



Tutorial Letter 201/2/2018

COMPANY LAW

LML4806

Semester 2

Department of Mercantile Law

This tutorial letter contains important information
about your module.

BARCODE

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Dear Student

1. FEEDBACK ON ASSIGNMENT 01

Question (a)

The general principle

In terms of section 38 of the Companies Act 71 of 2008, the board of directors may resolve to issue shares in a company at any time in accordance with the provisions of and within the classes authorised in terms of the company's Memorandum of Incorporation. Thus the approval of the shareholders is not required for the issue of shares unless the Memorandum of Incorporation provides otherwise.

The provision of section 41

However, section 41 of the Companies Act requires shareholder approval by a special resolution for issuing shares in certain cases.

Shareholder approval for issuing shares in certain cases

- (i) Chief Executive Officer (prescribed officer)

Legal principle

In terms of section 41(1)(a) of the Companies Act 71 of 2008, the approval of the shareholders by special resolution is required where the issue of shares is to a present director or prescribed officer of the company.

Application of legal principle

A Chief Executive Officer of a company is a director or a prescribed officer of the company. The approval of the shareholders by special resolution will be required to issue the shares to him or her.

(ii) Mr Molefe (director)

Legal principle

Section 41(1)(a) of the Companies Act 71 of 2008 provides that the approval of shareholders by special resolution is required when shares are issued to future directors. Section 41(6) of the Act provides that a “future director” does not include a person who becomes a director of the company more than six months after acquiring a particular right.

Application of the legal principle

Mr Molefe would be a future director of the company because he will become a director in three months' time. Therefore, shareholder approval will be required to issue the shares to Mr Molefe.

(iii) Employees

Legal principle

In terms of section 41(2)(d) of the Companies Act, the approval of the shareholders of a company is not required if the shares are issued pursuant to an employee share scheme that satisfies the requirements of section 97 of the Companies Act.

Application of the legal principle

If the shares are issued to employees in terms of an employee share scheme which does satisfy the requirements of section 97 of the Companies Act, then the shareholders of Abayomi Ltd will not be required to approve the issue of the shares. However, if the requirements of section 97 of the Companies Act are not satisfied, then the approval of the shareholders by special resolution will be required.

Question (b) – The consequences of non-compliance

Legal principle

In terms of section 41(5) of the Companies Act 71 of 2008, a director of a company is liable for any loss, damages or costs sustained by a company as a direct or indirect consequence of the director having been present at a meeting or having participated in the making of such a decision by written resolution and when such a director failed to vote against the issue of any shares despite knowing that the issue of those shares was inconsistent with section 41.

Note that the provisions of section 77(3)(e)(ii) may also apply.

Application of legal principle

Thus in terms of section 41(5) of the Act, the directors of Abayomi Ltd will be personally liable for any loss, damages or costs sustained by the company if they do not follow the correct procedures to issue the shares.

Refer to paragraphs 5.4 and 5.4.2 of the study guide and paragraphs 9.5 and 9.6 of the prescribed textbook.

Question (c) – Payment for the shares

In terms of section 40(1)(a) of the Companies Act 71 of 2008, the shares must be issued for adequate consideration. The adequate consideration for the shares must be determined by the board of directors before the company issues the shares.

2. FEEDBACK ON ASSIGNMENT 02
Discussion of key definitions: -

“Insider trading” refers to the sale and purchase of a company’s securities by insiders, persons associated with the company and who possess price sensitive information which is not generally available to the public.

An “insider” is a person who has inside information by:

- being a director, employee, shareholder of an issuer of securities listed on a regulated market to which the inside information relates; or
- having access to such information by virtue of employment, office or profession;
- or have obtained the inside information from a person in circumstances where the person knows that the information is obtained from my person who is an insider.

“Inside information” is

- specific or precise information
- that has not been made public and

- which is obtained or learned as an insider and
- if it were made public, would be likely to have a material effect on the price or value of any security listed
- on a regulated market.

Application of the relevant definitions

The news about the invention is inside information because it meets the criteria set out above. The information was obtained by Lerato who is an insider because she is an employee of Monifa Ltd.

Lerato

Lerato told Fulu about the content of the inside information and therefore is guilty of the disclosure offence.

Lerato encouraged Thakhani to purchase shares in Monifa Ltd and, even though she did not disclose the inside information to Thakhani, she is guilty of the offence of encouraging insider trading.

Fulu

Fulu is guilty of the offence of dealing since she knew that Lerato disclosed inside information to her and, based on this information, she purchased some shares of Monifa Ltd for herself.

Edward

Edward is not guilty of any offence because he did not have any inside information and bought the shares in Monifa Ltd independently.

