CORPORATE LAW

Chap. 1: PARTNERSHIPS

TOPIC - 1

1. LEGAL NATURE OF A PARTNERSHIP

- **The term 'partnership;**
- **General feature of partnership**
- **Historical & Sources**
- **Legal nature**
- **Types of partnership**
- **Rights and duties of partners**
- **Liabilities of partners**

1. 1. Partnership as a form of Business Entity

Choosing the right format for your business is fundamental to its success, and will depend on a range of factors. If your venture is going to have more than one, but less than 20 owners, a Partnership may be the way to go.

A Partnership is quite **cheap** to set up, as it does not have to be legally registered (like a company). The State only requires that stamp duty be paid in connection with the Partnership agreement, and this is minimal.

Partnerships are governed by the common law; legislation has only played a limited role. Thus Roman-Dutch law applies in this area. However, the treatise on the law of partnership by the French jurist Pothier has exerted great influence on this branch of South African law. Moreover, English law and English cases have been regarded as persuasive in the law of partnership. There are many similarities between South African and English law in this field. However, there are also important distinctions and English law can serve as no more than a guide.

1. 2. What is a partnership?

A partnership is a legal relationship that derives from a contract. The salient features of the contract are:

- it is concluded between two or more persons (but normally not more than 20 persons)
- each partner must undertake to contribute to an enterprise
- the object must be the making and sharing of profits

(a) Definition[s]

"*An association of two or more persons engaged in a business enterprise in which the profits and losses are shared proportionally. The legal definition of a partnership is generally stated as "an association of two or more persons to carry on as co-owners a business for profit"*

"*… a business enterprise entered into for profit which is owned by more than one person each of which is a "partner."*

liability is, that the trade has been carried on by persons acting on his behalf. When that is the case, he is liable to trade obligations, and entitled to its profits, or to a share of them … The correct mode of stating the proposition is to say that the same thing which entitles him to the one makes him liable to the other, namely, the fact that the trade has been carried on on his behalf, i.e., that he stood in a relation of principal towards the persons ostensibly acting as the traders, by whom the liabilities have been incurred, and under whose management the profits have been made.” [446-7]

However, this requirement may be subsumed under the second essential mentioned above.

General

→Finally, in establishing a partnership the partners must heed certain laws regarding its name. The Business Names Act places limitations on the choice of name. The Act places restrictions on the use of certain names such as “state” or “government” and the registrar of companies may prohibit the use of a name by a partnership if it is in his opinion calculated to deceive or mislead the public or to cause annoyance or offence to any person or class of persons or is suggestive of blasphemy or indecency. A name must not be used to commit passing-off in terms of the common law.

→A partnership is not a separate legal entity and strictly speaking it cannot have an estate. However, partners hold the assets of the partnership as co-right holders and this common stock may be called the partnership estate. These rights may take the form of co-ownership. Co-owners of partnership property hold such property in undivided shares and the property may only be utilised by the partners for partnership purposes.

However, the rights held by the partners are often of a more limited nature. It will be particularly important to determine what the nature of rights in the partnership estate is. It will affect not only the obvious issues such as who is entitled to the asset, but also the issue of insurance (who has the insurable interest) and whether or not the partnership must first be discussed before recourse can be had to the asset in question.

The question whether assets contributed to the partnership becomes the property of the partners or whether they merely acquire a right to use it for the purpose of the partnership depends on the intention of the parties. It is uncertain how the law will deal with a case where this intention is not clearly expressed by the parties. It is accordingly fundamental that it be carefully considered and clearly expressed in the agreement, particularly where the value of the asset itself is likely to increase (for instance, in the case of immovable property).

The partners will not become owners qua partners by mere agreement. For transfer of immovable, **registration** will also be necessary, while corporeal movables must be **delivered** to the firm. However, corporeal movable property in the partnership context often will not be transferred *de manu in manum* but by *constitutum possessorium*. Incorporeal property such as rights must be **ceded** to the partnership

TOPIC - 3

3. RIGHTS & DUTIES OF PARTNERS

Partners are bound to carry on the business of the firm to the greatest **common advantage**. Subject to this, the mutual rights and duties of partners may be decided by contract between

Goodrickes v Hall and Another 1978 4 SA 208 (N), Howard J: "*Mr Gordon referred in this connection to the law as summarised by Lee and Honoré The South African Law of Obligations para 478 in the following terms*:

