

TOPIC 3

SHAREHOLDERS AND SHARES

TOPIC OVERVIEW

Companies cannot exist without shareholders or share capital. It is therefore important to take note of the requirements relating to shareholders and shares in the Act. The topic does not only deal with shareholders, but also includes the requirements for capitalisation of profit companies.

This topic deals with the authorisation to issue shares, preferences, rights, limitations, and other share terms, as well as the issuing of shares, shareholder approval for issuing shares (in certain instances), financial assistance for subscription of securities, loans or other financial assistance and distributions, to name only a few. It also includes securities registration and transfer, governance of companies and public offering of company securities. This topic is therefore justly one of the most important topics for your studies.

The terms mentioned above might seem very new and unfamiliar to you, but as you work through the topic, your perception will change. Remember to refer to section 1 of the Act for definitions of terms with which you are unfamiliar.

Topic 3 is divided into the following learning units:

Learning unit	Title
3.1	Capitalisation of profit companies (sections 35-43 and 46-48)
3.1.1	Legal nature of company shares and requirement to have shareholders (sec 35) also refer to Regulation 31(3) and (5)
3.1.2	Authorisation for shares (sec 36)
3.1.3	Preferences, rights, limitations and other share terms (sec 37)
3.1.4	Issuing shares (sec 38)
3.1.5	Subscription of shares (sec 39)
3.1.6	Distributions to be authorised by the board (sec 46)
3.1.7	Capitalisation shares (sec 47)
3.1.8	Company or subsidiary acquiring company shares (sec 48)
3.2	Securities registration and transfer
3.2.1	Securities registration and transfer (sec 49–56) – also refer to Regulation 32
3.3	Governance of companies
3.3.1	Shareholders and voting rights (sec 57)
3.3.2	Proxies, quorums, notice of meetings and conducting meetings (sec 58-64)
3.3.3	Shareholders' resolutions (sec 65)
3.4	Public offerings of company securities
3.4.1	Public offerings of company securities (sec 95-97 and 99–111)

TEXTUAL AMENDMENTS AND ADDITIONS

Before proceeding with the study of this topic, please refer to Tutorial Letter 102 for this module to acquaint yourself with any textual amendments and additions that may have been indicated.

LEARNING OUTCOMES

Learning unit	In this topic, we will focus on the following learning outcomes:	Level
3.1 Capitalisation of profit companies (sec 35, 36, 37, 38, 39, 40, 41, 42, 43, 46, 47 and 48)	<ul style="list-style-type: none"> • Give advice, discuss concerns, and apply the requirements of the Act regarding the: <ul style="list-style-type: none"> – capitalisation of profit companies, including the legal nature of company shares and the requirement to have shareholders – authorisation of shares – distributions – capitalisation shares – the company or subsidiary acquiring company shares 	2
3.2 Securities registration and transfer (sec 49–56)	<ul style="list-style-type: none"> • Give advice, discuss concerns and apply the requirements of the Act regarding securities registration and transfer. 	1

3.3 Governance of Companies (sec 57–65)	<ul style="list-style-type: none"> • Give advice, discuss concerns and apply the requirements of the Act regarding the governance of companies, including requirements for shareholder meetings such as notices, quorums and voting rights 	2
3.4 Public offerings of company securities (sec 95, 96, 97, 99, and 100–111)	<ul style="list-style-type: none"> • Acquire basic knowledge and understanding of the requirements for public offerings of company securities in terms of the Act 	2

LEARNING UNIT 3.1

CAPITALISATION OF PROFIT COMPANIES

INTRODUCTION

In terms of the Companies Act, a security is a share, debenture or other instrument, that is issued by a profit company. In this topic, we will specifically refer to shares. The learning unit deals with different aspects of shares, such as their legal nature, how they are issued, and the rights and limitations attached to them. (Note: Refer to section 1 of the Act for definitions of unfamiliar terms used in this learning unit.)

3.1.1 LEGAL NATURE OF COMPANY SHARES AND REQUIREMENT TO HAVE SHAREHOLDERS (SEC 35) – ALSO, REFER TO REGULATION 31(3) and (5)

What is a share? Shares are units into which company divides its profit. Each “owner” (shareholder) of the company holds a certain amount of shares, which may entitle him/her to the profit of the company. Holders of shares are referred to as shareholders.

