

Tutorial Letter 201/2/2014

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 Students

1 FEEDBACK ON ASSIGNMENT 01

The appointment of a business rescue practitioner is regulated by section 138 of the Companies Act 71 of 2008.

There are six requirements for appointment as a business rescue practitioner:

- (1) The person must be a member in good standing of a legal, accounting or business management profession accredited by the Companies Commission.
- (2) The person must be licensed by the Companies Commission to practise as a business rescue practitioner.
- (3) The person may not be subject to an order of probation in terms of section 162(7).
- (4) The person must not be disqualified from acting as director of a company in terms of section 69(8).
- (5) 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.
- (6) The person must not be related to a person who has such a relationship contemplated above.

Any business rescue practitioner, irrespective of whether he or she was appointed by the board or by the court after a business rescue order was issued, may be removed by means of an order of court in terms of section 139(2) of the Companies Act 71 of 2008.

On application by an affected person, or on its own initiative (*mero motu*), a court may remove a business rescue practitioner from office based on any one of the six grounds listed in section 139(2). These are as follows:

- incompetence or failure to perform his or her duties as business rescue practitioner of the particular company
- failure to exercise the proper degree of care in performing his functions

- engaging in illegal acts or conduct
- no longer meeting the requirements for appointment as a business rescue practitioner as prescribed by section 138
- having a conflict of interests or lack of independence
- becoming incapacitated and unable to perform the functions of a business rescue practitioner and being unlikely to gain that capacity within a reasonable time

See your prescribed textbook par 12.6.

2 FEEDBACK ON ASSIGNMENT 02

Insider trading is now regulated by the Financial Markets Act 19 of 2012 ('FMA'). Previously, it was regulated by the Securities Services Act 36 of 2004, but this Act has now been repealed.

Before the insider trading offences are discussed, the concepts of "inside information" and "insider" must be defined. Inside information is specific or precise information that has not been made public, 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. An insider is a person who has inside information owing to his or her role as director, employee or shareholder of an issuer of securities listed on a regulated market, or who has access to such information by virtue of his employment, office or profession, or where such person knows that the source of the information was an insider.

The FMA lists various insider trading offences. One insider trading offence under the FMA is that of dealing. An insider who knows that he or she has inside information and who deals directly or indirectly, or through an agent for his or her own account in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it, commits an offence.

Insiders would not be guilty of the offence of dealing if they prove on a balance of probabilities that he they only became an insider after they had given the instruction to deal to an authorised user and the instruction was not changed in any manner after they became an insider.

Another offence under the FMA is that of disclosure. An insider who knows that he or she has inside information and who discloses such inside information to another person, commits an offence. A further offence under the FMA is that of encouraging another person to deal. An insider who knows that he or she has inside information and who encourages another person to deal in securities listed on a regulated market to which the inside information relates commits an offence.

Applying the legal principles to the facts, Tau instructed his broker Phiri to purchase the shares in Animal Park Ltd without even knowing about the positive financial results of Animal Park Ltd. This means that Tau did not have inside information at the time he bought the shares. Therefore Tau was not an insider when he instructed Phiri to buy the shares and accordingly he has not committed the offence of dealing.

Ben was an insider and had inside information by virtue of his role as a director of Animal Park Ltd. He disclosed the inside information to Tau and therefore Ben committed the offence of disclosure. It may also be argued that Ben encouraged Tau to deal in the shares by stating that Animal Park Ltd would announce positive financial results and thus Ben arguably also committed the offence of encouraging another person to deal.

See your prescribed textbook par 11.2.

3 OCTOBER/ NOVEMBER 2013 EXAMINATION
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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 2013 exam paper.

QUESTION 1

Lesego is a director of One Stop Groceries (Pty) Ltd. When the company needed to appoint a new marketing agent to advertise its products in Gauteng, Lesego persuaded the board to appoint The Best CC by convincing them that The Best CC would be ideal for this task. However, Lesego did not disclose the fact that his brother had a substantial member's interest in The Best CC. The Best CC was appointed but a few months later it became clear that the company had suffered substantial losses in Gauteng because its products were not being

advertised effectively, since The Best CC had no experience in this type of work. A number of One Stop Groceries (Pty) Ltd's shareholders now want to hold the company's directors liable for breach of their duty to act in the best interest of the company and their duty of care, skill and diligence by appointing an inexperienced close corporation as their marketing agent.