"Authority of Partner
Every partner is an agent of the firm and of the other partner or partners for the purpose of the business of the partnership and any contract made with third persons by a partner within the scope of his apparent authority binds the firm and the other partners, provided that the contract was entered into in the name and on behalf of the firm, unless the person with whom he is dealing either knows that he has no authority to act for the firm in the particular matter or does not know or believe him to be a partner, or unless such person is content to look to the sole credit of the contracting partner."[p211]

undisclosed principal
A partnership may also be bound if a partner concludes a contract with a third party who is unaware of the existence of the partnership.
Eaton & Louw v Arcade Properties (Pty) Ltd 1961 $ SA 233 (T), Munnik AJ: "*It is trite law that a partner who acts on behalf of a partnership acts as an agent for the partnership and thereby binds the partnership (including of course his co-partners). It seems to follow logically therefore that the law of agency in regard to acts by an agent on behalf of an undisclosed principal, namely that the undisclosed principal when discovered is liable to be sued on such a contract, is applicable where a partner acts on behalf of a partnership even though the existence of the partnership (and therefore of the other partners) is unknown to the party with whom he contracts in such circumstances.*

This principle however does not apply to anonymous partnerships and partnerships en commandite. This is understandable since the agent (i.e. an active or disclosed partner) has in fact no authority to bind the undisclosed partner, nor has he ostensible authority since at the time the contract is entered into the third party has no knowledge of the partnership. Where, however, a partner who acts on behalf of the partnership has by reason of the existence of a general partnership authority to bind the other partner or partners, it seems to me that the fact that the existence of such other partner or partners was unknown to the third party at the time of entering into the contract, cannot operate so as to make the rule relating to the acts of agents for undisclosed principals, to which I have referred above, inapplicable."[p240] and cf Karstein v Moribe 1982 2 SA 282 (T).

→The doctrine of the undisclosed principal will not apply where it could result in prejudice to a third party which was not foreseen by him at the time of entering the contract. This means that the partnership will be considered the contracting party only where the rights of the other contracting party are not thereby impaired.

Liability
When a partnership enters into a contract all the partners are, during the existence of the contract, joint co-debtors and co-creditors in respect of such contract.
Gcilitshana v General Accident Insurance Co SA Ltd 1985 2 SA 376 (C), Friedman J: "*When a person contracts with a partnership he is in effect contracting with all the partners individually. The individual partners are jointly and severally liable under the contract and debts arising under the contract are owed to the individual partners jointly and severally*." [p370-1]

Standard Bank of SA Ltd v Lombard 1977 2 SA 808 (T), Botha J: "*In the next place counsel for the defendant submitted that, since a partnership was not a legal persona separate from the individual partners, partners could not validly bind themselves as sureties for the partnership, because they would in effect be standing in as sureties for themselves. I was not referred to any authority for the proposition that partners could not validly bind themselves individually as sureties for partnership debts. (Cf. Caney on Suretyship, 2nd ed. at p. 48.) In matters of practice and procedure, the law does to some extent recognise the existence of a partnership as an entity in itself, albeit not as an entity endowed with legal personality. Thus a creditor of the partnership is obliged during the subsistence of the partnership to sue all the partners together for payment of the partnership debts and execution must first be levied on partnership assets before the assets of individual partners may be attached in execution. I can see no reason in principle why partners should not bind themselves to a partnership creditor in such a way that each partner is individually liable in solidum to the creditor for payment of the whole of the partnership debts, even during the subsistence of the partnership.*" [p813]

Chap. 3: COMPANY LAW

TOPIC 1

Monday 28 FEB 2011

INTRODUCTION TO COMPANY LAW

- ARTICLE TO READ: South African company law for the 21st century: Guidelines for corporate law reform.

The history of Corporate Law:

What is a company?

A company is defined as an organization of individuals conducting commercial enterprises. The studying of a company law is known as a Corporate Law. **Corporate law** (also "company" law) is the law of the most dominant kind of business enterprise in the modern world. **Corporate law** is the study of how **shareholders**, **directors**, **employees**, **creditors**, and other stakeholders such as **consumers**, the **community** and the **environment** interact with one another under the internal rules of the firm.