Under the previous Companies Act, shares could have a so-called par value. The term “**par value**” referred to a nominal value that was assigned to a share. It is important to note that under the new Companies Act, companies no longer have par value shares. Refer to Regulation 31(3) and (5), in which authorised shares of par or nominal value are set out and where it is indicated what should be done where no shares have yet been issued before the effective date (1 May 2011). This Regulation also deals with cases where authorised shares of par or nominal value, have already been issued before the effective date.

3.1.2 AUTHORISATION FOR SHARES (SEC 36)

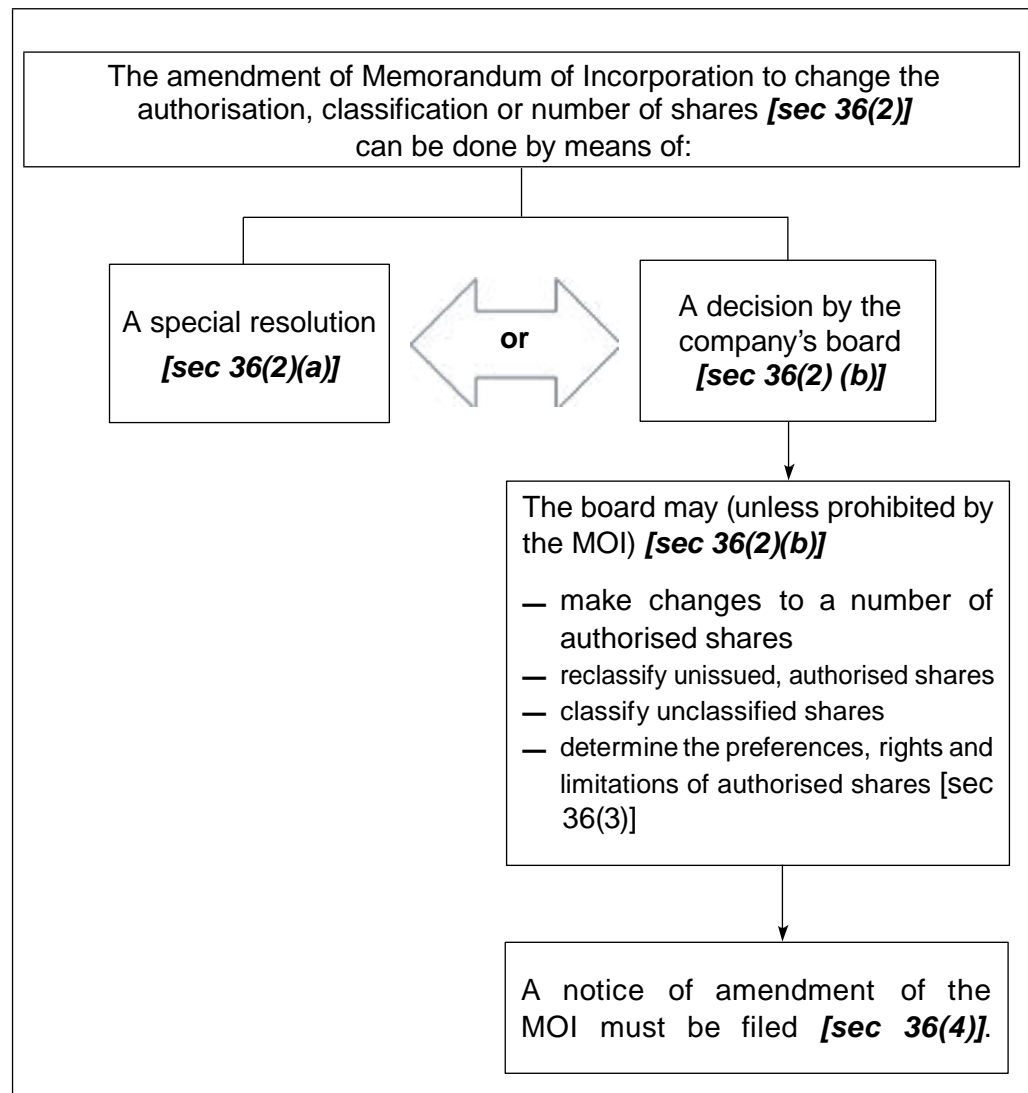
In its Memorandum of Incorporation (MOI), a company must set out the different classes and number of shares that the company is authorised to issue. This is referred to as the authorised shares of a company. The MOI should describe the name of each different class of share in order to distinguish it from other classes of shares, as well as indicate the preferences, rights (such as voting rights) and limitations of these shares.

