

TOPIC 6

TRANSACTIONS

TOPIC OVERVIEW

The topic deals with transactions where **financial assistance and loans** are provided (sec 44 & 45, respectively), and with **fundamental transactions** (sec 112 & 115).

Sections 44 and 45 are very important sections for your studies of the Companies Act.

Davis, Cassim, Geach, Mongalo, Buler, Loubser, Coetzee and Burdette (2011:191¹) describe fundamental transactions as transactions that significantly affect ownership of a company's assets or that signal a notable change in shareholding of a company. This attracted additional regulation under the Companies Act; however, some transactions are not permitted at all

Fundamental transactions refer to the following transactions:

- the disposal of all or the greater part of the company's assets or undertaking (sec 112)
- amalgamations or mergers (sec 113)
(for information purposes)
- schemes of arrangement (sec 117)
—(for information purposes)

¹ Davies, D, Cassim, F, Geach, W, Mongalo, T, Buler, D, Loubser, A, Coetzee, L & Burdette, D. 2011. *Companies and other business structures in South Africa*. Cape Town, SA: Oxford University Press.

We will just focus on the first fundamental transaction (sec 112) and you are only required to have a broad idea about the last two types of transactions.

Topic 6 is divided into the following learning units:

Learning unit	Title
6.1	Financial assistance for subscription of securities
6.1.1	Financial assistance for subscription of securities (sec 44)
6.2	Loans or other financial assistance to directors
6.2.1	Loans or other financial assistance to directors (sec 45)
6.3	Proposals to dispose of all or the greater part of assets or undertaking
6.3.1	Proposals to dispose of all or the greater part of assets or undertaking (sec 112 & 115)

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
6.1 Financial assistance for subscription of securities	<ul style="list-style-type: none"> Give advice, discuss concerns, and apply the requirements regarding financial assistance for subscription of securities. 	2
6.2 Loans or other financial assistance to directors	<ul style="list-style-type: none"> Give advice, discuss concerns, and apply the requirements regarding loans or other financial assistance to directors. 	2
6.3 Proposals to dispose of all or greater part of assets or undertaking	<ul style="list-style-type: none"> Give advice, discuss concerns, and apply the requirements regarding proposals to dispose of all or greater part of assets or undertaking. 	2

LEARNING UNIT 6.1

FINANCIAL ASSISTANCE FOR SUBSCRIPTION OF SECURITIES

INTRODUCTION

The Act deals with two types of financial assistance. The first is financial assistance for subscription of securities, and the second is loans or other financial assistance to directors. In this learning unit, we will deal with the first. An example of financial assistance for subscription of securities would be a company that lends money to someone to enable that person to purchase shares in the company. This will now be discussed in more detail.

6.1.1 FINANCIAL ASSISTANCE FOR SUBSCRIPTION OF SECURITIES (SEC 44)

It is important to note that section 44(1) indicates that financial assistance does not include lending money in the ordinary course of business by a company whose primary business is the lending of money. **For example**, a bank normally lends money in its ordinary course of business. If you were to lend money from the bank, at the same interest rate and repayment terms as would apply to any other person, and thereafter used this money to purchase shares in the bank, which lent you the money, this would **not** constitute financial assistance in terms of section 44.

Financial assistance includes a loan, a guarantee, or the provision of security or otherwise to any person for the purpose of, or in connection with, the subscription of any option, or securities, issued or to be issued by the company or a related or interrelated company, or for the purpose of any securities of the company or a related or interrelated company [sec 44(2)].

From the above paragraph, it is evident that the lending of money is not the only type of financial assistance covered by section 44. If a company would give up a building, which it owns as security in order for you to obtain a loan (to enable you to purchase shares in this company), it would constitute financial assistance in terms of section 44.

In order for financial assistance to be provided legally in terms of section 44

- it should be approved by the board (directors' resolution)

- any restrictions in the company's MOI must be complied with
- a special resolution should have been passed within the previous two years, which approved such assistance either for the specific recipient or generally for a category of potential recipients, and the particular recipient(s) should fall within this category
- the board should be satisfied that the solvency and liquidity tests have been satisfied immediately after providing the financial assistance
- the board should be satisfied that the terms under which the financial assistance is to be given are fair and reasonable to the company
- the board must ensure that if the company's MOI includes any conditions or restrictions regarding the giving of financial assistance, they must have been complied with (Note: It is not a prerequisite that the company's MOI must authorise such a transaction. In other words, if no reference is made in the MOI to financial assistance, the transaction can still go ahead, provided the company has complied with the other requirements set out above.)

