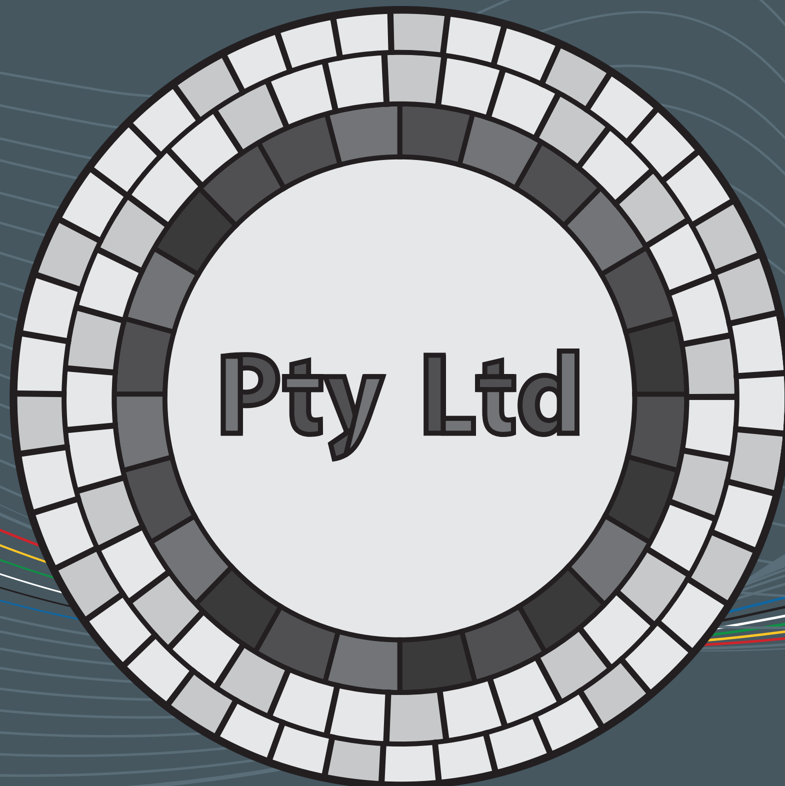

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INVESTMENT VEHICLES AND COMPANY LAW

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INVESTMENT VEHICLES AND THE COMPANY LAW REGIME

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Introduction

South African companies are primarily regulated by:

- the Companies Act, No. 71 of 2008 (Act);
- the Companies Regulations, 2011 (Regulations), which were published under the Act and contain Takeover Regulations and other matters relating to the regulation of companies;
- the King Report on Governance, 2009 (King III), which sets out principles of good corporate governance applicable to companies; and
- the Listings Requirements of the Johannesburg Stock Exchange (JSE). This applies to companies seeking to list, or who are presently listed, on the JSE, securities that issuers wish to list, and those presently listed, and to directors of listed companies (see Chapter 8 of this guide on Financial Services, Financial Markets and Market Abuse for further information).

The Act establishes various enforcement bodies, including:

- the Companies and Intellectual Property Commission (the Commission) which is responsible for:
  - registering corporate entities and intellectual property rights;
  - maintaining information on juristic persons;
  - ensuring compliance with, and enforcing, the Act; and
  - raising public awareness of company law.

Most importantly, it is able to issue compliance notices and conclude consent orders. It can also refer alleged offences for prosecution and matters to the courts or the Companies Tribunal (Tribunal):

- the Tribunal's functions are:
  - to serve as a forum for voluntary alternative dispute resolution in relation to matters arising under the Act;
  - to carry out reviews of certain administrative decisions made by the Commission;
  - to issue administrative orders exempting agreements, transactions, the Memorandum of Incorporation (MOI) and rules of a company, from certain provisions of the Act; and
- the Takeover Regulation Panel (Panel), which primarily regulates transactions that constitute "affected transactions" and offers and provides the framework within which these transactions must be conducted.

Investment vehicles

A number of vehicles are available to investors seeking to do business in South Africa. In determining the most suitable vehicle, several factors must be taken into account, including tax considerations, the need for flexibility in management, limited liability and perpetual succession. The preferred form of investment vehicle in South Africa is a limited liability company. Companies are categorised as profit or non-profit. Profit companies are incorporated for purposes of financial gain for their shareholders. These are further categorised into public companies, private companies, personal liability companies and state-owned companies. Non-profit companies are incorporated for a public benefit object. The income and property of a non-profit company is not distributable as dividends to members.