Corporate law is a part of a broader company law (or law of business associations) Other types of business associations can include partnerships or trusts. Corporate law is about big business, which has separate legal personality, with limited liability for its members or shareholders, who buy and sell their shares depending on the performance of the board of directors. It deals with the firms that are incorporated or registered under the Companies Act.

There are 3 defining characteristics of the modern company are:

(i) Separate Legal Personality of the company (the right to sue and be sued in its own name i.e. the law treats the company as a human being.

- **Limited Liability.** One of the key reasons for forming a company is the limited liability protection provided to its shareholders. Because a company is considered a separate legal entity, the shareholders have limited liability for the company's debts. The personal assets of shareholders are not at risk for satisfying corporate debts or liabilities.
- **Corporate Tax Treatment.** Since a company is a separate legal entity, it pays taxes separate and apart from its owners. Shareholders of a company only pay taxes on corporate profits paid to them in the form of salaries, bonuses, and dividends. The company pays taxes, at the corporate rate, on any profits.
- **Attractive Investment.** The capital structure of a company makes it attractive to investors.
- **Capital Incentive**. The capital structure also allows companies to attract key and talented employees by offering an ownership interest in the form of share options or shares.
- **Operational Structure.** Companies have a set management structure. Shareholders elect a Board of Directors, which then elects the officers. Other than the election of directors, shareholders do not typically participate in the operations of the company. The Board of Directors is responsible for the management of and exercising the rights and responsibilities of a company. The Board sets corporate policy and the strategy for the corporation. The Board elects officers; usually a CEO, vice president, treasurer and secretary, to follow the policies set by the Board and manage the corporation on a day-to-day basis. In a small company, the line between the shareholders, Board of Directors, and officers tends to blur because the same people may be serving in all capacities.
- **Perpetual Existence.** A company continues to exist until the shareholders decide to dissolve it or merge with another business. The company is not terminated or dissolved even when shareholders die or sell their shares.

Disadvantages

- **Fees.** It costs money to incorporate – registration; legal fees.
- **Formalities.** The proper corporate formalities of organizing and running a company must be followed in order to receive the benefits of being a company.
- **Paperwork.** A huge aspect of the corporate formalities that must be followed consists of paperwork. Reports and tax returns must be compiled and filed in a timely fashion; business bank accounts and records must be maintained and kept separate from personal accounts and assets; records must be kept of corporate actions, including meetings of shareholders and Board of Directors; and licenses must be maintained.
- **Dissolution.** Since companies have a perpetual existence, legislation provides a mechanism for dissolving a company and liquidating its assets. Dissolution does not happen automatically. A company can be dissolved voluntarily or involuntarily. A company's officers and directors are charged with responsibility for dissolving the company, including gathering corporate assets, paying creditors and outstanding claims, and distributing remaining assets to shareholders.
- **Tax Consequences.** C corporations have potential double tax consequences: once when the company makes its profit, and a second time when dividends are paid to shareholders.

Where did the word limited liability or corporate entity originate?

READ: ***Salomon v Salomon & Co***
It was held that the shareholder is not responsible for the company's debt.

Monday 07 MARCH 2011

TOPIC 2

LEGAL PERSONALITY & PIECING THE CORPORATE VEIL: THE COMPANY AS SEPARATE ENTITY & DISREGARDING SEPARATE ENTITY

- **A company as a legal person**
- **Acquisition of legal personality**
- **Theories of legal personality**
- **Company as separate entity**

CORPORATE VEIL

Why should companies became a legal person?

It started in 1700. the history of company in Britain. The first company was incorporated and the company became independent in its existence. In 1711, there was a company situated in UK called South Sea Company with 50 million pounds. The company was owned by British government. People bought the shares in this company with the purpose to pay the British government debts of war. UK spent a lot of money fighting in Latin America. The Lord Treasurer came up with the idea of incorporation ie to buy share so that the debt can be paid off. This share was sold by 12 pounds per share in 1720. The share was 100 pounds each. Other companies in UK were incorporated by using the idea of South Sea Co.

In 1720, Bubble Act forced the company to be incorporated in terms of Act of Parliament. The Act provided that no company would be incorporated without a stamp or permission of the government.

In 1856 there was a very first Company Act in UK and it was amended for number of times. It introduced limited liabilities when the company is liquidated or fraudulent. Courts had no discretion to lift corporate veil – piecing the veil by court was not allowed.