The inclusion of the special resolution requirement is an essential safeguard against potential abuse of power by the directors.

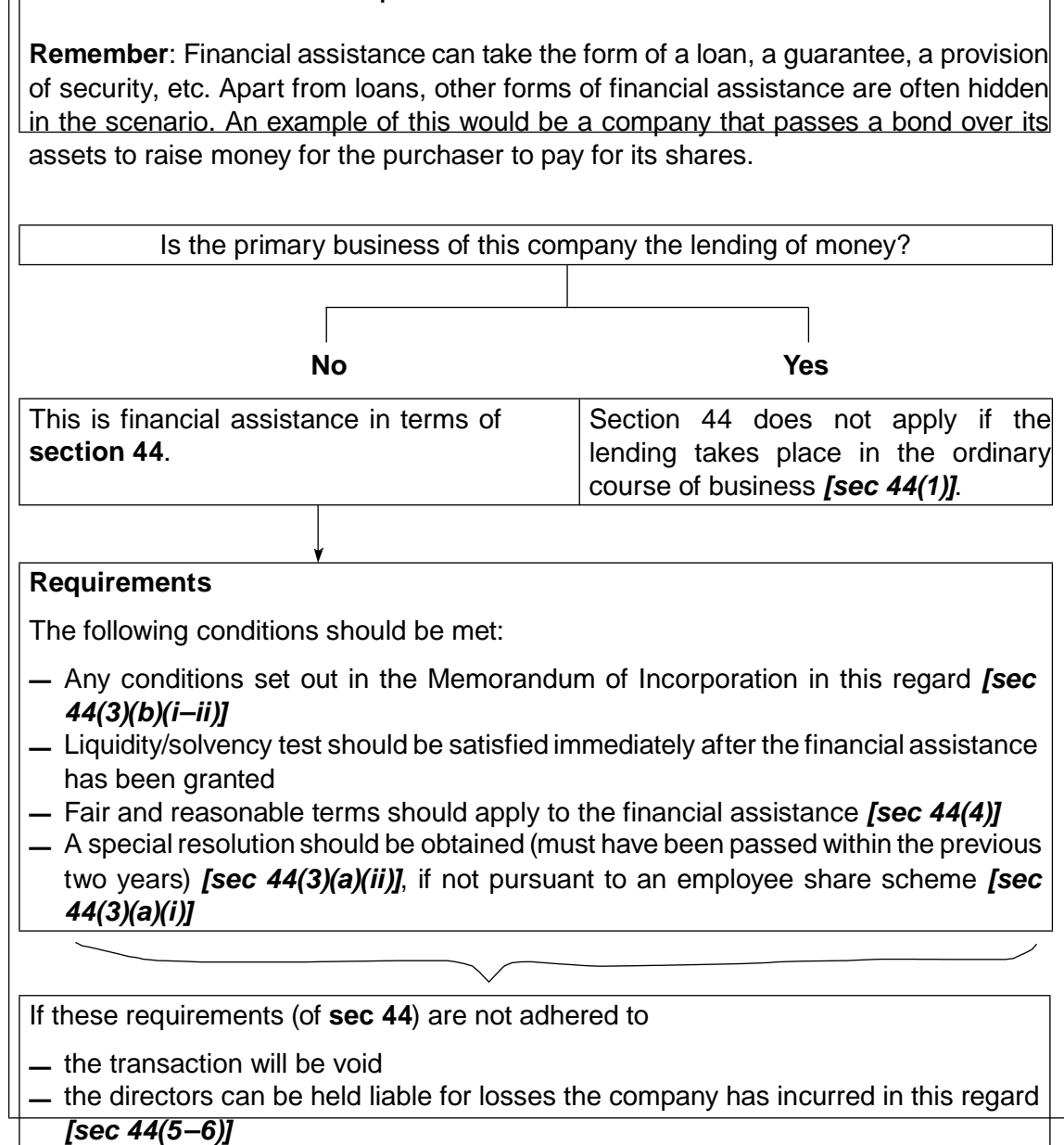
Securities referred to above include

- bonds, debentures and any other form of security
- the purchase of any securities of the company or a related or interrelated company (in other words, the securities of upward, downward and sideways-related companies)

Diagram 6.1.1 below contains a summary of section 44.

Diagram 6.1.1

Financial assistance to purchase securities



STUDY

Study section 44 of the Companies Act.

ACTIVITY 1

You have knowledge of the Companies Act.