Thakhani

Thakhani is not guilty of any offence because she did not purchase any shares in Monifa Ltd.

Refer to sections 77 and 78 of the Financial Markets Act 19 of 2012 and to learning unit 11 of the study guide.

<h3>3. OCTOBER/NOVEMBER 2017 EXAMINATION</h3>
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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. 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 2017 examination paper.

Please note that this semester's examination paper will be out of 80 marks.

QUESTION 1

[30]

- 1.1 The shareholders of Injabulo (Pty) Ltd, a black-economic empowerment company, are scheduled to hold a shareholders' meeting at 09:00 at the Head Office of the company. Injabulo (Pty) Ltd has 20 shareholders. At 10:00, 11 shareholders are present at the meeting. They are able to exercise in aggregate 24% of all the voting rights that are entitled to be exercised in respect of the matters to be decided at the meeting.

Two of the shareholders of the company have indicated to the chairperson that they will attend the meeting, but are delayed in traffic due to bad weather. These two shareholders each hold 2% of the voting rights in Injabulo (Pty) Ltd.

The chairperson of the board of directors consults you, as the secretary of the company, on whether the shareholders' meeting may proceed. With reference to the Companies Act 71 of 2008, advise the chairperson of the board of directors of his options in these circumstances.

(15)

- 1.2 Sifiso, a former director of Lerato (Pty) Ltd ("the company"), was convicted of fraud during his term of office as a director of the company. He was sentenced to 12 months' imprisonment without the option of a fine by the High Court. He was therefore disqualified to act as a director of the company and was accordingly removed from office one year ago. However, Sifiso believes that he has since been rehabilitated and wishes to be reinstated as a director of the company. Sifiso and Lukas are the only shareholders of the company. Sifiso has decided to apply to court for permission to be allowed to act as a director of the company despite his disqualification. Lukas is strongly opposed to Sifiso being reinstated as director of the company. With reference to the Companies Act 71 of 2008 and relevant case law, advise Sifiso on his prospects of success in obtaining such a court order.

(15)

QUESTION 2

[20]

- 2.1 Discuss the doctrine of constructive notice and the exceptions which apply to it. **(10)**
- 2.2 Tom (Pty) Ltd holds 25% of the voting shares in Pluto (Pty) Ltd, while Jerry (Pty) Ltd holds 20% of the voting shares in Pluto (Pty) Ltd. The remaining 55% of the voting shares in Pluto (Pty) Ltd are held by Mickey (Pty) Ltd.

Explain what is meant by a “group of companies” and discuss the factors one would consider to determine whether a company is a subsidiary company. Also explain the concept of a wholly-owned subsidiary. Indicate by giving reasons for your answer, whether Pluto (Pty) Ltd is a subsidiary of Tom (Pty) Ltd, Jerry (Pty) Ltd and/or Mickey (Pty) Ltd. **(10)**

QUESTION 3

[35]

- 3.1 The directors of Smarties (Pty) Ltd, M & M (Pty) Ltd and Wine Gums Galore (Pty) Ltd decide that it would be in the best interests of the respective companies to amalgamate or merge into one new company, Sweets for All (Pty) Ltd. Advise the directors of the respective companies whether such an amalgamation or merger is permitted in terms of the Companies Act of 2008, and, if so, of the requirements for such amalgamation or merger. Also explain the effect of an amalgamation or merger. **(15)**
- 3.2 Sandwich Delight (Pty) Ltd provides sandwiches to office outlets in Cape Town. The company is financially distressed and is under business rescue. The company buys its bread from a local bakery, Cape Bakeries (Pty) Ltd. They have since found that they can make sandwiches at a much lower cost by baking the bread themselves instead of purchasing it from Cape Bakeries (Pty) Ltd.
- 3.2.1 Discuss whether business rescue proceedings will enable Sandwich Delight (Pty) Ltd to **cancel** its contract with Cape Bakeries (Pty) Ltd, and whether Sandwich Delight (Pty) Ltd will be liable for breach of contract if they do so. **(10)**
- 3.2.2 Sandwich Delight (Pty) Ltd has appointed Andile as business rescue practitioner. Andile is believed to be an excellent choice by the company as he is a former

director of the company and a good friend of the current directors. Discuss whether Andile will qualify as a business rescue practitioner of Sandwich Delight (Pty) Ltd in terms of the Companies Act 71 of 2008. **(5)**

3.2.3 After 11 months Sandwich Delight (Pty) Ltd is still under business rescue. The directors are concerned whether this is permissible under the Companies Act 71 of 2008. Advise the directors of Sandwich Delight (Pty) Ltd of the circumstances under the Companies Act 71 of 2008 when it would be acceptable for business rescue to endure for a period of 11 months or longer. **(5)**

