

# **Tutorial Letter 201/2/2015**

**Company Law**

**LML4806**


**Semester 2**

**Department of Mercantile Law**

**IMPORTANT INFORMATION:**

This tutorial letter contains important information  
about your module.

BAR CODE



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Dear Student

## 1 FEEDBACK ON ASSIGNMENT 01

The duties of directors have been partially codified in the Companies Act 71 of 2008. A director of a company is under a duty to avoid a conflict of interest, to disclose personal financial interests (section 75) and to communicate information to the board for purposes of section 76(2)(b).

The duty to avoid a conflict of interest emanates from the common law – see *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168. Chris has a duty to avoid a conflict of interest between himself and Zero Degrees. In terms of section 75 Chris also has a legal duty to disclose any personal financial interest which he has and may be conflict of the interests of Zero Degrees.

Section 75(6) provides that if a director acquires a personal financial interest in a matter in which the company has a material interest after the matter was approved by the company, the director must promptly disclose to the board the nature and extent of that interest and the material circumstances relating to the director's acquisition of that interest.

In terms of section 76(2)(b) a director has a duty to disclose to the board at the earliest practicable opportunity any information that comes to his attention unless he reasonably believes that the information is: immaterial to the company; or generally available to the public; or known to the other directors; or he is bound not to make a disclosure by reason of a legal or ethical obligation of confidentiality.

In *Kukama v Lobelo* the court held that section 76(2)(b) creates a duty on the part of a director to communicate at the earliest practicable opportunity any information that comes to his attention to his board.

You should have reached a proper conclusion. Chris is under an obligation to disclose to the board of Zero Degrees (Pty) Ltd about his personal gains.

**See your prescribed textbook par 6.3.**

## 2 FEEDBACK ON ASSIGNMENT 02

For purposes of this assignment you should have discussed a compromise with creditors in terms of section 155. A compromise is an agreement between a company and its creditors in terms of which the creditors agree to accept less than their full claims against the company in full settlement of what is due to them.

A company's board of directors or the liquidator of such a company (if it is being wound up) may propose a compromise of its financial obligations to all of its creditors or all the members of any class of its creditors.

In terms of section 155(2) of the Companies Act 71 of 2008 the proposal of compromise is made by delivering a copy of the proposal and notice of meeting to consider the proposal to the Commission and to every creditor of the company or every member of the relevant class of creditors whose name and address is known to, or can reasonably be obtained by, the company. A proposal for a compromise must contain all the prescribed information.

In terms of section 155(6), the proposal for a compromise is adopted by the creditors or members of a company if it is supported by a majority in number, representing at least 75% in value of the creditors present and voting in person or by proxy at a meeting called to consider the proposal.

Section 155(7)(a) provides that if a proposal regarding a compromise of a company's financial obligations to all of the company's creditors is duly adopted, the company may apply to the High Court for an order approving the proposal. In terms of such an application, the High Court may also sanction the compromise as embodied in the proposal, if it is just and equitable to do so. In determining whether it would, in fact, be just and equitable to sanction the proposal for a compromise, the High Court must have regard to:

- the number of creditors of any affected class of creditors who were present or represented at the meeting and who voted in favour of the proposal; and
- in the case of a compromise in respect of a company that is being liquidated, a report of the Master required in terms of Chapter 14 of the Companies Act 61 of 1973.

Section 155(8)(c) is binding on all the company's creditors or all of members of the relevant class of creditors, as the case may be, as of the date on which it is filed.

See your prescribed textbook par 12.9 to 12.11.

<b>3      OCTOBER/NOVEMBER 2014 EXAMINATION</b>
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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. Feedback is also provided in this Tutorial Letter 201. The questions that you will find below were taken from the October/November 2014 exam paper.