Relevant details of the Loftus Group are as follows:

Holding company:	Loftus (Pty) Ltd	
Shareholders of Loftus (Pty) Ltd:	Victor Hatfield	40%
	Hein Meyer	15%
	Smiley Human	15%
	15 minor shareholders	30%

Loftus (Pty) Ltd holds 75% of the shares in Bulle (Pty) Ltd. Frontrow CC holds the other 25% of the shares in Bulle (Pty) Ltd. The members of Frontrow CC are Hotboy Rapele, Barry Boota and Wynand Oliver, each of whom has an equal members' interest.

Loftus (Pty) Ltd also holds 55% of the shares in Sundown (Pty) Ltd; numerous individuals, who are not connected with the Loftus Group at all, hold the other 45% of the shares.

The directors of the various companies are as follows:

Loftus (Pty) Ltd	Bulle (Pty) Ltd	<i>Sundown (Pty) Ltd</i>
Victor Hatfield	Hotboy Rapele	Brave Baloyi
Lane Kershner	Wynand Oliver	Danny Mudow
Hotboy Rapele	Jon Mametsi	Patrick Motsepa
Frans Hougie	Dupree Fourie	Frans Hougie

The following matters with possible legal implications have been referred to you:

Matter 1

Sundown (Pty) Ltd intends issuing shares to all its current shareholders. Bulle (Pty) Ltd agreed to finance the shareholders of Sundown (Pty) Ltd to enable them to purchase those shares. This is not financial assistance pursuant to an employee share scheme.

REQUIRED

In respect of **matter 1**, discuss the requirements of the Companies Act, 2008, which must be complied with in respect of the loan to the shareholders of Sundown (Pty) Ltd.

(12)

FEEDBACK ON ACTIVITY 1

Reference: Section 44 of the Companies Act

Matter 1

Bulle (Pty) Ltd may make this loan, provided

- any conditions or restrictions in respect of the granting of “financial assistance” set out in the MOI are adhered to
- the board is satisfied that immediately after providing the loan, Bulle (Pty) Ltd satisfied the liquidity/solvency test
- considering all reasonably foreseeable financial circumstances of the company
 - the assets of the company, fairly valued, equalled or exceeded the liabilities of the company, fairly valued
 - it appears as if the company would be able to pay its debts as they

become due in the ordinary course of business for a period of 12 months from the date of considering the liquidity and solvency of the company

- the board is also satisfied that the terms of the loan are fair and reasonable to the company
- a **special** resolution was obtained

The special resolution must have been obtained within the previous two years and could have been for a specific loan to the shareholders of Sundown (Pty) Ltd, or generally for a category of potential recipients, and the specific recipient falls into that category (sec 44(3)(a)(ii)).

The MOI cannot permit the granting of a loan in contravention of this section, for example, that it provides that the loan does not require a special resolution.

SUMMARY

In this learning unit, we explained and applied the requirements regarding financial assistance for subscription of securities in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, you should be able to:

Give advice, discuss concerns, and apply the requirements regarding financial assistance for subscription of securities.
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LEARNING UNIT 6.2

LOANS OR OTHER FINANCIAL ASSISTANCE TO DIRECTORS

INTRODUCTION

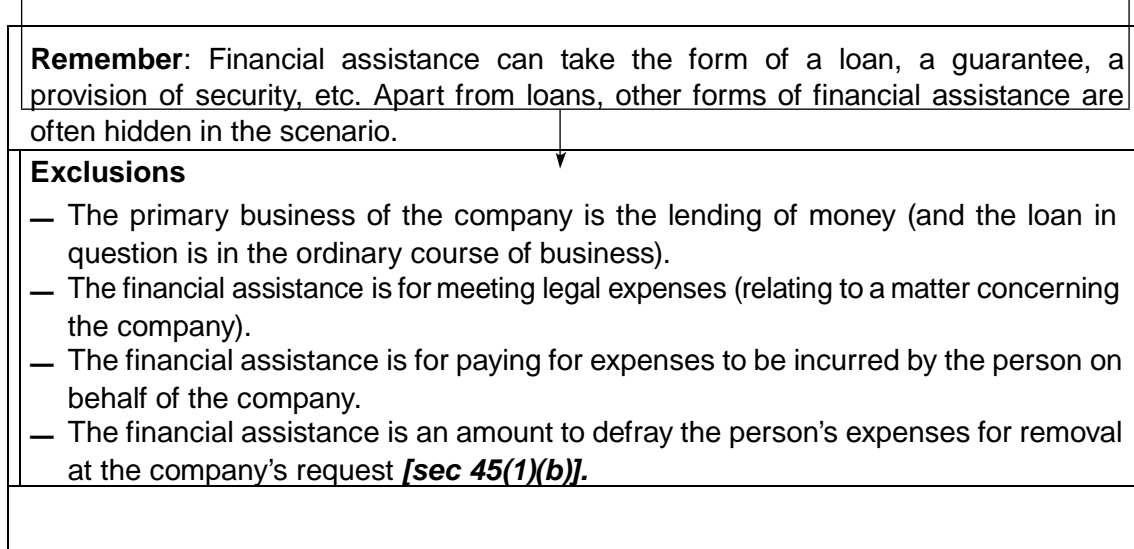
In this learning unit, we will discuss the second type of financial assistance, namely, loans or other financial assistance to directors. Section 45 applies to loans or financial assistance to directors and includes the granting of a loan or other financial assistance from a company to one of its directors or a related person (sec 2 of the Act) of the director. The requirements of section 45 are largely similar to those of section 44.