QUESTION 4

[15]

Thandeka is the secretary of Veryslim Ltd, a company that manufactures slimming tablets. At a board meeting at which Thandeka is required to take down minutes, the board discusses the development of a revolutionary new manufacturing process for slimming tablets. Thandeka realises that the implementation of the new procedure will influence the profitability of the company positively. She informs her mother, Veronica, of the new manufacturing process. Veronica immediately contacts her broker, Sam, and instructs him to purchase shares in Veryslim Ltd on her behalf. Veronica also buys shares through Sam for her son, Phineas. Thandeka further advises her friend Bongi to buy shares in Veryslim Ltd. However, Bongi decides not to buy the shares because Thandeka will not tell her why she should buy the shares. Beauty, Bongi's sister, overhears part of the conversation between Thandeka and Bongi. When she asks Thandeka whether she should buy shares in Veryslim Ltd, Thandeka tells her that she should not buy shares in Veryslim Ltd because she dislikes Beauty. When the new manufacturing process is implemented, the price of the shares of Veryslim Ltd increases dramatically.

Explain whether Thandeka, Veronica, Sam, Phineas and Bongi can be held liable for any **offences** under the Financial Markets Act 19 of 2012 regulating insider trading. Do not include a discussion of the definitions of an "insider" or "insider trading" in your answer and do not discuss the defences to the insider trading offences. **(15)**

TOTAL: [100]

4. FEEDBACK ON OCTOBER/NOVEMBER 2017 EXAMINATION

QUESTION 1

- 1.1 In terms of section 64 of the Companies Act 71 of 2008 ('the Act'), a shareholders' meeting may not begin until sufficient persons are present at the meeting to exercise in aggregate at least 25% of all the voting rights that are entitled to be exercised in respect of at least one matter to be decided at the meeting. This is subject to the Memorandum of Incorporation of the company which may specify a higher or a lower percentage instead of the 25% requirement.

In companies with more than two shareholders, at least three shareholders are required to be present and the 25% requirement (or a different requirement if stated in the Memorandum of Incorporation) must also be satisfied.

In this situation, assuming that the Memorandum of Incorporation has not changed the quorum requirements, a quorum is not present because the shareholders present at the meeting may exercise 24% of the voting rights instead of 25%. The company has more than two shareholders and 11 shareholders are however present at the meeting. Therefore, the requirement in section 64(3) has been satisfied.

Section 64(4) of the Act provides that if, within an hour after the scheduled time for the meeting to commence, the quorum is not met, the meeting may be postponed without motion, vote or further notice for one week.

In this situation, the one-hour period referred to section 64(4) of the Act has expired and there is no quorum. Thus the chairperson may postpone the meeting without motion, vote or further notice for one week.

In terms of section 64(5) of the Act, the person who presides over the meeting that cannot commence due to the fact that a quorum is not met, may extend the one-hour period allowed in terms of section 64(4) for a reasonable period on the grounds that:

- (i) exceptional circumstances such as weather, transport or electronic communication, have impeded the ability of the shareholders to be present at the meeting; or

- (ii) one or more shareholders who have been delayed have communicated an intention to attend the meeting and those shareholders, together with others in attendance, would satisfy the quorum requirements.

There are two shareholders who have indicated that they will attend the meeting and who together hold 4% of the voting rights. The two shareholders are held up in the traffic owing to bad weather which is a reason given in section 64(5) for the chairperson to extend the one-hour limit for a reasonable period. Therefore, the chairperson may extend the one-hour period for a reasonable period on the grounds that exceptional circumstances, being the weather, impede the shareholders from attending the meeting at the scheduled time and/or when adding the voting rights of the two shareholders who have indicated that they will attend, the aggregate of the voting will be 28%, which is more than the 25% required.

In conclusion, the chairperson may either postpone the meeting for a week without motion, vote or further notice or extend the one-hour limit for a reasonable period and wait for the two shareholders to arrive.

- 1.2 The circumstances in this question are regulated by section 69(11) of the Companies Act 71 of 2008 ('the Act') was considered in the cases of *Ex parte Barron* and *Ex parte Tayob*. In terms of section 69(11) of the Act, a court may exempt certain disqualified persons from their disqualification. A court is empowered to grant an exemption to a person who was convicted of fraud and sentenced to imprisonment without the option of a fine or a fine exceeding the prescribed minimum.