The 1856 Act was similar to **1926 Company Act** adopted in South Africa. There was a new Act in 1973. There were a few amendments in 1926 Act.

The **1973 Company Act**, due to some development in corporate led to **1999 amendment**, but everyone mentions that it was an outdated act, although it extremely amended important aspects. **In 2008**, there was a new Act but however, there was a lot of a grammar and misspelling errors. The 2008 Company Act was a disaster from the beginning. The drafters, people from Canada lacked legal expertise – there was a lot of discrepancies.

In terms of 1856 Act, the Act shows two things:

(i) Power value share

S 35 is divided into categories, namely:

(a) administrative formalities (requirements one and two);

(b) structural formalities (requirements three to five)

How does s35 operate?

In principle, the contracts that concluded by an agent who lacked authority, may be ratified by the principal to become legally binding on the principal. Therefore, where pre-incorporated contracts are concluded by an agent of non-existent company, should be ratified by the company once it becomes incorporated. The ratification is thus necessary for the company to be liable.

If the company does not yet possess the s176 certificate (the certificate to commence a business), a pre-incorporated contract is **provisional** only because the contract, although ratified, will not take effect until the certificate to commence business is issued. S35 ratification should however occur to shift the liability from agent to the company. S35 is an exception to the common law rule, if all the requirements are complied with, an agent will not be liable. In case one of the requirements is not complied with, the agent will be liable, because the protection under s35 will lapse, and the agent will be liable under misrepresentation.

Ratification simply means making something valid which was not valid. Where an agent acts without authority and principal ratifies the actions, principal will be liable. The principal thus gives retrospective authority to the agent as he had authority on contracting on his behalf on that time. Therefore, **the ratification works retrospectively**.

If s 35 finds its application, the contract comes into the effect when the company ratifies eg if an agent entered into a contract in June 2010 and the principal ratifies in October 2010, the principal is bound by a contract since June 2010. However, there is an **exception** in terms of s35. Under s 35, such contract will be valid and enforceable against the principal since October, but not June. June is applicable in terms of common law.

In terms of s35, the ratification does not operate respectively. It takes the effect from the day it is ratified [see the case ***Union Government***].

By contrast, if one closely and carefully reads s 35, it provides that the contract should be enforceable as if it is duly incorporated at such time. This shows retrospectivity operation of ratification but the court decided that ratification in terms of s35 does not operate retrospectively.

In terms of *stipulatio alteri*, a person enters into a contract on the benefit of a third party. There is a big advantage to the pre existing company, because the contracts concluded cannot be referred to the Registrar to be disclosed to the public. However, *stipulatio alteri* is not safe due to its uncertainty in terms of South African law. Pre incorporation contracts are very important because they are creator of the company and therefore s 35 must be followed.

According to Adv. Kotze, the court should include *stipulatio alteri* in the requirement of s 35.

- S36 finds no application if the directors has no necessary authority ie Director is not given authority at all by principal or he has authority to act but exceeded such authority;

Requirements for s36 of the Act:

(i) The company exceeds its capacity or acts beyond its main object;
(ii) The director lacks authority on the virtue that the company lacks capacity;
(iii) The transaction was concluded by a director acting as an agent.

To sum up:

- S36 of 1973 does away with external operations of *ultra vires* – *ultra vires* act is no longer void *ab initio*;
- Internal operation continues to apply – a company may be sued by shareholders or members;
- Directors' lack of authority – acts is void
- Where s36 finds no application, one must revert back to common law: act is void ab initio.
- S36 finds application if the directors have necessary authority, but the company has no necessary capacity.
- If any other person who is not a director acts on behalf of a company, s36 will not find application
- S36 does not abolish the doctrine of ultra vires;
- Estoppel does not find application;
- Turquand rule does not find application.

Ultra vires in terms of common law is void *ab initio*. In 1973 Acts, memorandum contains main object which provides the capacity of the company to enter into a transaction.

Test/Exam – problem Q:

- Look at the object in memo;
- Look at the transaction;
- If the transaction is not reflected in the object, then investigate s36 (are the requirements met? If yes, the ultra vires act is validated);
- Difference between ultra vires and intra vires.