6.2.1 LOANS OR OTHER FINANCIAL ASSISTANCE TO DIRECTORS (SEC 45)

To determine if a company may provide financial assistance to any of the parties as set out in **section 45(2)** of the Companies Act, the requirements as set out in diagram 6.2.1 below should be considered:

Diagram 6.2.1

Loans or other financial assistance to directors



Requirements

The following conditions should be met before providing the assistance:

- Any conditions set out in the Memorandum of Incorporation in this regard should be met **[sec 45(4)]**.
- The liquidity/solvency test should be satisfied immediately after the financial assistance has been granted **[sec 45(3)(b)]**.
- The terms should be fair and just.
- A special resolution should be obtained (must have been passed within previous two years) **[sec 45(3)(a)(ii)]** (except if the financial assistance is pursuant to an employee share scheme).
- Written notice of the meeting and the intended assistance should be given to all shareholders (unless all shareholders are directors) **[sec 45(5)]**.
- Written notice of the meeting and the intended assistance should be given to any trade union that is representing the employees of the company **[sec 45(5)]**.



If the requirements (of **sec 45**) are not adhered to

- the transaction will be void
- the directors can be held liable for losses incurred by the company **[sec 45(6–7)]**



STUDY

Study section 45 of the Companies Act.

ACTIVITY 2

After you have studied the relevant sections from your prescribed textbook, you should try to answer the following questions to test your knowledge.

You are a member of the audit team working on the 30 June 2012 audit of Smugglers (Pty) Limited, an export/import company. Borders Limited holds 70% of Smugglers (Pty) Limited's capital, while other companies in the group are Guards (Pty) Limited (of which Borders Limited holds 100%) and Contraband (Pty) Limited (of which 60% is held by Smugglers (Pty) Limited). Eleven private investors hold the remaining shares in Smugglers (Pty) Limited.

Of the four companies within the group, you are responsible for the audit appointment of Smugglers (Pty) Limited only. The three remaining companies are audited by other firms.

Borders Limited purchased 30% of its shares in Guards Proprietary Limited on 31 October 2011. Prior to this, it already owned 70% of the shares.

Your permanent audit file revealed the following:

Directors of:

Borders Limited	Billy Kidd Roy Rogers Davy Crockett Horst Trigger
Smugglers (Pty) Limited	J T Edson Louis L'amour Bill Ocean
Contraband (Pty) Limited	Roy Rogers Willy Nelson
Guards (Pty) Limited	Bill Haley Chuck Berry

You have been assigned to the audit of statutory matters and as part of the procedures you will need to perform, you have extracted the following matter for consideration:

A loan of R1.5 million made to Roy Rogers for his personal use.

REQUIRED

Discuss the loan made by Smugglers (Pty) Limited in terms of the Companies Act, 2008. (8)

FEEDBACK ON ACTIVITY 2

Reference: Section 45 of the Companies Act

In terms of section 45 of the Companies Act, the board of Smugglers (Pty) Limited may authorise the loan to a director of itself (not the case) or the director of a related company. Roy Rogers is a director of Smugglers (Pty) Limited's holding company and of its own subsidiary Contraband (Pty) Limited. Roy Rogers therefore qualifies as "related".

In making any loans to directors, the board has to comply with any conditions or restrictions contained in the MOI.

