the Companies Act 71 of 2008. (7)

[18]

## QUESTION 5

Define the terms *insider* and *inside information* for purposes of the Financial Markets Act 19 of 2012. [7]



**FEEDBACK ON OCTOBER/ NOVEMBER 2015 EXAMINATION**

**NB: Please note that the feedback given below is not a detailed memorandum, but serves as a guideline to assist you in answering the previous year's examination paper. You will have to refer to the textbook and the Module Online Letter to be able to provide complete answers to the questions asked. The guidelines below are merely a starting point and should not be regarded as model answers.**

**QUESTION 1**

- 1.1 To answer this question successfully, students had to note that both meetings are meetings of shareholders, but an annual general meeting is held annually and particular business should be dealt with at an annual general meeting. Secondly, they had to note that a public company must convene an annual general meeting, whereas it is not mandatory for a private company to hold an annual general meeting. Some of the business that must be conducted at an annual general meeting is the presentation of the directors' report, audited financial statements, audit committee report, the election of directors, the appointment of an auditor and audit committee, and any matters raised by shareholders.

**See your Module Online Letter at Learning unit 1, paragraph 1.14 and your prescribed textbook at paragraph 5.1–5.13.**

- 1.2 To answer this question successfully, students had to state that for an ordinary resolution to be approved by shareholders, it must be supported by more than 50% of the voting rights exercised on a resolution, whereas a special resolution must be supported by at least 75% of the voting rights exercised on a resolution. Secondly, they had to mention that a company's Memorandum of Incorporation may require a higher percentage of voting rights to adopt an ordinary resolution or a higher or lower percentage to approve a special resolution, provided that there is a margin of at least 10 percentage points between the highest requirement for approval of an ordinary resolution and the lowest requirement for approval of a special resolution.

**See your Module Online Letter at learning unit 1, paragraph 1.14 and your prescribed textbook at paragraph 5.15.**

- 1.3.1 To answer this question successfully, students had to mention that a company satisfies the solvency and liquidity test if, considering all reasonably foreseeable financial circumstances of the company at that time, the assets of the company as fairly valued, equal or exceed the liabilities of the company as fairly valued (solvency test); and 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 twelve months after the date on which the test is considered or, in the case of a distribution, twelve months following that distribution (liquidity test).

Secondly, they had to indicate that the solvency and liquidity test is applied when a company makes any distributions or share repurchases, gives financial assistance for the purchase of its shares, gives financial assistance to its directors, makes a loan, amalgamates or merges with another company.

**See your Module Online Letter at learning unit 6, paragraph 6.3 and your prescribed textbook at paragraph 4.4.**

- 1.4 To answer this question successfully, students had to indicate that an *ex officio* director is a person who is a director of a company as a consequence of holding some other office, title, designation or similar status. Secondly, an alternate director is a person who is elected or appointed to serve as a member of the board of directors in substitution for a particular elected or appointed director of that company. An alternate director may act as a director only in the absence of the person who appointed him. Thirdly, a temporary director is appointed by the board of directors to fill a vacancy and to serve as a director on a temporary basis until the vacancy has been filled by a director who has been elected by the shareholders.

**See your Module Online Letter at learning unit 2, paragraph 2.2 and your prescribed textbook at paragraph 6.1.**

- 1.5 To answer this question regarding the ineligibility of directors, students had to refer to a juristic person, an unemancipated minor, and a person who does not satisfy any requirements in the company's Memorandum of Incorporation as instances when a person is ineligible to be appointed as a director. In regard to the disqualification of

directors, students had to refer to a person who is prohibited by a court from being a director, a person who has been declared delinquent by a court of law in terms of section 162 of the Companies Act 71 of 2008, or an unrehabilitated insolvent as instances where a person is disqualified from being a director. Please note the other instances of disqualification of directors set out in the Companies Act 71 of 2008.