Wednesday, 11 May 2011

TUTORIAL CLASS – ***Ultra vires***

In terms of common law, if the company enters into a contract which does not fall under the main objects as illustrated in the MOA, such act is *ultra vires* and void *ab initio*. S36 validates ultra vires act and it is thus enforceable. However 3 requirements must be met:

(i) The transaction must have been concluded by a director;
(ii) Director must be lacking authority on the strengths that company has no capacity or exceeded its power;
(iii) The act is ultra vires ie the company exceeded its capacity to act

However, where an agent could have acted without necessary authority, there are 3 possibilities of validating agent's action:

(i) a company can ratify the contract/transaction;
(ii) a third party can rely on Turquand rule;
(iii) a third party can rely on estoppel as a defence

S36 suggests is similar to s20 suggests:

- **S20(1)** applies to a company if its memo limited its contractual capacity. S20 is applicable to RF companies. The third party will be able to identify that a company is RF thru the company's name. S20 provides that it will apply where the power of the company is restricted/limited/qualifies its power.

If the company acts not in accordance with limited capacity, its action will be ultra vires BUT the contract is not void simply because the company acted beyond its limited capacity.

S20 explains what the ultra vires will be even though it does not refer to it as ultra vires. In terms common law, ultra vires act is void ab initio BUT it is not void in terms of s20.
If the company does not have authority, s20 makes it clear that if a Director does not have authority because company does not have capacity, then s20 applies. But if the director does not have authority due to any other reason(s), s20 **will not apply**.

What has changed? S36 applies to all companies whereas s20 applies to only RF company.

S20 abolishes ultra vires action if the requirements are met. In respect of internal perspective, ultra vires continue to exist. S20(1)(b) provides that the shareholders may approach the court for **<u>an interdict</u>** – the shareholders may stop a director from acting ultra vires.

- S20(2) refers to a **<u>special resolution</u>** by shareholders to ratify the directors ultra vires action.

This section gives a weird power to shareholders to ratify the ultra vires actions. In the 1973 Act, this could not happen. The act should have remained void. Now it is no longer the case because it can be ratified. The problem: If the company has restricted itself to buying and selling immovable property, but however, it buys a car, why should the shareholders ratify such action? Because ultra vires internally exists. Internal operation of ultra vires can be validated in terms of s20(2) by special resolution.

Other example is where the company has restricted itself to buying and selling cars in its memo, and buys a farm. A third party should know that the company is RF, and due to such fact, the ultra vires act is no longer void in terms of s20(1). However, the shareholders can have a legal recourse against directors, and they will be held liable in terms of s20(1)(b). Again, shareholders may ratify the transaction in terms of s20(2).

What happens if the shareholders ratify an ultra vires action but they do not ratify another act in the future? If the shareholder does not ratify it in the future; the **estoppel** will be applicable on the ground that the shareholders have ratified the similar action in the past.

- S20(3) – an act may not be ratified if it is in contravention of the new Act;

Monday, 01 August 2011

Company capacity and Agent's authority under 2008 Co. Act:

In terms of the 2008 Act, a company is incorporated with only one document which is called '**Memorandum of Incorporation**.' It is a simple document. In terms of 1973 Act, there was a memorandum of association which was regarded as the Constitution of a Company. It contained in terms of s52 a number of requirements, *inter alia*, particulars of the company, representation of the company, power of the company and the authority of an agent (contractual capacity), internal management, etc. Article of association should contain information about the meetings, company's directors, contractual capacity, etc. These all information is contained in one document namely "**Memorandum of Incorporation (MOI)**" under 2008 Act.

The 2008 Act, in terms of ss13 and 14, refers to incorporation. S13 refers to the procedure of incorporation – The company must file two document with a 'company commissioner.' These two documents are:

(i) Notice of incorporation – indicates an intention to register a new company. The notice is provided on a standard form, which one finds in a regulation of a company;

(ii) Memorandum of incorporation

There must be as well payment of registration. It is a prescribed fee and receipt must be attached to the notice.

Notice of incorporation must contain the following information:

- Type of the company to be incorporated e.g private or public, etc;
- Incorporation date and a day of registration;
- Company financial year end;
- Registered address;
- Number of the directors

Company name:

There are more possibilities:

(i) The registration number may be a company name;

(ii) Name reservation must appear in the memo of incorporation

(iii) Four names must be submitted, and the commissioner will select one

Note that South Africa must appear on the name selected.

S13(3) of 2008 Act relates to RF companies and its registration procedure.