### QUESTION 1

- 1.1 The Memorandum of Incorporation of Guns 'n Roses (Pty) Ltd ('the company') provides that the main business of the company is the manufacturing and sale of toy guns. Mr Hoodlum, one of the directors, has been authorised by a board resolution to act on behalf of the company. While acting on behalf of the company Mr Hoodlum concludes a contract with Mr Brothel for the purchase of a nightclub. Mr Brothel has no knowledge of the contents of the Memorandum of Incorporation of the company. Mr Orthodox, a majority shareholder of the company, is upset about the purchase of the nightclub. Mr Orthodox approaches you for legal advice and requires you to advise him on the following:
- 1.1.1 Is the contract concluded by Mr Hoodlum and Mr Brothel valid and enforceable against the company? Give reasons for your answer. **(5)**
- 1.1.2 Are there any remedies available to him as shareholder in the case where the company has already concluded the contract? Give reasons for your answer. **(5)**
- 1.1.3 Are there any remedies available to him as shareholder in the case where the company and its directors are still contemplating the conclusion of the contract? Also discuss whether Mr Brothel may have any claims against the company or its directors in such a case. Give reasons for your answer. **(5)**
- [15]**

- 1.2 The Companies Act 71 of 2008 introduces the solvency and liquidity test which directors of companies must apply prior to embarking on certain actions or transactions. With reference to this statement you are required to do the following:
- 1.2.1 Explain the requirements of the solvency and liquidity test as set out in section 4 of the Companies Act 71 of 2008. **(5)**
- 1.2.2 List the actions or transactions to which the solvency and liquidity test must be applied. **(5)**
- [10]**

## QUESTION 2

- 2.1 Sipho, a director of Blue Bells Limited, a company which is listed on the Johannesburg Stock Exchange, comes to see you for advice. He informs you that Blue Bells Limited, a subsidiary of ABC Limited, which is also listed on the Johannesburg Stock Exchange, wishes to have voting power on decisions made by ABC Limited. He also tells you that Blue Bells Limited would like to acquire 26% of the shares in ABC Limited.

Sipho further informs you that he was advised by his friend, Jonathan, who is doing his articles at an auditing firm, that ABC Limited would be required to prepare consolidated financial statements. Sipho does not know what consolidated financial statements are and whether or not these would have to be prepared by ABC Limited.

Advise Sipho on the following:

- 2.1.1 Whether Blue Bells Limited may acquire 26% of the shares in ABC Limited and whether it may have voting power on resolutions adopted at general meetings of ABC Limited if it acquires any shares in ABC Limited. **(5)**
- 2.1.2 What consolidated financial statements are and whether Jonathan is correct in that consolidated financial statements would have to be prepared by ABC Limited. **(5)**
- [10]**

- 2.2 With reference to examples, discuss the difference between affected and fundamental transactions under the Companies Act 71 of 2008. In your answer you should also discuss the role and the significance of the Takeover Regulation Panel under the Companies Act 71 of 2008.

The mark allocation for this question is as follows:

- the difference between fundamental and affected transactions (5)
  - examples of fundamental transactions (3)
  - examples of affected transactions (3)
  - the role and significance of the Takeover Regulation Panel (4)
- [15]**

### **QUESTION 3**

- 3.1 The directors of Koma Business Solutions (Pty) Ltd discover that Mpho, one of their co directors, has been redirecting company funds from the accounts of Koma Business Solutions (Pty) Ltd to his personal account. They also discover that these illicit transactions have been taking place undetected for a period of five years. The directors of Koma Business Solutions (Pty) Ltd decide to press criminal charges of fraud and theft.

- 3.1.1 Consider whether under the circumstances of this case the board will have grounds to successfully obtain a delinquency order against Mpho in terms of the Companies Act.

**(7)**

- 3.1.2 Discuss requirements that must be satisfied in order to have an order of delinquency rescinded or set aside.