It is important to note that an authorised share has no rights associated with it until the share has been issued. The person to whom the share is issued, becomes

the holder of the share, and is called the **shareholder**. A company is not allowed to issue shares to itself.

Should a company want to change the classification, authorisation or number of shares, the MOI may be amended in terms of section 36. Refer to diagram 3.1.2 below in this regard.

Diagram 3.1.2 Amendment of the Memorandum of Incorporation (MOI) regarding shares



STUDY

Study sections 35 and 36 of the Companies Act as well as Regulations 31(3) and (5).

ACTIVITY 2

Example: ABC (Pty) Ltd currently has 1 000 authorised ordinary shares. The director of ABC (Pty) Ltd, Mr Joe Soap, wants to convert 100 of these ordinary shares to preference shares. Explain to Mr Soap how the requirements of the Companies Act relate to this matter.

FEEDBACK ON ACTIVITY 2

Reference: Section 36 of the Companies Act

Answer: In terms of **section 36** of the Act, the Memorandum of Incorporation of ABC (Pty) Ltd may be amended to change the classification of these shares by means of a **special resolution**. (Note: A “resolution” is a decision. Learning unit 3.3 deals with resolutions.)

OR

In terms of **section 36** of the Act, the **board of the company** may decide to change the classification of these shares (unless stated otherwise in the Memorandum of Incorporation). The board must then file a notice of amendment of the Memorandum of Incorporation.

3.1.3 PREFERENCES, RIGHTS, LIMITATIONS AND OTHER SHARE TERMS (SEC 37)

In terms of section 37(2), every share, irrespective of its class, has associated with it one voting right, subject to the provisions of the Companies Act and the MOI. The MOI may determine the preferences, rights and limitations. This means that a voting right can be limited, but not excluded.

The “provisions of the Act” mentioned above are as follows:

- If there is only one class of shares, those shares must have voting rights in respect of all voting matters and must be entitled to the surplus at liquidation [sec 37(3)(b)].
- If there is more than one class of share, the MOI must provide that at least one class of share must have voting rights in respect of all matters on which can be voted. Further, a class of share (not necessarily the voting class) must be entitled to the surplus at liquidation (the monetary value that is available if the company should be liquidated) [sec 37(4)].
- Shares with limited voting rights will, irrespective of the provisions of the MOI, nevertheless have voting rights on any proposal to amend the rights associated with that share [sec 37(3)(a)].
- All the shares of a particular class must have the same preferences, rights, limitations and other terms [sec 37(1)].

What do rights mean? “Rights” refer to

- control rights – which relate to voting rights at meetings
- financial rights – which relate to the right to dividends and the right to any excess upon liquidation



STUDY

Study section 37 of the Companies Act.

ACTIVITY 3

Example: ABC (Pty) Ltd is in the process of liquidating. Mr Joe Soap, a shareholder of ABC (Pty) Ltd, wants to know if he will be equally entitled to the surplus net assets of the company upon its liquidation, distributed to all the other shareholders. ABC (Pty) Ltd has only one class of shares.