Registration certificate:

S14 of 2008 Act relates to '**Registration Certificate'**. In terms of s1 (definition), the registration certificate means the evidence of registration. There is no longer a requirement of the certificate to commence the business after registration. And the certificate is no longer called 'certificate of incorporation' BUT registration certificate and may be referred to as company will buy back the shares. The authority to buy back shares must come from AOA. Thus the modern model of AOA does not allow for buying back shares. The buying back will occur if there is a special resolution.

Monday, 08 August 2011

RECAP:
Share is nothing more than personal right, an incorporeal movable property, transferable in terms of memo.

Nature of the share

Company gets capital from share or loan capital. Generally, it is known as share capital. In 1973 Company Act, reference to share capital is made too many occasions. Actually, the company provides shares.

Example of share definitions:

(i) Certificate representing one unit of ownership in corporation or mutual fund or limited partnership;
(ii) Any of the equal products into which the capital stock of corporation or company is divided;
(iii) Evidence of ownership that represents…..

►Share is something as interest.

Randfontein Estates v The Master, 1909:
Shares are simply right of action – *jus in personam* – entitling their owner to certain interest in the company, its assets and dividend.

In ***Cooper v Boyes*** – Whether or not a share could be the subject of one or the other of these institutes could not have known…..

Normally, the person in whom the share vests, is the registered shareholder in the book of the company. Note that normally does not mean always.

In terms of s35/2008, a share is defined as a movable property. *What law applies to a particular share eg if there is a lawsuit regarding the share's ownership/interest?* In 1973 Act, there was real value attached to the share which was called '**power value.**' The power value has been removed and converted in no power value. Power value was mystical. Power Value should be trading value, etc. In term of 2008 Act, there is no value attached to it. S36 of the 2008 Company Act provides for the company, in its memo, to divide shares into classes.

Rights – Dividend – Voting – claim against company assets if liquidated. All or some of these rights should be accorded to a shareholder depending upon the class of share he/she holds. In terms of 2008 Act, all class of shares enjoys equal rights. However, in memo, a company can classify the rights as:

►Look at other documents ie issue, shareholders agreement, legislation, company rules, etc. s15 provides that the rules are subject to the memo and where there is a clash or a conflict the memo will prevail.

►Nature of shares (s35) – shares are movable incorporeal and transferable property.

TOPIC 8

LEGAL CONCEPT OF CAPITAL, BUYBACK AND REDEMPTION OF SHARES & FINANCIAL ASSISTANCE (S38)

- **Share capital;**
- **Acquisition of own shares;**
- **Issue of shares at a discount;**
- **S38 – Financial Assistance;**
- **Alteration of shares capital and shares.**

Issue of shares and authorized shares:

These two terms are not used in the Act. In memo, the company has to authorize some shares, once authorized, they will be issued. Authorization may be increased or decreased by shareholders. Authorization can be fractured any time. The number of shares that are allocated in memo is from legal perspective irrelevant subject to one understanding that issue will come from authorized share capital. There may be no issue if there is nothing to issue – look at memo and find if there are authorized shares.

The term 'issue' is very closely related to the nature of shares – incorporeal movable property. *How does then share come into existence?*

The share is issue and authorized share is not a share. A share must be allowed to be incorporeal movable which can be transferred. **Share is not in existence** if it is still an authorized share.

READ the following case that explains issue (find the definition of issue and how it operates):

- ***Moosa v Lalloo and Another* [1957] 4 All SA 62 [D]**

Issue of shares – Meaning:

Shares provided in memo are '**authorized shares**'. Shares do not exist before they are issued.

<u>Issue procedure</u>:

Subscription contract: If the company wants to issue shares, prospective shareholders will have to subscribe as a person subscribe if wants to buy a newspaper. This is a funny kind of a contract. There will be **offer and acceptance.** The principle of consensus is followed. However, note that this is not a contract of Purchase and Sale despite of the fact that one pays for shares. A buyer has money and the company has object. Why not called the contract of Purchase and Sale? The requirements of Purchase and Sale are: Thing, Price and Consensus. Share is not a thing Why? The share does not exist until such time it is issued. There, the thing being sold is not in existence yet. This is therefore a **contract of subscription**.