In *Ex parte Barron*, the applicant had been a director of several private companies of which he and his wife were the only shareholders. He had tried to circumvent certain regulations prohibiting the export of ostrich leather. He did this by pretending that the consignment consisted of ostrich feathers when, in fact, it consisted of ostrich leather. That constituted fraud and he was tried and convicted on this charge. He was therefore disqualified to be a director. He subsequently applied to court for authorisation to act as a director. The court held that the factors that affected the discretion of the court were the following:

- the type of offence;
- whether or not it was a first conviction;
- the type of punishment imposed; and
- the attitude of shareholders and whether all the shareholders supported the applicant's application

The court held that it could be more lenient in a case where a private company was concerned because the director of a public company obviously deals with funds belonging to a vast number of people.

In *Ex Parte Tayob* the applicants had been convicted of bribery. One year after their conviction they brought an application for permission to be allowed to act as directors despite their disqualification. The court held that bribery and corruption pose a serious threat to an open and honest community. The court therefore concluded that too little time had lapsed between the date of the conviction and the date of the application to prove that the applicants had been rehabilitated from their dishonest ways. The application was therefore refused.

Factors which would support Sifiso's application are the fact that the company is a private company and not a public company. It will also count in his favour if this is his first conviction.

Factors that will count against Sifiso's application are the fact that Lukas objects to his becoming a director; this will be taken into account by the court. As in *Ex Parte Tayob*, too little time has lapsed in the given scenario between the date of the conviction and the date of the application.

Based on the factors counting against him, Sifiso will most probably not be successful with his application.

QUESTION 2

[20]

- 2.1 The doctrine of constructive notice provides that third parties are deemed to be fully acquainted with the contents of the company's public documents whether they have read them or not. The doctrine of constructive notice has been partially abolished by section 19(4) of the Companies Act. Third parties are no longer deemed to have had notice or

knowledge of the contents of the public documents of the company merely because they have been filed with the Companies and Intellectual Property Commission or are accessible for inspection at the company's office.

Even though the doctrine of constructive notice has been abolished, the Companies Act (section 19(5)) introduces two exceptions when the doctrine of constructive notice will apply. The first is that a person is deemed to have knowledge of any ring-fencing provisions in the company's Memorandum of Incorporation. Ring-fencing provisions are provisions prohibiting any provision of the Memorandum of Incorporation to be amended or any restrictive condition or procedure for its amendment. This exception applies only if the company's name includes the letters "RF" and the Notice of Incorporation contains a prominent statement drawing attention to such provision.

The second exception where the doctrine of constructive notice applies is in the case of a personal liability company. Persons dealing with personal liability companies are deemed to be aware of the effect of the directors' and former directors' joint and several liability for debts and liabilities of the company contracted during their periods of office.

2.2

- A group of companies means a holding company and all of its subsidiaries.
- Section 3(1) of the Companies Act 71 of 2008 defines a 'subsidiary company'.
- A company is a subsidiary of another juristic person if –

that company or one or more of its nominees or subsidiaries alone or in combination is directly or indirectly able to exercise the majority of the general voting rights or

- can directly or indirectly control the exercise of the majority of the voting rights or
- can appoint or elect directors who control a majority of the voting rights in board meetings or
- can control the appointment of such directors

- A wholly-owned subsidiary is a company in which all of the voting rights are held by another person or persons.

In the facts provided, Tom (Pty) Ltd and Jerry (Pty) Ltd both hold a minority of the voting shares in Pluto (Pty) Ltd. Pluto (Pty) Ltd is not a subsidiary of Tom (Pty) Ltd or Jerry (Pty) Ltd because these companies are not able to exercise or control the exercise of the majority of the voting rights in Pluto (Pty) Ltd.

Mickey (Pty) Ltd holds 55% of the voting rights in Pluto (Pty) Ltd and can therefore exercise the majority of the voting rights in Pluto (Pty) Ltd. For this reason, Pluto (Pty) Ltd is a subsidiary of Mickey (Pty) Ltd.

QUESTION 3

3.1 This transaction would constitute an amalgamation or merger in terms of section 113(2) of the Companies Act 71 of 2008 provided it that the amalgamation or merger of the three profit companies would result in the formation of a new company, Sweets for All (Pty) Ltd, holding all the assets and liabilities of Smarties (Pty) Ltd, M & M (Pty) Ltd and Wine Gums (Pty) Ltd.

Upon completion of the amalgamation or merger, Smarties (Pty) Ltd, M&M (Pty) Ltd and Wine Gums (Pty) Ltd would cease to exist.

The amalgamation or merger of Smarties (Pty) Ltd, M&M (Pty) Ltd and Wine Gums (Pty) Ltd is permissible provided that the directors of each company reasonably believe that, upon completion of the amalgamation or merger, Sweets for All (Pty) Ltd will satisfy the solvency and liquidity test.