Private companies

Key characteristics of a private company include the following:

- it is identified by the suffix "Proprietary Limited" or "(Pty) Ltd";
- it must have a minimum of one shareholder;
- its MOI must restrict the transferability of its securities and prohibit any offer to the public of its securities; and
- it has limited liability, separate legal personality and perpetual succession.

Public companies

If a company is not a state-owned company, or a personal liability company or its MOI does not satisfy the criteria for a private company, then it is a public company. Key characteristics of a public company include the following:

- it is identified by the suffix “Limited” or “Ltd”;
- it must have a minimum of one shareholder;
- its MOI may not restrict the transferability of its securities;
- it is capable of raising capital from the general public and of being listed on the JSE; and
- it has limited liability, separate legal personality and perpetual succession.

Personal liability companies

A personal liability company must meet the criteria for a private company and its MOI must state that it is a personal liability company. Certain professions that are statutorily prohibited from enjoying limited liability (such as attorneys and accountants) often incorporate a personal liability company to regulate their affairs.

Key characteristics of a personal liability company include the following:

- it is identified by the suffix “Incorporated” or “Inc”;
- directors are jointly and severally liable with the company for all company debts incurred during their term of office;
- a director’s liability is limited to the company’s contractual debts and does not include delictual (tort) or statutory liability; and
- it has separate legal personality and perpetual succession.

Partnerships

Partnerships may be constituted by contract or by implication from the conduct of the partners. Key characteristics of a partnership include the following:

- they are regulated by common law and not statute; and
- they do not have a separate legal personality.

South African law recognises various types of partnerships. The liability of the partners varies depending on the type of partnership.

Business Trusts

A business or trading trust may be a preferred vehicle to conduct business in South Africa as the stringent requirements and provisions of the Act do not apply. The Trust Property Control Act 57 of 1988 governs the operation of South African trusts. Business trusts are constituted by the trustees of the trust lodging a trust deed with the Master of the High Court of South Africa. Key characteristics of a business trust include the following:

- no separate legal personality, except for taxation purposes generally;
- property is administered by the trustees for the benefit of other persons and property vests in the trustees and creditors may only execute against the trust’s property;
- a trust has limited liability in that neither the trustees nor the beneficiaries are liable for obligations incurred by the trust; and
- a trust is governed largely by the provisions of the trust deed, which usually provides for perpetual succession.

Joint ventures

A joint venture is an association of two or more persons combining property and expertise to carry out a single business enterprise and having a joint proprietary interest, a joint right of control and a sharing of profits and losses. A joint venture is most likely to take the form of a joint venture company (incorporated joint venture), partnership or a contractual joint venture. A private company is the most common type of incorporated joint venture, while a partnership or contractual joint venture is most commonly used for a specific project rather than a continuing relationship. The choice of joint venture vehicle will depend on a variety of factors, including: legal implications; the liability of the joint venture parties, commercial objectives, tax considerations; financial needs of the vehicle and funding techniques.

Foreign and external companies

A foreign company conducting business in SA but does not wish to incorporate a South African subsidiary, may instead register as an external company (also known as a branch office). Less stringent compliance requirements apply to external companies under the Act. A foreign company must register as an external company within 20 business days after it begins to "conduct business" in South Africa. A notarially certified copy (in English) of the foreign company's constitutional documents must be filed with the Commission to effect registration. If the foreign company fails to register within this period, the Commission may issue a notice requiring compliance within a specific time, failing which it may require the foreign company to cease carrying on its business or activities in South Africa.

A foreign company will be considered to be "conducting business" in South Africa if it:

- is a party to one or more employment contracts within South Africa; or
- is engaging in a course of conduct, or has engaged in a course or pattern of activities within South Africa over a period of at least six months, such as would lead a person to reasonably conclude that the company intended to continually engage in business within South Africa.

Key characteristics of an external company include the following:

- it has no separate legal personality – it is regarded as an extension of the foreign company. The foreign company's assets will therefore be at risk if the branch debts are not paid;
- it must appoint a designated director, employee or other person to ensure it complies with the administrative requirements relating to external companies under the Act;
- it must maintain at least one office in South Africa;
- it must submit annual returns to the Commission; and
- it is taxed at the same rate as domestic companies but its profits can be remitted to its head office free of dividends tax.

Company registration and formation requirements

Minimal requirements for incorporation of a company are imposed. One person may incorporate a profit company. A company becomes incorporated by the adoption of its MOI, the filing of a Notice of Incorporation with the Commission and payment of the prescribed fee.