The prospective shareholder will make an offer to buy and the company will accept or reject an offer. The company's acceptance is referred to as '**allotment**' – Prospective shareholder is allotted. A prospective shareholder makes for instance an offer to buy 100 shares. He/she makes such offer after he/she sees an advertisement. Then he/she approaches the company that is selling shares. The company has to take a decision relating to who will get more or who will get less shares. The decision depends upon the company. The company's acceptance is called allotment and allotment is unilateral internal act of the company (This is a **contract of allotment**). The company can allot the shares to you but this is not an issue (issue is not created yet). The company informs the offeror if wants to allocate to him shares. The share if issued, comes into existence. When the shares are in existence that is when shareholders can exercise his rights. Before the issue, the shareholder has no right against the company; the right is born once the shares are issued. As a result of issue, a SH may have right to dividend or to vote, etc.

After the allotment, then the shares are issued. After issue, the SH has the proprietary rights. Issue completes the title of a person to who the shares have been allocated ie it puts him in control of shares. SH would receive the **share certificate**. The company then will establish Share Register, where each name of a shareholder will appear.

REMEMBER: Before the issue, there is no share; therefore the time is so important. Although, the right to shares is effective for the offer and acceptance (allotment), a share is created and comes into existence as an item of property upon its original issue by the company. If the issue of shares is subject to **condition**, then such condition must be complied with. In the case of *Moosa*, the answer to these aspects of the matter stems from the fact that an allotment by which shares are acquired is a contract.

Usually, the company attracts your attention through adverts. If you are interested you will approach a company with an offer. If you submit a form to the company to buy a 100 shares which costs R100, you will attach the proof of the payment. The BoD will determine to whom shares will go because many would-be shareholders have been approached the company. The company may decide to allocate to one client 5 shares. If only 5 shares are allocated to you and you have paid for 100 shares, the company will give you back the money left from what you have paid. The company will accept in the form of allotment and once the shares issued, that is when the shares comes into existence and you will be entitle to enjoy the right attached to them (see *Moosa* case – Nature of Sales).

S38 of 2008– Authorization/Authority to issue shares:

This is something new. In the past, the authority to issue shares was afforded to shareholders. Shareholders [SH] could decide in a general meeting to issue shares. Now, the directors must take the decision. The director can water down some rights attached to shares because if the company issues a 100 shares, and the company may get for example another 20 SH who will share dividend with the existing SH. As a result, dividend allocated to each SH will decrease.

NOTE that if there is any of the requirements is missing, the transaction is **void**. The board is liable; however, a director who was not in a meeting is not liable

To sum up, the requirements for provision of FA are:

(i) Employee share scheme;
(ii) Special resolution;
(iii) Insolvency and liquidity test;
(iv) Fair and reasonable term;
(v) Conditions in MOI

Breakage of s38 provides a good test in which FA could be tested. The legislature did not provide for the definition of FA. The court tried to provide its own (common law) definition.

The impoverishment test – is about comparison of financial division.
For over 20 years, South African courts tested the FA to ascertain whether it was given by applying impoverishment test – whether the company has become poorer. This test refers a person to the '<u>company balancing sheets'</u> – the test is thus referred to as '**the balancing sheet test.**'

In terms of 1973 Act, if the transaction was void, and the company liable, the penalty was a fine of R1000. A company cannot go to jail (a juristic person). However, the company could decide to conclude an invalid transaction if it will benefit millions from that transaction, and be liable of ridiculous amount of R1000.

The test of impoverishment, has over the years, been developed. In 1979, the Appellate Division put an end to the uncertainty of the test – Why? Because sometimes, impoverishment test become superfluous. The company should not have been impoverished. <u>The court did not abolish it completely</u> but provided another test. The judges will encounter a lot of problems in terms of dispensation of the Company Act – 2008 Act.

"**The financial assistance is given for the purpose of or in connection with the purchase of company shares**"

S44(2) provides that:
"*To the extent of memorandum of incorporation of a company provides otherwise, the board may authorize <u>the company to provide</u> financial assistance by way of a loan, guarantee, the provision of security or otherwise to any person <u>for the purpose of, or in connection with,</u> the subscription of any option, or any securities, issued or to be issued by the company or a related or inter-related company, subject to sections 3 and 4.*"

In terms of s38 of 1973 Act, if the FA was given for anything else but not shares, there was no transgression of s38.

In 2008 Act, s44 goes wider than that – it makes reference to any option (normal option). It refers to securities (see definition includes shares). It covers a range of other documents other than shares.