FEEDBACK ON ACTIVITY 3

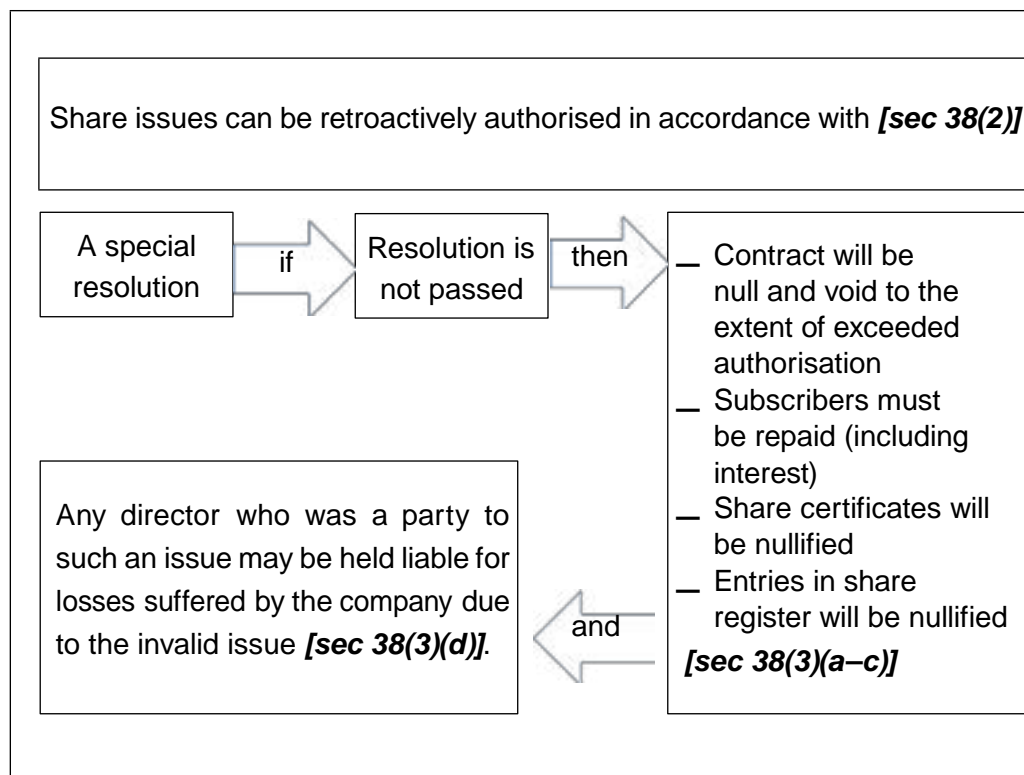
Answer: In terms of **section 37** of the Act, if a company has only **one class** of shares, all these shares will have **equal** preferences, rights and limitations.

3.1.4 ISSUING SHARES (SEC 38)

The board of directors has the power to issue shares in terms of section 38(1). However, such a share issue must be approved by a special resolution if the issue is to a director or prescribed officer (or a person related to or interrelated to the director, prescribed officer or the company), or to a future director or prescribed officer. (The requirements in section 38 and 40 do not apply in a business rescue scheme where the practitioner can issue shares and determine the consideration.)

The actions in diagram 3.1.4 can be taken if the board issues shares that either are not authorised (as per section 36), or exceed the number of authorised shares according to the Memorandum of Incorporation:

Diagram 3.1.4
Retroactive authorisation of shares





STUDY

Study section 38 of the Companies Act.

3.1.5 SUBSCRIPTION OF SHARES (SEC 39 to 43)

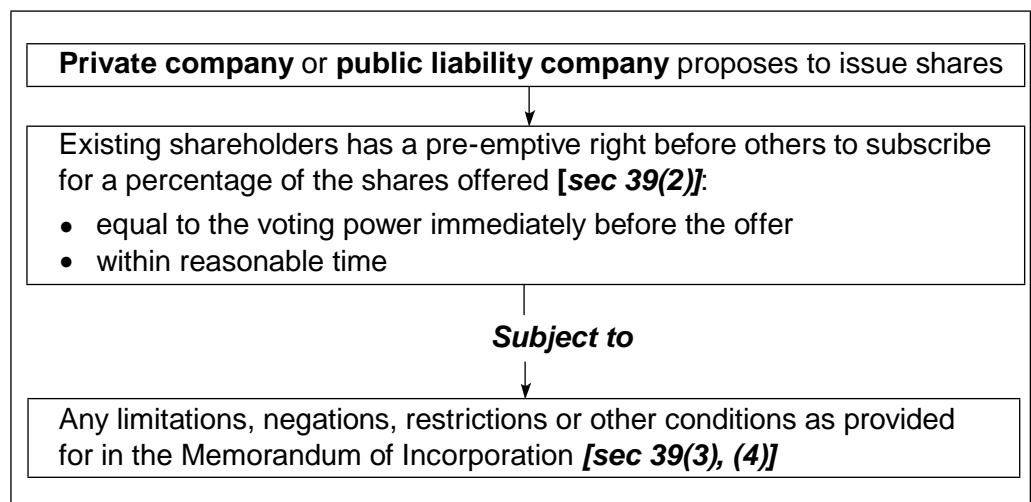
This section does **not apply to public or state-owned companies** (except if provided otherwise in the Memorandum of Incorporation) **[sec 39(1) (a)]**.