**(3)**

**[10]**

- 3.2 Nomsa and Jacky have recently bought shares in Neo Enterprises (Pty) Ltd. Their shares entitle them each to 20% of voting rights in the issued shares. The company has realised good profits for the 2013 financial period, and as a result, the board of directors propose a merger with Aloewell (Pty) Ltd. Nomsa and Jacky are informed that a resolution of shareholders adopted at a properly constituted meeting is required to effect a merger. Delia, who holds 30% of the voting rights in Neo Enterprises (Pty) Ltd wants to abstain from voting because she is opposed to the merger, whereas Nomsa and Jacky intend to

vote in favour of it. The remaining 30% of the voting rights in Neo Entreprises is held by various minority shareholders.

Since Nomsa and Jacky are not familiar with company law, they approach you for advice on the following:

- 3.2.1 Discuss the requirements for the approval of this proposed transaction. **(5)**
  - 3.2.2 Explain what is meant by an ordinary resolution in terms of the Companies Act 71 of 2008 and state the requirements of an ordinary resolution. **(2)**
  - 3.2.3 The requirements for a notice to convene a meeting of shareholders. **(8)**
- [15]**

#### **QUESTION 4**

4.1 Mothibi is the director of a printing company, Print Your Paper (Pty) Ltd, which specialises in the printing of academic journals. Mothibi is concerned about the trend to move away from publishing hard copies of journals towards publishing academic journals electronically. Although Print Your Paper (Pty) Ltd is not insolvent and does not have cash flow problems, he is considering entering into an agreement with the creditors of Print Your Paper (Pty) Ltd in terms of which Print Your Paper (Pty) Ltd offers to pay 80% of all creditors' claims against the company in full and final settlement. Mothibi knows the offer will be accepted by most of the creditors, but a small minority might reject the offer. Mothibi approaches you for legal advice in order to establish whether there is a specific procedure in the Companies Act 2008 that makes it possible to make the settlement agreement binding on all creditors if the offer to creditors is accepted by most of them. In your opinion to Mothibi you must do the following:

- 4.1.1 Clearly suggest and name a suitable procedure by referring to the requirements that must be met (you do not have to discuss the contents of the documentation). **(8)**
  - 4.1.2 Discuss the effects of such a transaction, if approved, and the requirements that need to be met after approval. **(7)**
- [15]**

4.2

- 4.2.1 Name four insider-trading offences provided for in the Financial Markets Act. **(4)**
  - 4.2.2 Fully explain who (which persons) can be held liable for insider trading offences. **(6)**
- [10]**



**4 FEEDBACK ON OCTOBER/NOVEMBER 2014 EXAMINATION**

**NB: Please note that the feedback given below is not a detailed memorandum but serves as a guideline only to assist you in answering the previous year's examination paper. You will have to refer to the textbook and the study guide 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**

1.1.1 To answer this question successfully, students should have referred to the impact of section 19(1) of the Companies Act 71 of 2008 (the Act) on the legal capacity of the company and the *ultra vires* doctrine. Section 19(1) of the Act provides that a company has all the legal capacity and the powers of a natural person except to the extent that a juristic person is incapable of exercising any such power. The company is also not restricted by its main business. Although the company's MOI may impose restrictions on the legal capacity of the company, any such restrictions would not render invalid any contract that conflicts with these restrictions (section 19(1)(b)(ii) read with section 20(1)). The company cannot rely upon the *ultra vires* doctrine in terms of section 19(4). Thus, the contract is valid and binding on the company and the other party to the contract.

**See your prescribed book at paragraph 2.13 and Module Online Letter at paragraph 4.2.**

1.1.2 Section 20(6) of the Act provides that each shareholder has a claim for damages against any person who fraudulently or due to gross negligence cause the company to do anything inconsistent with the Act or a limitation, restriction or qualification on the powers of the company as stated in its Memorandum of Incorporation, unless it is ratified by special resolution in terms of section 20(2) of the Act.

