DEPARTMENT OF MERCANTILE LAW

ENTREPRENEURIAL LAW (MRL2601)

TUTORIAL LETTER 201/1/2011

FIRST SEMESTER

Dear Student

You should already have received the following tutorial letters:

1 Tutorial Letter MRL2601/101/3/2011, which deals with various matters, including Assignments 01 and 02
2 Tutorial Letter MRL2601/102/3/2011, which deals with the particulars of the lecturers, the discussion classes and details of the examination

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1 FEEDBACK ON ASSIGNMENT 01

QUESTION 1

Answer: (3)


(1) is CORRECT. Even though trusts are not separate legal personae, trust debts are usually only paid out of the trust estate.

(2) is CORRECT. It is possible to provide for the continuation of a trust, despite a change in trustee or the trust beneficiaries. Therefore trusts may enjoy the privilege of perpetual existence.

(3) is INCORRECT. Any person, whether a natural or legal person, may be a trust beneficiary.

(4) is CORRECT. There are few statutory limitations connected with trusts.
QUESTION 2

Answer: (2)

Reason: See *Companies and other business structures in SA, par 14.12.*

(1) is CORRECT. Natural and legal persons may be party to a trust as founders, trustees or beneficiaries.

(2) is INCORRECT. A trustee cannot expose trust assets to business or other risks because this would be a breach of a trustee’s fiduciary duties.

(3) is CORRECT. Business trusts hold the advantage of limited liability and they are not exposed to risks and failures.

(4) is CORRECT. Natural and legal persons may be party to a trust as founders, trustees or beneficiaries.

QUESTION 3

Answer: (4)

Reason: See *Companies and other business structures in SA, par 12.3.4 and 12.3.5.*

A and C are INCORRECT. A partnership is formed by means of a valid agreement, including all the *essentialia* for a partnership contract. Partnerships may also not conduct business that is prohibited by law or public policy. Legality is one of the general requirements for the conclusion of a valid contract.

B and D are CORRECT. There is no prohibition against the conclusion of a partnership agreement between natural and legal persons.

QUESTION 4

Answer: (1)

Reason: See *Companies and other business structures in SA, par 12.3.1.*

(1) is INCORRECT. A contribution must be exposed to the risk of the business, otherwise it does not comply with the requirements for a valid contribution.

(2) is CORRECT. As long as the contribution has an economic value, it complies with the requirement.

(3) is CORRECT. The use of her truck may be viewed as a contribution, as it does have a money value.

(4) is CORRECT. Even though it is one of the *naturalia* of a partnership agreement that no compensation be payable in respect of contributions made, it is possible for the parties to agree otherwise.
QUESTION 5

Answer: (2)

Reason: See *Companies and other business structures in SA, par 12.3.*

(1) is INCORRECT. The *essentialia* for conclusion of partnership agreements include that the partnership be established for the purpose of making a profit.

(2) is CORRECT. The purpose of the establishment of the partnership is clearly not to make a profit. As this is one of the *essentialia* of a partnership, the partnership does not come into existence.

(3) is INCORRECT. A contribution must be appreciable or have an economic value. Despite the fact that the building material must be paid for, it remains a valid contribution because the saving for getting the material at cost price is appreciable.

(4) is INCORRECT. If not all the *essentialia* are present, no valid partnership can be concluded.

QUESTION 6

Answer: (1)

Reason: See *Companies and other business structures in SA, par 12.5 and 12.6.2.*

(1) is INCORRECT. Partners enjoy authority to conclude contracts falling within the scope of the partnership business. This is also referred to as the principle of mutual mandate.

(2) is CORRECT. It is one of the rights of partners to participate in the management of the partnership.

(3) is CORRECT for the same reason as (2) above.

(4) is CORRECT. The right to inspect the accounting books coincides with the duty of each partner to keep proper accounts. Therefore, each partner has the right to inspect the partnership’s accounting records.