Except to the extent that the MOI of a private or personal liability company provides otherwise

- a shareholder may, in exercising the pre-emptive right, subscribe for fewer shares than he/she would be entitled to subscribe for
- shares not subscribed for by a shareholder within a reasonable time may be offered to other persons to the extent permitted by the MOI

Section 39 is explained in diagram 3.1.5 below.

Diagram 3.1.5 Issuing of shares



Example: Macbeth has general voting rights relating to 35% of the shares in Hamlet (Pty) Ltd. Hamlet (Pty) Ltd plans to issue 1 000 shares. This would mean that Macbeth has a pre-emptive right to 35% of these shares, which are 350 shares.



STUDY

Study section 39 to 43 of the Companies Act.

3.1.6 DISTRIBUTIONS TO BE AUTHORISED BY THE BOARD (SEC 46)

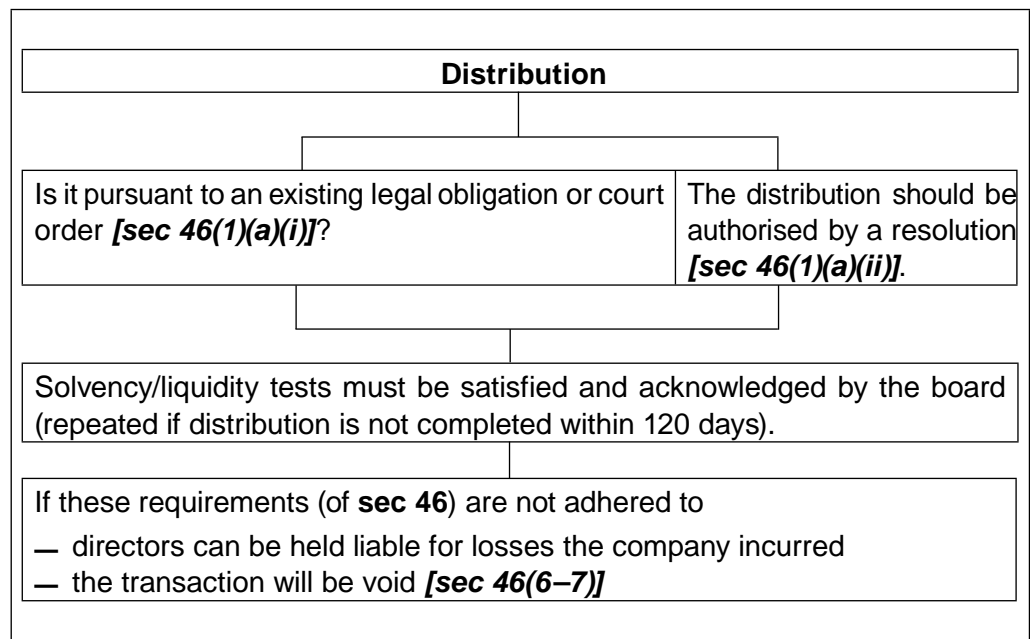
Study the definition of a distribution as described in sections 1 and 46 of the Companies Act. It is important to note that distributions include payments for share buy-back (where a company buys back its own shares) and the payment of dividends. A dividend is a portion of a company's earnings, which is distributed to its shareholders.

In terms of section 46(1)(a)(ii), all distributions must be authorised by a resolution of the board of directors. Shareholder approval is not required unless it is prescribed by the company's MOI.

In addition, it must reasonably appear that the company will satisfy the solvency and liquidity test immediately after the distribution. The board must acknowledge by resolution that it has applied the test and has reasonably concluded that the company will satisfy the test immediately after completing the distribution.

The directors responsible for an invalid distribution, in other words, those directors who, despite knowing that the requirements for a valid distribution were not satisfied, had nevertheless either voted for or had assented to the authorisation of the distribution, would be personally liable, jointly and severally, to restore to the company the amount of the unlawful distribution less the amount, if any, that is recovered by the company from the persons to whom the distribution was made. Creditors are not given a right to institute legal action against the directors for an unlawful distribution. The errant directors are liable to the company – not its creditors. See the summary in diagram 3.1.6 below.

Diagram 3.1.6
Distribution



STUDY

Study section 46 of the Companies Act.