Registration of a new company takes, on average, between 14 and 21 calendar days, depending on the time taken by the Commission to process the registration.

Legal capacity and powers

A company has, from the date and time of its registration, all the legal powers and capacity of an individual, except to the extent that a juristic person is incapable of exercising any such power or having any such capacity, or unless the company's MOI provides otherwise.

Even if a company's MOI imposes restrictions, limitations or qualifications to the purposes, powers or activities of a company, these will have no effect on the validity of the company's actions, except in the case of ring-fenced companies (RF companies).

RF companies have certain “restrictive conditions” in their MOI, often together with additional requirements (in addition to those contained in the Act) restricting their amendment. Where a company’s MOI contains these types of provisions this must be indicated by the suffix “(RF)” at the end of the name of the company. When dealing with RF companies, extra care must be taken to ensure any activity of the company is within the power, purpose and capacity of such company and its directors, as the person dealing with the company will be deemed to have constructive notice of any “restrictive conditions”.

Accountability and transparency requirements

The Act imposes accountability and transparency requirements on companies. Public companies and certain other companies are subject to a more demanding disclosure and transparency regime.

All companies are required to:

- provide CIPC with up-to-date information (including regarding the company’s MOI, registered office, directors details, auditors details (if applicable), company name and alterations in share capital);
- maintain certain categories of records for seven years;
- make the register of members and register of directors available for inspection;
- file annual returns;
- have a fixed financial year;
- maintain accurate and complete accounting records; and
- prepare annual financial statements.

The annual financial statements of all public companies and certain other companies determined by the Regulations, must be audited. If the Regulations do not require the company’s annual financial statements to be audited, they must be either (a) audited voluntarily if the company’s MOI, a shareholders’ resolution or the company’s board requires it; or (b) be independently reviewed in accordance with the Regulations. Exemptions from independent review are provided for private companies where every shareholder is also a director, subject to certain exceptions.

Public companies are required to appoint a company secretary and an auditor and have an audit committee. These additional requirements also apply to private companies where required by the Act, the Regulations or the private company’s MOI.

Every public company as well as any other company with a “public interest score” above 500 points in any two of its previous five financial years, must appoint a social and ethics committee (unless the company is a subsidiary of another company with such a committee, which will also perform that function for the subsidiary). The “public interest score” is calculated with reference to average number of employees, third party liability of the company, the company’s turnover and beneficial interest or membership in the company. The Regulations set out how a company’s “public interest score” is to be calculated.

Companies obliged to have a social and ethics committee may apply to the Tribunal for an exemption from this requirement, which may be valid for up to five years.

The social and ethics committee’s functions include:

- monitoring the company’s activities in light of legislation, legal requirements and codes relating to best practice;
- drawing matters within its mandate to the attention of the board as is necessary; and
- reporting to the shareholders at the company’s annual general meeting.

Matters to be addressed relate to social and economic development, including employment equity and Broad-Based Black Economic Empowerment, good corporate citizenship, the environment, health and public safety, consumer relationships and employment.

Shareholders' Meetings

Shareholder decisions may be taken either at a meeting of the shareholders or by written resolution. The threshold required to requisition a shareholders' meeting is 10% of the voting rights entitled to be exercised on the proposed matter, however, the MOI may specify a lower percentage. At general meetings of public and private companies, the quorum for both the meeting to begin and for a matter to be decided is 25% of all voting rights to be exercised. Different thresholds may, however, be specified in the MOI. If the company has more than two shareholders, a minimum of three shareholders must be present.

The Act provides for certain decisions to be taken either by ordinary or by special resolution of the shareholders. Ordinary resolutions must be approved by more than 50% of the voting rights exercised in respect of the resolution. However, the MOI may provide for a higher percentage (or one or more higher percentages for the approval of specific matters). The approval threshold for special resolutions is 75%, however, the MOI may provide for a higher or lower percentage (or one or more higher or lower percentages for the approval of specific matters). There must, however, at all times be a margin of at least 10% between the thresholds for an ordinary and a special resolution.

Management of companies

South African companies are managed by a single board of directors. The board has the authority to exercise all company powers and functions unless legislation or the company's MOI provides otherwise. The board is entitled to delegate specific powers and functions to committees, officers, agents and the company secretary. However, the directors remain responsible and are not absolved from their own duties. The Act makes provision for the concept of a "prescribed officer". A prescribed officer is a person who, despite not being a director, exercises significant control or management over the whole or a significant portion of the business or activities of the company. Prescribed officers have the same duties as directors in certain respects (eg the disclosure of personal financial information and standards of conduct).