QUESTION 7

Answer: (3)

Reason: See *par 10.4 of the study guide.*

A and C are CORRECT. If a partner’s co-partners consent to his or her personal use of a partnership asset, or if the personal use is limited and does not conflict with the interests of the partnership, such a partner would be permitted to use the asset.
QUESTION 8

Answer: (4)

Reason: See *Companies and other business structures in SA, par 12.4.1.2.*

(1), (2) and (3) are INCORRECT. Had the car been bought for the partnership, the partners would have been co-owners of the car and co-debtors towards Damascena. In that case Damascena would have to sue the partners either jointly or alternatively in the name of the partnership.

Because the asset was bought for Zola and is not a partnership asset, Damascena will have to sue Charles.

QUESTION 9

Answer: (4)

Reason: See *Companies and other business structures in SA, par 12.4, 12.6.1 and 12.6.2.*

See also study unit 10.5 of the study guide.

(1) is CORRECT. Partners share in the losses of the partnership in the same relation as in the partnership’s profits, unless they agree otherwise.

(2) is CORRECT. Owing to the fact that a partnership does not enjoy separate legal personality, the partners are co-owners of the partnership assets.

(3) is CORRECT. It is a natural consequence of a partnership agreement that partners will not receive compensation for the contributions they make. They are remunerated by the profits made and divided between them.

(4) is INCORRECT. This is one of the *essentialia* of a partnership.

QUESTION 10

Answer: (1)

Reason: See *Companies and other business structures in SA, par 12.2.2.*

(1) is CORRECT. A silent partnership is a partnership that is run in only some of the partners’ names.

(2) is INCORRECT. If an extraordinary partner starts acting as an ordinary partner and starts participating in the management of the partnership, he or she loses his or her protection.

(3) is INCORRECT. A partner *en commandite* is also liable for the partnership debts, but his or her liability is limited to a specific amount.

(4) is INCORRECT. Only a partner *en commandite*’s liability is restricted to a specific amount. A silent partner remains liable for his or her share of the partnership debts.
2 FEEDBACK ON ASSIGNMENT 02

QUESTION 1

See part 13.1 of the textbook.
See also study unit 11.2 of the study guide.

You should have mentioned five (5) advantages attached to close corporations. You could have mentioned any of the following:

- A close corporation is a juristic person distinct from its members (it enjoys separate juristic personality).
- It is granted the capacity and powers of a natural person.
- Close corporations enjoy perpetual succession.
- A single person can form a close corporation; it need not be an undertaking for gain.
- Members are allowed the greatest possible flexibility in arranging their internal relationships and the management of the close corporation.
- Its formation and administration is subject to a minimum number of formalities.
- It is allowed to use its capital as it pleases, as long as it maintains solvency and liquidity.
- All members have an equal say in the management of the business.
- Members enjoy limited liability.
- The common-law principles relating to fiduciary duties and duties of care and skill in managing the affairs of the corporation are codified; thus a member knows exactly what is expected of him or her.
- The accounting and disclosure provisions are less extensive than in companies.

QUESTION 2

In this question you are asked to decide whether or not a decision to declare a dividend without a duly constituted meeting of shareholders was valid. You are also specifically instructed to refer to relevant case law.

Please note that if you did not refer to relevant case law, you would have forfeited 2 marks. If you did not reach a conclusion as to whether or not the declaration of the dividend was valid, you would also have lost a mark.

REMEMBER: Always read the questions carefully!

See study unit 6.5 of the study guide.

Certain decisions may be valid without a meeting being held if all the members are fully aware of the facts and all of them assented thereto (unanimous assent).

Refer to Gohlke and Schneider v Westies Minerals (Pty) Ltd 1970 (2) SA 685 (A) (or use an acceptable abbreviated reference). In this case it was decided that members may validly appoint a director to the board without any formal meeting being held because there was evidence of their unanimous consent.
In *re Duomatic Ltd* [1969] 1 ALL ER 161 (Ch) (or use an acceptable abbreviated reference), it was held that the unanimous approval of directors’ remuneration by the two directors holding all the voting shares in a company could be regarded as a resolution of a general meeting approving the payment.