For the purpose or in connection with:

Which offers? Any offer. Always, it has been problematic. But the matter is so simple. It must be an offer made to the public and must fall within chap 4 of the Act. S96 provides exceptions. It lists offers which cannot be regarded as offers to the public. Offer to the public is listed under s95(b)(h)(i) – includes offer of securities.

See the case of ***Gold Fields Ltd v Harmony Gold Mining Co Ltd (2005)*** which deals with two questions:

(i) Was the offer made for subscription (this has disappeared in terms of 2008 Act)?
(ii) What constitutes an offer to the public (relevant in terms of 2008 Act)?

Judge said '*I think it is unhelpful and potentially misreading to attempt to determine by inference what is included in offer*.' Judge concludes that offer to the public under old Act is drafted in wide terms. It is narrowed by s96 of 2008 Act. Even if it does not fall in the ambit of exceptions, it may not qualify as an offer depends upon the terms or case law. It may not comply with requirements.

The court in *Gold Fields* held that:
The ordinary meaning of the word public is the community as a whole rather than the community as an organized body. Therefore to qualify as an offer to the public, the term of the offer would, at least, need to be capable of being offered to and accepted by public at large. That is not to say that every offer in such terms is necessary an offer to the public. Nor is it to say that an offer must be necessarily be made to the public at large in order to qualify. But an offer that is made to the public would necessarily be in terms that would be made to and accepted by the public at large, and it could thus be with indifference to any random section of the public. An offer to sell shares eg in return for cash, is capable of being made to the public at large, and might thus be made as much to that section of the public that resides in Bloemfontein as to section of the public that resides in Upington (see para 13).

An offer that aims to acquire specific private property would not achieve its purpose if it was made to the public for no reason but that the property is in private hands. The offer in the present case is in that category. It is not made to the public but to shares in Gold Fileds who are, in that capacity, a mere section of the public at large (see para 16).

Look at the statute definition and exceptions – look at the circumstances of each case – offer to one or some people is not public offer.

Exceptions:

- see s96 and also s144 of 1973 Act;
- See *Gold Field* Case

Advertisement

Advertisement relating to offer – 2 possibilities in the Act:

(i) Offer actually made by the way of the advertisement;
(ii) Advertisement simply draws the attention of the public to an offer which is made by prospectus (see s 102 – 111 and s98(3)(b))

Requirement for prospectus and content:

- S100 requirement;

SALE AND TRANSFER OF SHARES & SHARES SECURITY

- **Offer of sale**
- **Meaning of public**
- **Transfer of shares**
- **Security by means of shares**

Offer of sale

When a company makes an offer, there should a **prospectus** that provides information to the public. If a person makes an offer, acts independently from the company, he is not required to issue prospectus. He may avail himself with **written statement** instead of more comprehensive prospectus.

S141(1) of 1973 Act provides that:

> "*No person shall either orally or in writing make an offer of shares for sale to the public or issue, distribute or publish ant such material which in its form and context is calculated to be understood as an offer as aforesaid unless it is accompanied by **a written statement** containing the particulars required by this section to be included therein.*"

The court, in ***Vlakspruit Landgoed (EDMS) BPK v J Mentz (EDMS) BPK (1977),*** held that:

> "*The object of the Legislature in s141(1) was obviously to combat the peddling of shares in worthless companies by unscrupulous selling agents and not to interfere in 'domestic offers' where the intention was not to deal in shares but merely to place the assets of the company under new management. Although s141 is formulated in peremptory terms, the provisions of s141(9) are in conflict with an intention that a contract which was concluded in **conflict** with s141 **is void**.*"

In terms of s141(9), if a contract concluded in contravention of s141(1), the court may make an order as it thinks proper for repayment of any money or retransfer of any shares.

Transfer of Shares

Three elements of full and technical transfer do not make reference to security certificate, namely:

(i) **Agreement of transfer:** Full and complete transfer in the sense of words – transfer is made in the form of cessation;

(ii) **Execution of deed of transfer:** The company normally use a standard form – this instrument contains the name of buyer and seller, their personal info, class of shares etc;

(iii) **Registration of transfer:** The company does administration thing.

S35 – the court interpreted the word transfer as not to have security. If the shares reached a company with share certificate accompanied them, the company must destroy the certificate and issue a new certificate.