The transaction must first be approved by a special resolution of the shareholders of all three companies.

The notice of a shareholders' meeting to consider the resolution must be accompanied by a copy of the amalgamation or merger agreement or a written summary of the precise terms of the transaction and details of the proposed special resolution and appraisal rights.

The three companies would have to enter into a written agreement setting out the terms and means of effecting the amalgamation or merger.

In particular, they would have to set out the following particulars in the agreement:

- the memorandum of incorporation of the newly formed company
- the name and identity number of each proposed director of the new company
- the manner in which the securities of each merging company are to be converted into securities of the proposed new company
- If securities of any of the merging companies are not to be converted into securities of the merged company, the consideration that the holders of those securities are to receive instead.
- the manner of payment of any consideration instead of the issue of fractional securities
- details of the proposed allocation of the assets and liabilities of the merging companies
- details of any arrangement or strategy necessary to complete the merger; and
- the estimate cost of the proposed merger.

3.2.1 In terms of section 136(2) of the Companies Act 71 of 2008, the business rescue practitioner will not have the power to cancel any provision of a contract. He may, however, apply urgently to the court to cancel either entirely, partially or conditionally any obligation of the company on terms that are just and reasonable in the circumstances.

A court may not cancel any provision of an employment contract or an agreement to which section 35A or 35B of the Insolvency Act would have applied, had the company been liquidated.

The other party to the contract that has been partially or entirely cancelled may only claim damages from the company and not, for instance, specific performance of the contract.

Sandwich Delight (Pty) Ltd will therefore not have the right to cancel the agreement but the business rescue practitioner will have to apply to court to cancel the agreement. A

court will cancel the agreement only if the terms are just and reasonable in the circumstances. Cape Bakeries (Pty) Ltd will have the right to claim damages from Sandwich Delight (Pty) Ltd if the contract is cancelled.

3.2.2 In order to be a business rescue practitioner, the person must not have any other relationship with the company that would lead a reasonable and informed third party to conclude that his or her integrity, impartiality or objectivity is compromised by that relationship. The fact that Andile is a former director of the company and a good friend of the current directors could lead a reasonable and informed third party to conclude that his integrity, impartiality or objectivity is compromised. Therefore, Andile will most probably not qualify to be a business rescue practitioner of Sandwich Delight (Pty) Ltd.

3.2.3 If a company's business rescue proceedings have not ended within three months after the start of those proceedings or such longer time as the court on application by the practitioner may allow, the practitioner must –

- prepare a report on the progress of the business rescue proceedings and update it at the end of each subsequent month until the end of those proceedings and
- deliver the report and each update to each affected person and to the court (if the proceedings have been the subject of a court order) or to the Companies and Intellectual Property Commission in any other case

Therefore, it is acceptable for the business rescue proceedings to endure for eleven months provided that the business rescue practitioner complies with the above requirements.

QUESTION 4

In terms of the Financial Markets Act 19 of 2012, an insider who knows that he or she has inside information and who deals directly or indirectly or through an agent (for example, a stockbroker) for his or her **own account** in the securities listed on a regulated market to which the inside information relates, commits an offence (s 78(1)).

An insider who knows that he or she has inside information and who deals directly or indirectly or through an agent (for example a stockbroker) for **any other person** in the securities listed on a regulated market to which the inside information relates, commits an offence (s 78(2)).

A person who deals for an insider directly or indirectly or through an agent in the securities listed on a regulated market to which the inside information possessed by the insider relates or which are likely to be affected by it, who knew that such person is an insider, commits an offence. (s 78(3))

An insider who knows that he/she has inside information commits an offence if he or she discloses that information to another person (s 78(4)(a)). Even if the other person does not commit any insider trading offence after the disclosure, it is still an offence to disclose it.

It is also an offence for an insider who knows that he or she has inside information to encourage or cause another person to deal or to discourage or stop another person from dealing in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it (s 78(5)).

Thandeka is guilty of disclosing inside information to her mother, Veronica, and friend, Bongi. Thandeka is also guilty of discouraging Beauty from buying shares because she told Beauty not to buy shares in Vervyslim Ltd.

Veronica is guilty of dealing through an agent (Sam) for her own account and on behalf of her son Phineas based on inside information.

Sam is not guilty of an offence provided he did not have knowledge of the inside information and provided he did not know that Thandeka was an insider.

Phineas is not guilty of any offence because he had no knowledge of the inside information.

Bongi is not guilty of an offence because she did not have knowledge of the inside information and she did not buy any shares.