Advise Lesego and the other directors of One Stop Groceries (Pty) Ltd on whether they can escape liability on the basis of the business judgment rule. **[10]**

QUESTION 2

Gary is a preference shareholder of Fast Cricket Balls Ltd, a company that manufactures South African cricket balls. The preference shares do not confer the right to vote. The company is under severe pressure as a result of competition from India. Consequently, the demand for South African cricket balls has decreased to such an extent that a resolution has been proposed for the winding-up of Fast Cricket Balls Ltd. Gary is very upset about the proposed resolution.

Advise him on whether he has the right to vote on the proposed resolution. **[10]**

QUESTION 3

Manjane (Pty) Ltd has 14 shareholders who each hold 1 share in the company. Vintos Ltd is one of the shareholders that holds 1 share in Manjane (Pty) Ltd. Vintos Ltd wishes to make an offer to acquire all the issued shares in the Manjane (Pty) Ltd and has decided to offer each of the other shareholders R1 million for their respective shares. The board of Vintos Ltd has heard that all the shareholders except one are very keen to sell their shares. However, Vintos Ltd does not wish to acquire anything less than 100% ownership of Manjane (Pty) Ltd. The board of Vintos Ltd does not wish to structure the deal as a scheme of arrangement.

Advise Vintos Ltd regarding the rules which regulate such a transaction and how it could structure an offer to ensure that it would not have to acquire less than all the issued shares.

[10]

QUESTION 4

The board of directors of Wanabee Ltd wants to issue shares to some of its employees to express their appreciation for their loyal and hard work during the past ten years. The employees have to render future services in return for the shares. One of the directors of Wanabee Ltd, Sandile, is however very concerned that this would not amount to "adequate consideration" in terms of the Companies Act 71 of 2008 and that the directors will incur liability should they proceed to do so.

Advise Sandile on whether the issue of shares in return for future services will amount to "adequate consideration" in terms of the Companies Act 71 of 2008 and also on the possibility of the directors incurring liability for their actions. **[15]**

QUESTION 5

Rafia is approached to become a director of Enter (Pty) Ltd. A friend tells Rafia that he believes Enter (Pty) Ltd is a member of a group of companies. This worries Rafia, who is convinced that apart from the fact that the group has its own separate legal personality, there are other consequences that flow from the existence of a group of companies.

Rafia approaches you with a request to provide her with an explanation how to determine whether a company is a subsidiary of another company, and to advise her about the legal consequences that flow from the existence of a group of companies. Advise Rafia accordingly. **[20]**

QUESTION 6

Shaydi (Pty) Ltd, a road construction company, concluded a five year contract with the Department of Public Works to build toll roads. This contract was the company's major source of income. At the end of the five year period, the Department of Public Works decided not to renew the contract due to the public opinion on toll roads. Shaydi (Pty) Ltd was left in a financial dilemma which resulted in its board filing a resolution to commence business rescue proceedings. The trade union representing the employees of Shaydi (Pty) Ltd is worried that the business rescue proceedings might cause job losses and forfeiture of their members' salaries.

Advise the trade union movement on the effects of business rescue proceedings on employment contracts, remuneration of employees and the rights of employees to participate in the business rescue proceedings.

[10]

QUESTION 7

The board of directors of Giveme Ltd has taken a resolution to issue some of its shares to:

- (a) its existing directors and their spouses; and
- (b) in pursuance of an employee share scheme.

The board is however uncertain whether they need to obtain the approval of the shareholders of the company for the resolution. Advise the board of directors of Giveme Ltd on whether the resolution needs to be approved by the shareholders of the company.

[10]

QUESTION 8

Samson who is the legal advisor of Bulk Shares Ltd, a public listed company, sees correspondence between Mat, the managing director of the company, and a business associate while going through some of the legal documents pertaining to a proposed new investment. From the correspondence it is clear that Bulk Shares Ltd is in the process of concluding a multi-million rand deal with a major role player in the mining industry, and that the share price of Bulk Shares Ltd will rise considerably once this news is made public. Samson immediately phones his brother Jo to tell him the news. Jo however, cannot afford to purchase shares as he is a student. Samson also tells his girlfriend Patty, who immediately buys 200 shares to sell at a profit when the share price rises. Samson also buys 200 shares which he intends to sell at a later date. Two months later, after the conclusion of the deal and a drastic rise in the share price, Patty sells her shares in Bulk Shares Ltd at a 40% profit. Samson decides not to sell his shares just yet

Explain whether Patty, Samson and Jo may incur civil liability under the legislation regulating insider trading. Your answer should include a discussion of the meaning of 'insider' and 'inside information'. You do not have to discuss the available sanctions or the criminal offences.