In terms of section 60 of Companies Act 71 of 2008, a resolution may be submitted to shareholders and, if adopted in writing by the required majority, will have the same effect as if it had been adopted at a meeting, without actually holding a general meeting of shareholders. This means that the unanimous assent of all shareholders will no longer be necessary.

However, any business of a company that must, in terms of the Companies Act 71 of 2008 or the company’s memorandum of incorporation, be conducted at an annual general meeting may not be conducted by using this procedure.

Application: According to the facts, Bongi and Zandile are the directors of the company, but are also the only shareholders as they each hold 50% of the shares in Montaness (Pty) Ltd. The decision to declare the dividend is not one that must be taken exclusively at an annual general meeting.

Conclusion: Yes. Decision to declare dividend was validly made.

### 3 FEEDBACK ON CONCEPT EXAMINATION PAPER

**PLEASE NOTE:** The answers below are only guidelines and should not be regarded as model answers.

#### Section A

**Question 1**

1.1

- A profit company is incorporated for the purpose of financial gain for its shareholders.
- A profit company may be incorporated by one or more persons.
- Four entities qualify as profit companies: private, public, state-owned and personal liability companies.

- A non-profit company was previously recognised as a section 21 company and its objective must be a public object or an object relating to one or more cultural or social activities or communal or group interests.
- All assets and income of a non-profit company must be used to further the company’s stated objective.
- A non-profit company is not required to have members, but the MOI can make provision for members.

*See Companies and other business structures in SA, par 2.6.*

1.2 Existing close corporations will continue to exist, but after the promulgation of the Companies Act 71 of 2008, new close corporations can no longer be formed, nor will companies be allowed to convert into close corporations.

*See Companies and other business structures in SA, par 2.7.*
1.3

- Section 21: A person may enter into a written agreement in the name of, or purport to act in the name of, or on behalf of an entity that is contemplated to be incorporated but does not exist at the time of the agreement.

- Within 3 months of the date that the company was incorporated, the board of that company may completely, partially or conditionally ratify or reject the pre-incorporation contract. The contract is ratified retrospectively from conclusion. If the board has not ratified or rejected the contract, the company will be regarded to have ratified the agreement.

- If it has been ratified, then it is enforceable against the company as if the company had been a party when the agreement was made.

- A promoter is jointly and severally liable with any other such person for liabilities in the pre-incorporation contract if the company is not incorporated or rejects the contract.

- The common law is not excluded by section 21. A contract for the benefit of a third party is still possible. There are no formal requirements for section 21; it will be difficult to determine which construction has been used if the wording used in the contract is not clear.

See *Companies and other business structures in SA*, par 2.10.

Comparison:

- Common law may be better, as the promoter is personally liable in terms of section 21.

- You need to provide your own opinion here. An important issue is that in terms of the new section 21, the promoter will be personally liable. This is not automatically the case with the common-law construction. It is important that parties clearly identify which structure they are using: section 21 or the common law.

1.4

The MOI and any rules of a company are binding between

- the company and each shareholder (s 15(6)(a))
- the shareholders of the company (s 15(6)(b))
- the company and each director or prescribed officer of the company (s 15(6)(c)(i))
- the company and each member of the audit committee or member of a committee of the board *in the exercise of their functions within the company*

A mark would also be awarded if you indicate that it is not clear what the legal status of this relationship is; it seems as if it is contractual.