In making the loan, the board must

- ensure the loan is pursuant to a special resolution of the shareholders, adopted within the previous two years and which approved the loan specifically to Roy Rogers or generally to a category of potential recipients into which Roy Rogers would fall (for example, directors)
- be satisfied that immediately after providing the financial assistance, Smugglers (Pty) Limited would satisfy the solvency and liquidity test
- be satisfied that the terms and conditions of the loan are fair

The MOI cannot overrule the above conditions.

The board must provide written notice of this resolution to the shareholders and any trade union representing its (Smugglers (Pty) Limited's) employees. If the total value of all financial assistance (contemplated under this section) given within the financial year exceeds one-tenth of 1% of the company's net worth at the time of the resolution, this notice must be given within 10 business days of the resolution. If the total value does not exceed one-tenth of 1% of the net worth, the notice period will be 30 days from year end.

If the board approves the loan in contravention of section 45 or the MOI, it will be void.

ACTIVITY 3

Using the information provided in activity 1 (learning unit 6.1) and the following matters, answer the question below.

Matter 1

The board of Loftus (Pty) Ltd approved low-interest unsecured loans of R500 000 each to Frans Hougie and Brave Baloyi to enable them to invest (in their private capacities) in a newly formed company that manufactures rugby and soccer balls. The loans were approved based on a unanimous decision the four directors of the board made after the board had considered the liquidity and solvency of Loftus (Pty) Ltd and found it to be satisfactory.

REQUIRED

In respect of **matter 1**, discuss the possible consequences of granting the loans to Frans Hougie and Brave Baloyi. (15)

FEEDBACK ON ACTIVITY 3

Reference: Sections 45, 76 and 77 of the Companies Act

Matter 1

These loans were granted in contravention of the Companies Act, 2008. The loans were granted on the strength of the **board's** approval that required a special resolution of the shareholders. A special resolution was required, as the loans were granted to a director (Frans Hougie) of the company itself **and** a company related to Loftus (Pty) Ltd (Sundown [Pty] Ltd) and another director, Brave Baloyi, of the same related company. Sundown (Pty) Ltd is a subsidiary of Loftus (Pty) Ltd.

It is also evident that Frans Hougie voted on a transaction in which he had a direct financial interest. He is not entitled to vote on the matter or even participate in the consideration of the loan.

The board of directors also failed to ensure that the conditions of the loan were fair to the company. Providing **unsecured** low-interest loans, which they should have

known were to be invested in a newly formed company, is not fair to the company (Loftus [Pty] Ltd).

It is further evident that these loans were given in contravention of section 45; they will therefore be void. As all four directors voted in favour of the loan, they will be jointly and severally liable for any losses that Loftus (Pty) Ltd may suffer because of, say, the loans not being repaid.

Then there is the matter of the directors' standards of conduct. In terms of section 76, a director must exercise the powers and functions of a director

- in good faith and for a proper purpose
- in the best interest of the company
- with the degree of care, skill and diligence reasonably expected of a director

This means that the director should take reasonable, diligent steps to be informed about the matter at hand. A diligent director would definitely have been aware of the authority and procedures required for the proper authorisation of a loan to a director. Thus, the directors have not acted in accordance with the above guidelines.

In terms of section 77, the directors of Loftus (Pty) Ltd may be held liable for any loss, damages or costs the company sustained because of a breach of fiduciary duty. Did they, for example, act in bad faith when approving the loans, or did they commit a delict regarding any breach of the directors' duty to act with the necessary degree of care, skill and diligence?

SUMMARY

In this learning unit, you learned about the requirements regarding loans or financial assistance to directors in terms of the Companies Act .

After having worked through the learning unit and the references to the prescribed study material, you should be able to:

Give advice, discuss concerns, and apply the requirements regarding loans or financial assistance to directors.

LEARNING UNIT 6.3

PROPOSALS TO DISPOSE OF ALL OR THE GREATER PART OF ASSETS OR UNDERTAKING

INTRODUCTION

A company's board of directors has the power to manage the company, but what happens if the board wants to dispose of the whole or the greater part of the company's business or assets? This does not constitute managing the business, but involves putting an end to the business or the greater part of it. This is a decision of a fundamental nature and sections 112 and 115 deal with decisions of this nature.