**See your prescribed book at paragraph 2.13 and Module Online Letter at paragraph 4.2.**

1.1.3 One has to refer to the remedies in section 20(4) read with section 20 (5) of the Act. A shareholder, director or prescribed officer may institute proceedings to prevent the company from doing anything inconsistent with the Act or a specified limitation under the memorandum. Moreover, a third party, who did not have actual knowledge of this limitation or qualification and acted in good faith, will in such a case have a claim for any damages suffered as a result.

**See your prescribed book at paragraph 2.13 and Module Online Letter at paragraph 4.2.**

1.2.1 Students should have stated the definition of the solvency and liquidity test as set out in section 4(1) of the Act.

**See your prescribed book at paragraph 4.4 and Module Online Letter at paragraph 6.3.**

1.2.2 To answer this question successfully, the students should have identified the actions or transactions to which the solvency and liquidity test must be applied. These actions or transactions are dealt with in your **prescribed book at paragraph 4.4.**

## **QUESTION 2**

2.1.1 The students should have discussed and applied the requirements set out in section 48(2)(b) of the Companies Act 71 of 2008 (the Act). Having applied these requirements, they should have concluded by stating that Blue Bells may not acquire 26% of the shares in ABC Limited. Even if Blue Bells acquired 10% of the shares in ABC Limited these shares would not have any voting rights.

**See your Module Online Letter at paragraph 6.2.**

2.1.2 Consolidated financial statements are the combined financial statements of a holding company and its subsidiaries. They present a summary of the financial position of a holding company and its subsidiaries and enable one to assess the overall position of an entire group of companies. The Act does not specifically require a group of companies to prepare consolidated financial statements. However, under the International Financial Reporting Standards (IFRS) consolidated financial statements must be prepared when the IFRS applies to that company. If IFRS does not apply to a company, consolidated financial statements would not be required. Listed companies are required to prepare consolidated financial statements. Blue Bells Limited and ABC Limited are both public companies and are both listed on the JSE Limited, therefore Jonathan is correct in saying that consolidated financial statements of ABC Limited would have to be prepared.

**See your prescribed book at paragraph 3.4 and Module Online Letter at paragraph 7.8.**

2.2 In order to answer this question successfully, one should understand the difference between fundamental transactions and affected transactions. Fundamental transactions and affected transactions significantly affect the ownership of a company's assets or signal a significant change in its shareholding. A transaction is referred to as an "affected

transaction” if a regulated company is involved. A regulated company is a company to which Part B and Part C of the Act and the Takeover Regulations apply. Students should have given the examples of regulated companies as stated in section 118(1) of the Act.

Examples of fundamental transactions are disposals of all or the greater part of the assets or undertaking in terms of section 112, amalgamation or merger in terms of section 113 and a scheme of arrangement in terms of section 114. Students should be able to notice that these transactions will also qualify as affected transactions if a regulated company is involved. Examples of affected transactions are listed in section 117(1)(c).

The Takeover Regulation Panel (TRP) is established in terms of section 196 of the Act as a juristic person and as an organ of state within the public administration. The significance of the TRP is that it is a very important and powerful body in the regulatory regime established by the Companies Act 71 of 2008 to regulate affected transactions and it has jurisdiction throughout South Africa. It is independent and subject only to the Constitution of the Republic of South Africa 1996 and the law.

The role of the TRP is to regulate affected transactions in the manner required by Chapter 5 of the Act and the Takeover Regulations; to initiate or receive complaints relating to affected transactions and investigate complaints and issue compliance notices; to apply for a court order to wind up a solvent company in circumstances where there has been fraudulent or illegal activity and failure to comply with a compliance notice; consult with the Minister in respect of changes to the Takeover Regulations; and to approve all documents relating to an affected transaction, including announcements and circulars before posting or publication.

**See your prescribed book at paragraph 10.1–10.3 & 10.5 and Module Online Letter at paragraph 8.1–8.3 & 8.7–8.9.**

**QUESTION 3**

3.1.1 One should have considered the grounds for an application to declare a director delinquent set out in section 162 (5)(c) of the Companies Act 71 of 2008 (the Act). Depending on the grounds on which a person has been declared to be a delinquent, he will subsequently be either unconditionally disqualified from being a director for the rest of his life, or disqualified for a period of at least seven years, subject to any conditions that the court considers appropriate. Students should have given their opinion whether the circumstances of the case warrant a delinquency order.