See *Companies and other business structures in SA*, par 2.9.7.
1.5

- to disclose to the board any personal financial interest in matters of the company (s 75)
- not to use the position of director or information obtained as director to gain an advantage for himself or another person, or to knowingly cause harm to the company or a subsidiary (s 76(2)(a))
- to disclose to the board of directors any material information that comes to a director’s attention (s 76(2)(b))
- to act in good faith and for a proper purpose (s 76(3)(a))
- to act in the best interests of the company (s 76(3)(b))
- to act with a reasonable degree of care, skill and diligence (s 76(3)(c))

See *Companies and other business structures in SA*, par 6.14. [Question 1: 25]

**Question 2**

2.1

To determine whether financial assistance has been provided, it must be determined

1. whether the company will be left poorer as a result of the transaction or exposed to risk

   *Gradwell (Pty) Ltd v Rostra Printers*

2. what the purpose of the assistance is, namely whether it was to enable the person to acquire shares in the company or not

   *Lipschitz v UDC Bank Ltd* 1979 (1) SA 789 (A)

**Application:**

The facts clearly indicate that the company will be poorer as a result of the loans made; moreover, the loans made to Anthony, Carl and Xander are made for the purpose of enabling them to acquire shares in the company.

**Conclusion:** The loans qualify as financial assistance.

2.2

- Cumulative preference shares: If a dividend is not declared in a specific year, the shareholder’s right to a dividend is carried over to the next year. When a dividend is declared the next year, the preference shareholder will have to be paid two years’ dividends before the ordinary shareholders can receive their dividends.
- Participating preference shares: After receiving their preference dividends, preference shareholders may be given the right also to receive normal dividends along with the ordinary shareholders, or just after the ordinary shareholders.

- Preferential right to capital on winding-up: Preference shareholders could be given the preferential right to receive repayment of the capital they contributed to the company on its winding-up.

- Additionally, preference shareholders may enjoy the right to share in any surplus assets of the company upon its winding-up, after receiving their capital contributions; however, this is the exception rather than the rule.

- Convertible preference shares: The right to convert the preference shares to shares of another class after a certain date is attached to the preference shares.

2.3

- Dividends may be paid out of profits or out of share capital, if certain requirements are met.

- Section 46 regulates distributions.

A distribution may be made in the following circumstances:

- The board of directors must authorise the distribution.
- It must reasonably appear that the company will be able to satisfy the solvency and liquidity test immediately after the distribution has been made.

- Solvency test: considering all reasonably foreseeable financial circumstances of the company at that time, the assets of the company, fairly valued, equal or exceed the liabilities of the company as fairly valued.

- Liquidity test: considering all reasonably foreseeable financial circumstances of the company at that time, it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after the distribution. If the distribution was in the form of giving a loan to a shareholder or writing off a loan made to a shareholder, the period runs from 12 months after the test was considered.

- The distribution must be made within 120 days of applying the test, otherwise the resolution by the board must be taken again and the test must be applied again.

2.4.1

Firstly, a wider category of persons may bring an action. In terms of section 266 of the Companies Act 61 of 1973, the members were able to bring an action.

Section 165 of the Companies Act 71 of 2008 provides for a general power to institute action on behalf of a company. The following persons may institute action:

- shareholders (registered or entitled to be registered)
• directors and prescribed officers
• registered trade unions or other employee representatives
• any other person, when the court regards it as necessary in order to protect a legal right of that person

2.4.2
Unlike section 266 of the Companies Act 61 of 1973, the Companies Act 71 of 2008 does not prescribe the type of conduct (e.g. breach of trust by a director) that should have infringed the rights of the company. The only requirement is that the company’s legal interest should be in need of protection.

2.5
This question dealt with duties of directors and, more specifically, directors’ fiduciary duties. You should always start by illustrating the general principles from legislation or the common law. Although the Companies Act 71 of 2008 partially codifies the duties of directors, it expressly provides that the common-law duties still apply.

Statutory duties: (in terms of the Companies Act 71 of 2008)

• not to abuse the position of director or information obtained as director to gain an advantage for himself or another person, or to knowingly cause harm to the company or a subsidiary (section 76(2)(a))

• to disclose to the board of directors any material information that comes to a director’s attention (section 76(2)(b))

• to act in good faith and for a proper purpose (section 76(3)(a))

• to act in the best interests of the company (section 76(3)(b))

There are many prescribed cases that you may have referred to. Because we do not ask questions for more than 6 marks, you can earn full marks for your answer even if you are able to refer to only two of the following cases (or use an acceptable abbreviation of the references):