6.3.1 PROPOSALS TO DISPOSE OF ALL OR THE GREATER PART OF ASSETS OR UNDERTAKING (SEC 112 AND 115)

Section 112(2) provides that [except for those instances mentioned in sec 112(1)] the requirements for disposal of the greater part of the assets or undertaking include inter alia

- a special resolution of the shareholders, in accordance with section 115 (A special resolution is required in order to protect minority shareholders in particular by ensuring that a significant minority can block large disposals.)
- that the company has satisfied all other requirements set out in section 115, to the extent that those requirements are applicable to such disposal by that company (The protective measure in section 115(4) promotes fairness and decreases the risk of conflicts of interest.)
- the notice of a shareholder's meeting to consider a resolution to approve the special resolution in the first point above, which must
 - be delivered in terms of section 62
 - include or be accompanied by a written summary of the precise terms of the transaction to be considered at the shareholder's meeting as well as the provisions of sections 115 and 164

Section 112(4) requires that where any part of the assets of the company or the undertaking is disposed, the company must be sold at its fair market value. The

price should be that which an interested seller would pay to an interested buyer in an open market.

A resolution contemplated in this section is effective only to the extent that it authorises a specific transaction [sec 112(5)]. The effect of this provision is to remove the possibility of a company seeking broad approval at an annual general meeting and then making substantial asset sales soon thereafter.

Section 115 makes provision for approvals required for major disposals, mergers and amalgamations, and schemes of arrangement. It provides inter alia that the proposed transaction must be approved

- by a special resolution adopted by persons entitled to exercise voting rights on such matter, at a meeting called for that purpose and at which sufficient persons are present to exercise, in aggregate, at least 25% of all the voting rights that are entitled to be exercised on the matter, or any higher percentage as may be required by the company's MOI, as contemplated in section 64(2)
- by a special resolution, also in the manner described in the above paragraph, by the shareholders of the company's holding company (if applicable), if
 - the holding company is a company or an external company
 - the proposed transaction concerns a disposal of all or the greater part of the assets or undertaking of the subsidiary
 - having regards for the consolidated financial statements of the holding company, the disposal by the subsidiary constitutes a disposal of all or the greater part of the assets or undertaking of the holding company
- by the court, to the extent required under the circumstances and in the manner contemplated in subsections (3) to (6) of section 115.

Take note that despite a resolution having been adopted as contemplated in the first two manners set out above, a company may not proceed to implement that resolution without the **approval of a court** and without meeting certain further requirements (refer to sec 115(3)(a) and (b)).

ACTIVITY 4

Block (Pty) Ltd is a company that manufactures brass-plumbing requisites. The company has five directors. The most senior directors of Block (Pty) Ltd, John Joint and Eric Elbow, have been concerned about the falling sales of brass-plumbing requisites and the appearance on the market of a new plastic range of plumbing requisites imported from Taiwan. They intend taking the following action:

They are planning to sell all the company's manufacturing equipment, thus getting out of the brass-plumbing requisites market.

A scrutiny of the company's statutory records has revealed that the company has 150 000 authorised shares, 100 000 of which are in issue. John Joint and Eric Elbow hold minor shareholdings, while no other directors hold shares. The authorised shares are no par value shares.

REQUIRED REQUIRED

Discuss the intentions of John Joint and Eric Elbow regarding the selling of all the company's manufacturing equipment in terms of the Companies Act.

FEEDBACK ON FEEDBACK ON ACTIVITY 4

Reference: Sections 112 and 115 of the Companies Act

Disposal of the greater part of the assets

1. The directors may not dispose of the greater part of the assets of Block (Pty) Ltd without a special resolution taken by the shareholders.
2. As the two directors are "minor" shareholders, they will not have sufficient voting rights on their own.
3. The directors need to give 10 business days' notice of the meeting to the shareholders.
4. The notice must include a written summary of the terms of the transactions (selling the assets).
5. To form a quorum, sufficient persons (shareholders/proxies) must attend the meeting to exercise at least 25% of the voting rights that are entitled to be exercised on the matter.
6. Unless the MOI stipulates a different percentage, the resolution must be passed by 75% of the voting rights (exercisable on the matter) present in person or by proxy.

SUMMARY

In this learning unit, you learned about the requirements regarding proposals to dispose of all or greater part of assets or undertaking of a company in terms of the Companies Act.

After having worked through the learning unit and the references to the prescribed study material, you should be able to:

Give advice, discuss concerns, and apply the requirements regarding proposals to dispose of all or greater part of assets or undertaking of a company.

CONCLUSION

In this topic about **transactions**, we explained and applied the requirements regarding financial assistance for subscription of securities, loans or other financial assistance to directors and proposals to dispose of all or greater part of assets or undertaking of a company. The next topic, topic 7, deals with business rescue, compromise with creditors as well as deregistration and winding up of a company (when a company ends).