**See your prescribed book at paragraph 6.8 and Module Online Letter at paragraph 2.8.**

3.1.2 In order to answer this question successfully, students should have discussed the requirements for the rescission or setting aside of an order of delinquency. These requirements are set out in section 162(11) and (12).

**See your prescribed book at paragraph 6.9 and Module Online Letter at paragraph 2.8.**

3.2.1 The requirements for the approval of this proposed transaction (merger) are set out in section 115 (2) of the Act. Neo Enterprises Ltd's shareholders need to approve the transaction by way of a special resolution at a shareholders' meeting held for the purpose of considering the proposed transaction. A special resolution is a resolution adopted with the support of at least 75% of the voting rights exercised on the resolution or a different percentage as specified in a company's MOI. The meeting must be attended by sufficient persons that have the right to exercise, in aggregate, at least 25% of all voting rights that are entitled to be exercised on that matter, or any higher percentage as may be required by the company's MOI.

**See your prescribed book at paragraph 10.3.2.2 and Module Online Letter at paragraph 8.4.**

3.2.2 Students should have referred to the definition of "ordinary resolution" in section 1 of the Act. An ordinary resolution is a resolution requiring more than 50% of the votes exercised. The Act allows a company to stipulate a higher percentage for the approval of all or some ordinary resolutions in its Memorandum of Incorporation (except a resolution for the removal of a director).

**See your prescribed book at paragraph 5.15.1.**

3.2.3 To answer this question successfully, students should have outlined the requirements for a notice to convene a meeting of shareholders. These requirements are set out in section 62 of the Act.

**See your prescribed book at paragraph 5.5 and Module Online Letter at paragraph 1.4.**

#### **QUESTION 4**

4.1.1 Section 155 (1) of the Companies Act 71 of 2008 (the Act) provides for a procedure, called a compromise, which specifically provides a remedy for the facts in this question. This section provides that a company may effect a compromise with its creditors, or a specific class of creditors, whether the company is in financial distress or not, unless it is in business rescue. This procedure is limited to a compromise between a company and its creditors/class of creditors, and not shareholders, like in the previous act. A proposal for the compromise must be made by delivering a copy of the proposal and notice of a meeting to consider the proposal to the Commission, and to every creditor, or class of creditor, depending on the circumstances, whose name and address is known to the company or can be reasonably obtained by the company. The proposal must contain certain prescribed information. Students should also refer to paragraph 12.11 in the prescribed book for the other requirements that must be met.

**See your prescribed book at pages 263–267 and Module Online Letter at paragraph 10.1–10.3.**

4.1.2 Students should have discussed the filing requirements and the effect of a sanctioned compromise. These are set out in section 155(8) and (9) of the Act and paragraph 12.11.5 in the prescribed book.

**See your prescribed book at paragraph 12.11.5 and Module Online Letter at paragraph 10.4.**

4.2.1. This question deals with insider trading, which is regulated by the Financial Markets Act 19 of 2012. The Financial Markets Act prohibits insider trading. The five insider-trading offences under section 78 of the Financial Markets Act are dealt with in paragraph 11.2.3 of the prescribed textbook. Students should have named four of these insider-trading offences.

**See your prescribed book at paragraph 11.2.3 and Module Online Letter at paragraph 11.3.**

4.2.2 For all offences except dealing for another person who has inside information, it is required that the person must be an insider who has inside information. Therefore, to be able to answer this question, students should know the definitions of "insider" and "inside information". The core of the insider trading concept is the fiduciary relationship between the insider and the company.

**See your prescribed book at paragraph 11.2.1 and Module Online Letter at paragraph 11.2.**