3.1.7 CAPITALISATION SHARES (SEC 47) STUDY



Study section 47 of the Companies Act.

3.1.8 COMPANY OR SUBSIDIARY ACQUIRING COMPANY SHARES (SEC 48)

May a company buy back its own shares? (**Note:** This is not the same action as a company issuing shares to itself, which is prohibited.)

Yes, provided that the requirements of **section 46** (distributions) and those of **section 48 [sec 48(2) (a)]** are met.

The **board** may determine that the company should acquire a number of its own shares. However, the board decision must be approved by a **special resolution** of the shareholders of the company if the company is to buy-back any shares from a director or prescribed officer of the company, or a person related to a director or prescribed officer of the company.

May a subsidiary of a company buy the shares of that company?

Yes, provided that

- no more than 10%, in aggregate, of any class of shares is held by all the subsidiaries taken together
- voting rights attached to those shares may not be exercised **[sec 48(2) (b)]**

STUDY



Study section 46 and 48 of the Companies Act.

SUMMARY

In this learning unit, we explained and applied the requirements for the capitalization of profit companies in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, determine if you are able to:

Give advice, discuss concerns, and apply the requirements of the Act regarding the capitalisation of profit companies, including the legal nature of company shares and the requirement to have shareholders, authorisation of shares, distributions, capitalisation shares, and the company or subsidiary acquiring company shares.

LEARNING UNIT 3.2

SECURITIES REGISTRATION AND TRANSFER

INTRODUCTION

This learning unit will give you an overview of the registration and transfer of securities.

3.2.1 SECURITIES REGISTRATION AND TRANSFER (SEC 49–56) – ALSO REFER TO REGULATION 32

Section 49 provides that securities must be evidenced by certificates, but they may also be without any certificates. Certificated means evidenced by a certificate, while uncertificated means that no certificates have been issued. **Section 50** provides that every company must establish a register of its issued securities in the prescribed form and maintain such register according to prescribed standards (refer to **Regulation 32** for the form and standards). **Section 51** stipulates the information that must be included in a certified security certificate and the information that must be entered in the security register when a transfer takes place. **Section 56** provides for a company's issued securities to be held and registered in the name of one person for the beneficial interest of another person.



STUDY

Study sections 49 to 56 of the Companies Act as well as Regulation 32.

SUMMARY

In this learning unit, we explained and applied the requirements for the registration and transfer of securities in terms of the Companies.

After having worked through the learning unit and the references to the prescribed study material, determine if you are able to:

Give advice, discuss concerns, and apply the requirements for securities registration and transfer.

LEARNING UNIT 3.3

GOVERNANCE OF COMPANIES

INTRODUCTION

This learning unit discusses the way in which a company is governed. It includes matters such as shareholders and their voting rights, the conducting of meetings and shareholders' resolutions.

3.3.1 SHAREHOLDERS AND VOTING RIGHTS (SEC 57)

Take note that a shareholder is entitled to exercise any voting rights in relation to a company, irrespective of the form, title or nature of the securities (shares) to which those voting rights is attached.

Section 57 furthermore provides for the way in which voting rights will be exercised in instances where, in a profit company (other than a state-owned company), there is only one shareholder or only one director, and another instance where every shareholder is also a director of the company.

It also provides that the governance requirements in sections 59 to 65 do not apply where a profit company (other than a state-owned company) has only one shareholder. For example, the requirements for notice, quorum and conduct at meetings will not apply.



STUDY

Study section 57 of the Companies Act.

3.3.2 PROXIES, QUORUMS, NOTICE OF MEETINGS AND CONDUCTING OF MEETINGS (SEC 58-64)

The requirements for the above should be studied, as they form part of the steps in passing ordinary or special resolutions.

What is an ordinary shareholders' resolution? What is a special shareholders' resolution? How do these resolutions differ from a directors' resolution?

Study the definitions of these terms found in section 1 of the Companies Act; note how these two types of resolutions differ from each other. You need to remember that a special resolution requires a higher percentage of voting rights than an ordinary resolution would. This will be discussed in more detail in, section 3.3.3.

Directors are discussed in topic 4 of this study guide. They are the people managing the company, and they make the day-to-day decisions necessary to run a company.



STUDY

Study sections 58-64 of the Companies Act.