**See your Module Online Letter at learning unit 2, paragraph 2.6 and your prescribed textbook at paragraph 6.6.**

## QUESTION 2

- 2.1 To answer this question successfully, students had to state that in terms of section 76(4) of the Companies 71 of 2008, the business judgment rule provides that a director will have satisfied the duty to act in the best interests of the company and the duty to act with the degree of care, skill and diligence, provided the three elements of the business judgment rule are present. They had to refer to the three elements. Secondly, they had to provide that a director may rely on the performance and advice of employees, professional persons and the board or a board committee. Thirdly, they had to provide that the effect of the business judgment rule is that a director will not be held liable for decisions that lead to undesirable results if the director has complied with the requirements of section 76(4) of the Companies Act 71 of 2008. Lastly, they had to provide, in support of the business judgment rule, that it serves as motivation for capable persons to accept directorships, and that it encourages directors to engage safely in risk-taking activities. On arguments against the business judgment rule they had to provide that it could result in accepting a standard of conduct that is below acceptable standards that ought to be required of directors. Moreover, the exact content of the business judgement rule is difficult to define and establish, and the difficulty in the codification thereof is evident in the various attempts undertaken in the United States of America.

**See your Module Online Letter at learning unit 3, paragraph 3.2.4 and your prescribed textbook at paragraph 6.3.3.**

- 2.2 To answer this question successfully, students had to discuss the meaning of control and had to determine whether A Ltd controls E (Pty) Ltd or controls companies that control E (Pty) Ltd. In this scenario, A Ltd controls B (Pty) Ltd and D (Pty) Ltd, which together

control E (Pty) Ltd. Therefore this makes E (Pty) Ltd a subsidiary of A Ltd.

**See your Module Online Letter at learning unit 7, paragraph 7.3 and your prescribed textbook at paragraph 3.1.2.**

### QUESTION 3

3.1.1 To answer this question successfully, students had to mention that, in order to ascertain whether an intended transaction constitutes financial assistance in connection with the purchase of shares, the transaction should pass two phases. The first phase is whether the transaction constitutes financial assistance and the second phase is whether the financial assistance is for the purpose of acquiring shares in a company.

To ascertain whether the transaction qualifies as financial assistance, the impoverishment test as formulated in the case of *Gradwell (Pty) Ltd v Rostra Printers Ltd* 1959 (4) SA 419 (A) should be relied upon. The impoverishment test considers whether a transaction will have the effect of leaving the company poorer, and if so, then financial assistance was provided.

In *Lipschitz NO v UDC Bank Ltd* 1979 (1) SA 789 (A), the court held that the impoverishment test is not the only test for determining whether financial assistance has been provided, but providing security or otherwise exposing the company to risk will also qualify as financial assistance. The court further held that if the company buys an asset from a person in order to enable that person to buy shares in the company, it will depend on the facts whether this constitutes financial assistance.

Factors that have emerged from case law to assist in this regard, are whether the company needs the asset in its normal business and whether the company paid a fair price for it.

To ascertain whether the transaction is for the purpose of acquiring shares in a company, will depend on the facts of each case.

In terms of section 44 of the Companies Act 71 of 2008, if the person obtained a loan to purchase shares in a company, and the company stood surety for that loan, it will constitute financial assistance.

In this case, if Dakota Hotel Group Limited does not need the catering equipment and the purchase price of R500 000 is higher than the equipment's true value, then the transaction would qualify as financial assistance for the purpose of acquiring shares. If it does need the catering equipment and the purchase price of R500 000 is a fair price for the equipment, then the transaction would not qualify as financial assistance for the purpose of acquiring shares.

**See your Module Online Letter at learning unit 6, paragraph 6.5 and your prescribed textbook at paragraph 4.7.6.**

3.1.2 To answer this question successfully, students had to set out the requirements that must be complied with when a company provides financial assistance for the purchase of its shares. The requirements are:

- The provision of financial assistance must be pursuant to an employee share scheme that satisfies the requirements of section 97, or the provision of financial assistance must be 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.
- The board must be satisfied that immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test, and that the terms under which the financial assistance is proposed to be given, are fair and reasonable to the company.
- The board must ensure that any conditions or restrictions regarding the granting of financial assistance set out in the company's Memorandum of Incorporation have been satisfied.