- Robinson v Randfontein Estate Gold Mining Co Ltd 1921 AD 168 [75]
- Regal Hastings Ltd v Gulliver 1 All ER 378 (HL) [76]
- Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd 1981 (2) SA 173 (T) [80]
- Sibex Construction (SA) (Pty) Ltd v Injectaseal CC 1988 (2) SA 54 (T) [81]
- CyberScene Ltd and Other v i-Kiosk Internet and Information (Pty) Ltd (in textbook)
- Ghersi and others v Tiber Development (Pty) Ltd and others (in textbook)
- Fisheries Development Corporation of SA v Jorgenson 1980 (4) SA 156 (W) [87]
Application:

- A conflict of interest is present. Samson is acting in his own best interest for personal gain. It can be argued that he is acting on information acquired while he was a director of the company. A director can be guilty of breach of his or her fiduciary duties despite the fact that he or she is no longer employed by the company. In the Sibex case, the directors resigned in order to start their own business in direct competition with the company they resigned from.

- Conclusion: Yes, Samson acted in breach of his fiduciary duties.

[Question 2: 25]

Question 3

3.1

- A member of a close corporation who fails to pay his/her initial contribution is liable for all the corporation’s debts from the date of registration of the founding statement of the corporation.

- Such a member is jointly and severally liable with the corporation for its debts.

- A creditor may choose to sue either the close corporation or the member in question, or he/she may sue both jointly.

- Other members would be liable only if reckless behaviour was present or insufficient information was obtained.

3.2

- In terms of section 65 of the Close Corporations Act 69 of 1984, the court may declare that the close corporation is deemed not to be a juristic person with regard to the rights, obligations or liabilities of the close corporation or of any of its members, or any person specifically referred to. In such an order, the court may also make any order it deems fit to give effect to its declaration.

- If a member continues acting as a manager of the corporation after having been disqualified.

- If the accountant position is vacant for more than six consecutive months, all members are personally liable for any business concluded during this period.

- If financial assistance is given to a member to pay members fees without the written consent of every member of the close corporation.

- If a pre-incorporation contract is signed by a member and not adopted or ratified by the other members on registration of a close corporation.
3.3

- The ultra vires doctrine does not apply to close corporations.
- Full capacity of a natural person.
- Thus a close corporation’s capacity and powers are not affected by the statement of the corporation’s principal business in its founding statement.
- There is no constructive notice of any particulars stated in a founding statement.
- However, there are some restrictions on the capacity and powers of a close corporation in that it cannot perform acts closely associated with the physical being of a natural person.
- Section 54 states that any act by a member of a close corporation binds the corporation, irrespective of whether the act is performed for the carrying on of the corporation’s business.
- There is no effect on external relations.
- However, the position is different internally.

3.4  This is also your assignment question.

You should have mentioned five (5) advantages attached to close corporations. You could have mentioned any of the following:

- A close corporation is a juristic person distinct from its members (separate juristic personality).
- It is granted the capacity and powers of a natural person.
- Close corporations enjoy perpetual succession.
- A single person can form a close corporation; it need not be an undertaking for gain.
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- Its formation and administration are subject to a minimum number of formalities.
- It is allowed to use its capital as it pleases, as long as it maintains solvency and liquidity.
- All members have an equal say in the management of the business.
- Members enjoy limited liability.
- The common-law principles relating to fiduciary duties and duties of care and skill in managing the affairs of the corporation are codified; thus a member knows exactly what is expected of him or her.
- The accounting and disclosure provisions are less extensive than in companies.

We wish you success in your studies!

Ms J Geldenhuys (course leader) 012 429 8472 geldej@unisa.ac.za
Adv MA Mthembu 012 429 8489 mthemma@unisa.ac.za
Mr P Munyai 012 429 8621 munyaps@unisa.ac.za
Prof DM Farisani 012 429 8486 farisdm@unisa.ac.za
Mrs BM Masuku 012 429 8481 masukbm@unisa.ac.za