ACTIVITY 5

TechNet (Pty) Ltd is a large computer services firm that specialises in the implementation of computer networks. As would be expected, TechNet (Pty) Ltd uses leading-edge technology and its own financial and related systems are fully integrated. The company has fifteen ordinary shareholders.

Daniel Buys has informed Nancy Loop is of his intention to raise additional finance amounting to R5 000 000 for the company by issuing another number of ordinary shares. The company's only authorised share capital comprises 100 000 ordinary shares that have no par value. However, these shares have already been issued in full. Daniel Buys has therefore asked Jolly & Hills for advice in this regard, particularly about the requirements relating to the issue contained in the Companies Act. It is intended that the directors of TechNet (Pty) Ltd be offered shares. None of the directors currently hold shares. The company's MOI prohibits shareholders' meetings from being held via electronic means.

REQUIRED

Discuss the sections of the Companies Act, with which TechNet (Pty) Ltd will need to comply in respect of the proposed issue, but **only in terms of the requirements applicable to the shareholders' meeting to be held**. You must deal with all matters pertaining to the meeting, for example, the quorum, resolution, notice, etc. You will also have to apply section 65 that relates to section 4.3.3 of the study guide.

(21)

(Adapted – Gowar & Jackson 2012)

FEEDBACK ON ACTIVITY 5

As there is a need to hold a shareholders' meeting, the board will have to provide all shareholders with written notice

- of the date, time and place of the meeting
- of the specific purpose of the meeting (to issue shares) (A copy of the resolution must be provided.)
- of the percentage of voting rights required for the resolution (special)
- that a shareholder, who is entitled to vote, may appoint a proxy (this must be reasonably prominently displayed on the notice)
- that satisfactory identification will be required from shareholders to attend

This notice must be given at least 10 business days before the meeting will be held. (The MOI may stipulate a longer or shorter notice period.)

The meeting to pass this resolution may only begin if 25% of the voting rights entitled to be voted in respect of at least one matter to be decided at the meeting (there may be other matters to be covered at the meeting) are present.

For the debate to commence on the share issue resolution, holders of at least 25% of the shares entitled to vote in respect of the share issue must be present when the matter is called on the agenda. For TechNet (Pty) Ltd, it means that holders of at least 25% of the (existing) ordinary shares need to be present. (Note: The MOI may stipulate lower percentages.)

The previous paragraph deals with a voters' quorum. In addition, as TechNet (Pty) Ltd has more than two shareholders, the meeting may not begin or a matter be debated, unless at least three shareholders are present at the meeting.

At the commencement of the meeting, shareholders' identity as well as their right to attend or participate must be verified. The person presiding over the meeting must be satisfied with the validity of the shareholders' identity.

The proposed resolution must be sufficiently clear and specific. It must also be accompanied by sufficient information to enable a shareholder to decide whether to participate in the meeting and "influence the outcome" of the vote on the resolution or not.

For the (special) resolution on the share issue to be passed, at least 75% of the voting rights exercised on the resolution must support it. (Note: The MOI may stipulate a lower or higher percentage, but the difference between the percentage for an ordinary and a special resolution must be at least 10%.)

Voting should be by poll (not by a show of hands). Voting by poll enables those shareholders with larger shareholdings to exercise greater influence on the vote.

3.3.3 SHAREHOLDERS' RESOLUTIONS (SEC 65)

Shareholders' resolutions can be one of the following

- **Ordinary resolutions**

In terms of the definition given in section 1, an ordinary resolution means a resolution adopted with the **support of more than 50%** of the voting rights exercised on the resolution, or a higher percentage as contemplated in section 65(8).

- **Special resolutions**

In terms of the definition given in section 1, a special resolution means a resolution adopted with the **support of at least 75% of the voting** rights exercised on the resolution, or a different percentage as contemplated in section 65(10).

Note: Both of the above resolutions are **shareholders'** resolutions. Should you in the exam, or in any of your assignments, refer to "*an ordinary or a special resolution of the board/directors*", you will not receive any marks for the statement.

A company's Memorandum of Incorporation may permit

- (a) a different percentage of voting rights to approve any special resolution; or
- (b) one or more different percentages of voting rights to approve special resolutions concerning one or more particular matters, respectively, provided that a margin of at least 10 percentage points must be maintained at all times between the highest established requirement for approval of an ordinary resolution on any matter, and the lowest established requirement for approval of a special resolution, on any matter.