**See your Module Online Letter at learning unit 6, paragraph 6.5 and your prescribed textbook at paragraph 4.7.6.**

3.2 To answer this question successfully, students had to mention that in terms of section 2 of the Companies Act 71 of 2008, company A controls company B (or its business) if company B is a subsidiary of company A, or company A, on its own or together with any related or interrelated person, is directly or indirectly able to exercise (or control the exercise of) the voting rights in company B (whether pursuant to a shareholders' agreement or otherwise), or has the right to appoint or elect (or control the appointment

or election of) directors of company B, who control the majority of votes at the company's board meetings, or company A has the ability to materially influence the policy of company B.

**See your Module Online Letter at learning unit 7, paragraph 7.3, your prescribed textbook at paragraph 3.1.2 and section 2 of the Companies Act 71 of 2008.**

- 3.3 To successfully answer this question, students had to provide that a shareholder's pre-emptive right means that if a company proposes an issue of new shares, the shares must be offered to the existing shareholders first in proportion to their current shareholding before these shares are offered to any other person who is not a shareholder of a company. They had to also state that section 39 of the Companies Act 71 of 2008 grants shareholders of a private company an automatic pre-emptive right unless altered, or negated by the company's Memorandum of Incorporation. This right prevents dilution of ownership in private companies. Shareholders of a public and state-owned company do not have an automatic pre-emptive right. Students had to furthermore provide that the pre-emptive right is applicable in this case, because this is a private company, unless altered, limited or negated by the Memorandum of Incorporation. They had to mention that in terms of section 39(1)(b) of the Companies Act 71 of 2008, shareholders' pre-emptive rights in a private company do not apply to shares issued in terms of options or conversion rights, shares issued for future services or benefits, and when there is a capitalisation issue.

**See your Module Online Letter at learning unit 5, paragraph 5.4.1, your prescribed textbook at paragraph 4.7.5, and section 39 of the Companies Act 71 of 2008.**

#### **QUESTION 4**

- 4.1.1 To answer this question successfully, students had to note that this is a disposal of a greater part of the assets of the company and, consequently, it is a fundamental transaction. Secondly, since Dolphins Hides Ltd is a public company, it means that it is a regulated company and consequently this transaction is an affected transaction. Lastly, because it is an affected transaction, the Takeover Regulations will apply.

**See your Module Online Letter at learning unit 8, paragraphs 8.1–8.3, your prescribed textbook at paragraphs 10.1–10.2.1 and sections 112 and 115 of the Companies Act 71 of 2008.**

- 4.1.2 To answer this question successfully, students had to mention that the transaction needs to be approved by a special resolution and if the resolution is opposed by at least 15% of shareholders who were entitled to vote on the resolution, the approval of the court is required if, within five business days of the vote, the company is requested to seek court approval by a shareholder who voted against the resolution.

**See your Module Online Letter at learning unit 8, paragraph 8.6 and your prescribed textbook at paragraph 10.3.4.**

- 4.2 To answer this question successfully, the students had to provide that the resolution for commencement of business rescue plan may be set aside before the adoption of business rescue plan when there is no reasonable basis for believing that the company is financially distressed; when there is no reasonable prospect for rescuing the company; and when the company failed to comply with procedural requirements in terms of section 129 of the Companies Act 71 of 2008. Secondly, they had to provide that the appointment of the business rescue practitioner may be set aside when the practitioner does not comply with section 138 of the Companies Act 71 of 2008; when the business rescue practitioner is not independent of the company; and when the business rescue practitioner lacks the necessary skills.

**See your Module Online Letter at learning unit 9, paragraph 9.6, your prescribed textbook at paragraph 12.5.8 and sections 145 and 147 of the Companies Act 71 of 2008.**

## **QUESTION 5**

To successfully answer this question, students had to indicate that an insider is somebody who has inside information through being a director, employee, shareholder of an issuer of securities on a regulated market to which the information relates, or having access to such information by virtue of employment, office or profession or where such person knows that the direct source of such information was a person described above. Secondly, inside information means specific

information that has not been made public and which is obtained or learned as an insider and if it were made public, would likely materially affect the price or value of any security listed on a regulated market.

**See your Module Online Letter at learning unit 11, paragraph 11.2 and your prescribed textbook at paragraph 11.2.1.**