[15]

4 FEEDBACK ON OCTOBER/ NOVEMBER 2013 EXAMINATION
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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

To answer this question successfully, students should have referred to the business judgement rule and its elements, as set out in section 76(4) of the Companies Act 71 of 2008 ("the Act"). When applying the theory, a student must be able to identify that Lesego and his brother are related persons for purposes of the Act. This has the effect that Lesego had a material personal interest in the appointment of The Best CC. Because Lesego had not disclosed this interest, he cannot rely upon the business judgement rule. However, the other members of the board may rely upon the business judgement rule as they reasonably relied upon the information Lesego gave them.

See your prescribed textbook at paragraph 6.3.3.

QUESTION 2

The holders of preference shares generally do not have the right to vote at general meetings. The right to vote is usually curtailed in the Memorandum of Incorporation of a company. However, section 37(3)(a) provides that the holder of a share has an irrevocable right to vote on any proposal to amend the preferences, rights, limitations and other terms associated with their shares. In contrast with the Companies Act 61 of 1973 which explicitly provided that a proposed resolution for the winding up of the company does not confer voting rights upon preference shareholders, the Companies Act 71 of 2008 is silent on this matter. Based on *Utopia Vakansie-Oorde Bpk v Du Plessis*, one may argue that the rights of preference shareholders are "affected" by a proposed winding up and therefore preference shareholders will be entitled to vote on such a resolution.

QUESTION 3

The best way of approaching the transaction as described in the question paper is to make a compulsory acquisition in terms of section 124 of the Act. The offeror will be able to force the minority security holders to sell if the offer is accepted, amongst other requirements, by at least

90% of the current holders of security. Students would have successfully answered this question if they discussed and applied the requirements set out in section 124 of the Act.

See your prescribed textbook at paragraph 10.5.2

QUESTION 4

To answer this question successfully, one has to consider the provisions of section 40 of the Act. Section 40 provides that the board determines whether the consideration for shares to be issued by the company is adequate. Consideration means that anything of value is given and accepted in exchange for any property, service or the like. Consideration may be either in cash or in any other form. The fact of the matter is whether shares are issued for cash or non-cash consideration, the consideration should always be adequate. Shares may also be issued in exchange for future services or payment.

When shares are issued for future services or future payment, the shares must be issued immediately and should be held in trust until the future obligations are fulfilled.

With regard to liability, the board will incur liability because they breached their fiduciary duties in issuing shares for inadequate consideration.

See your prescribed textbook at paragraph 4.7

QUESTION 5

To determine whether a holding-subsidary relationship exists between two or more companies, the definition in section 3(1)(a) should be considered and discussed. The legal consequences of such a holding-subsidary relationship between two or more companies affect the following:

- the acquisition of shares
- directors' conduct
- public offerings
- the disposal of all or the greater part of assets or undertaking
- the solvency and liquidity test
- financial assistance

See your prescribed textbook at paragraph 3.1 and 3.3.

QUESTION 6

In general, business rescue proceedings have no effect on the rights and interests of employees. Employees are regarded as "affected persons" in terms of section 131, and therefore have the right to participate and negotiate in business rescue proceedings. The rights of employees are protected during business rescue proceedings, for example, the business rescue practitioner may suspend any contractual obligations of a company, except for employment-related contracts. The effect of business rescue proceedings on employment contracts and the way in which unpaid remuneration is dealt with, is explained in detail in **your prescribed textbook at paragraph 12.5.4.**

QUESTION 7

The board of directors have the power to issue shares without the approval of the shareholders but these shares must be authorised by the Memorandum of Incorporation. In certain circumstances, however, the board will need shareholder approval. This approval will sometimes be in the form of a special resolution and in other cases in the form of an ordinary resolution. In this specific case, a special resolution will be required when the shares are issued to directors and their spouses. When shares are issued in terms of an employee share scheme an ordinary resolution is required.

See your prescribed textbook at paragraph 4.7.4.

QUESTION 8

This question deals with insider trading which is regulated by the Financial Markets Act 19 of 2012. The Financial Markets Act prohibits insider trading. To answer this question, students should be familiar with the term "insider" and "inside information". Insider-trading offences are dealt with in chapter 11 of your prescribed textbook.

It is important to note that this question was set when the Securities Services Act 36 of 2004 still regulated insider trading.