When is a special resolution needed?

A special resolution is required to

- (a) amend the company's Memorandum of Incorporation to the extent required by section 16(1)(c) and section 36(2)(a)
- (b) ratify a consolidated revision of a company's Memorandum of Incorporation, as contemplated in section 18(1)(b)
- (c) ratify actions by the company or directors in excess of their authority, as contemplated in section 20(2)
- (d) approve an issue of shares or grant of rights in the circumstances contemplated in section 41(1)
- (e) approve an issue of shares or securities as contemplated in section 41(3)
- (f) authorise the board to grant financial assistance in the circumstances contemplated in section 44(3)(a)(ii) or 45(3)(a)(ii)
- (g) approve a decision of the board for re-acquisition of shares in the circumstances contemplated in section 48(8).
- (h) authorise the basis for compensation to directors of a profit company, as required by section 66(9)
- (i) approve the voluntary winding-up of the company, as contemplated in section 80(1)
- (j) approve the winding-up a company in the circumstances contemplated in section 81(1)
- (k) approve an application to transfer the registration of the company to a foreign jurisdiction as contemplated in section 82(5).
- (l) approve any proposed fundamental transaction, to the extent required by Part A of Chapter 5
- (m) revoke a resolution contemplated in section 164(9)(c)

The section numbers referred to in the above paragraph are the sources for the particular special resolution requirements. Since some sections referred to are not listed on pages 5 and 6 of this study guide, it will not be necessary for you to discuss, for example, the requirement for a special resolution in instances such as in (b), (i), (j), (k) and (m) in the examination.

Take note that in terms of the Act, sections 57, 59 and 61 to 65, which relate to this topic, are alterable.



STUDY

Study section 65 of the Companies Act.

SUMMARY

In this learning unit, we explained and applied the requirements regarding governance of companies, including the meeting requirements regarding notices, quorums and voting relating to special resolutions in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, determine if you are able to:

Give advice, discuss concerns, and apply the requirements for the governance of companies, including the meeting requirements in respect to notices, quorums and voting relating to special resolutions.
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LEARNING UNIT 3.4

PUBLIC OFFERINGS OF COMPANY SECURITIES

INTRODUCTION

The sections that are dealt with in this learning unit are to be studied on level 1. This means that you will not be required to give advice, discuss concerns and apply the requirements for the matters included in this learning unit, as set out in the Companies Act.

3.4.1 PUBLIC OFFERINGS OF COMPANY SECURITIES (SEC 95- 97 AND 99–111)

Since share offers to the public are restricted (section 99), section 96 lists the instances where an offer is not an offer to the public and where restrictions will not apply. Section 97 provides for standards for qualifying employee share schemes; exemptions, for which an employee share scheme qualifies, are contemplated in sections 42(2)(d), 44(3)(a)(i) or 45(3)(a)(i). The first section refers to shareholder approval (special resolution) that is not required if the issue is pursuant to an employee share scheme, while the second and last sections refer to the board's authorisation of financial assistance if it is pursuant to an employee share scheme.

Section 100 lists the requirements for a prospectus and further provides that every prospectus be subject to the requirements of sections 102 to 111. In order to understand some of the phrases used in the sections listed above, you will have to study the definitions in section 95. For example, section 100(1) provides that the requirements for a prospectus do not apply to listed securities, except listed securities that are the subject of an initial public offering. The definition of the latter is included in section 95(1)(e).

Section 104 provides for liability for untrue statements in the prospectus. It refers to four parties that may be liable to compensate any person, who acquired securities on the faith of the prospectus, for any loss or damage the person may have sustained as a result of any untrue statement in the prospectus. Section 105 provides for liability of experts and others. According to the definition of an expert in terms of section 95, it includes, for example, an accountant or an auditor.



STUDY

Study sections 95-97 and 99- 111 of the Companies Act on level 1.

SUMMARY

In this learning unit, we explained and applied the requirements for public offerings of company securities in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, determine if you have:

A basic knowledge and understanding of the requirements for public offerings of company securities in terms of the Act is required.

CONCLUSION

In this topic about **shareholders and shares**, we explained and applied the requirements regarding capitalisation of profit companies, securities registration and transfer, governance of companies, and public offerings of company securities in terms of the Companies Act.

In the next topic we will deal with these persons who manage the affairs of a company. They are called the directors.