The board of a private company or personal liability company must comprise at least one director. The board of a public company must comprise at least three directors (in addition to the minimum number of directors required to satisfy the requirements of an audit committee and, if applicable, a social and ethics committee). The recommendations of the King III must also be taken into account when the board's composition is determined.

Certain categories of persons are ineligible to be appointed as directors or are disqualified from being a director. These include: corporate persons, persons under the age of 18, persons prohibited by a court or any public regulation, or declared a delinquent by a court; unrehabilitated insolvents, persons removed from an office of trust for misconduct or dishonesty and the auditor of the company.

Foreign nationals or residents may be directors of companies. However, the company's public officer (appointed to act as a representative for tax purposes) must be a South African resident.

Directors are appointed or elected in accordance with the company's MOI. The Act, however, requires that a minimum of at least half of all directors (and their alternates) must be elected by shareholders of the company. The MOI may provide for the direct appointment of a specified person or for a person to be a director due to holding a particular office or title. Shareholders may remove a director by ordinary resolution adopted at a shareholders meeting, provided the director concerned has been given notice of the meeting and a reasonable opportunity to make representations regarding his removal. The Act also enables the board (excluding the director concerned) to resolve to remove a director where a shareholder or director alleges that a director has become ineligible, disqualified or incapacitated or has neglected, or been derelict in, the performance of his or her functions as director.

Directors' duties and liabilities

Directors' duties are determined by common law, legislation, the company's MOI and any contract between the director and the company. Directors' duties have been partly codified in the Act. Directors' duties are owed to the company and not to the company's shareholders or to the group to which the company may belong. Directors are required to exercise their powers and perform their functions in good faith and for a proper purpose and in the best interests of the company. Furthermore, a director cannot use his or her position on the board, or information obtained by virtue of his or her position, to:

- gain an advantage for anyone other than the company or a wholly-owned subsidiary; nor
- do harm to the company or any subsidiary (whether wholly-owned or not) of the company.

Directors are also required to disclose all information that is relevant to the company unless they are subject to a legal or ethical obligation not to disclose it, and must avoid conflicts of interest.

The Act sets out the common law duty of care and skill. Under the Act, a director is required to exercise the care, skill and diligence that may reasonably be expected of a person carrying out the same functions as that director and having the general knowledge, skill and experience of that director.

Directors are still subject to those common law duties that are not expressly dealt with in the Act or that do not conflict with those in the Act. A director may be held personally liable for losses or damages caused to the company if he or she breaches his or her duties to the company. He or she may also be liable in delict (tort) if he or she fails to perform his or her functions as a director with due care, skill and diligence. Additional remedies against a director for breach of his or her duties include interdict, the right to set aside agreements concluded in breach of duties, the right to claim the profit or benefit arising from the breach, and damages. Although directors' duties and liabilities in the Act are owed to the company (in line with common law), the Act effectively extends liability for a breach of any such duty to anyone who has suffered loss due to the breach. A director may also face criminal liability if he or she is a party to fraudulent activities or signs or authorises financial information containing false statements.

The Act contains detailed provisions dealing with the indemnification of directors. A company may indemnify a director against any liability, except where the director acted beyond his or her authority; or allowed the company's business to be conducted recklessly, with gross negligence, or fraudulently; or was guilty of wilful misconduct or wilful breach of trust.

The company may indemnify or advance expenses to a director defending an action brought against him or her arising out of his or her service to the company and may also purchase insurance to protect the director and the company against any liability or expenses for which the company is permitted by law to indemnify the director. The director can also, in his or her personal capacity, purchase insurance for any indemnifiable event.

Corporate Finance

Shares issued in terms of the Act do not have a nominal or par value, save for shares issued by companies under the Companies Act, No.61 of 1973 and that have not yet been converted to non-par value shares.

The Act contemplates that shares can be issued for consideration other than cash. Consideration may be in the form of an instrument such that the company cannot realise the value of the consideration until a date after the time the shares are to be issued, or by way of an agreement for future services, future benefits or future payment.

Boards of companies are granted extensive powers to facilitate equity financing. They have the right to:

- increase or decrease the number of authorised shares of any class;
- reclassify any authorised but unissued classified shares;
- classify shares that are authorised but are unclassified and unissued;
- determine the preferences, rights, limitations or other terms of shares which have been authorised but not issued; and
- make distributions.

The MOI may, however, limit these powers. In addition, minority shareholders are protected by the requirement of shareholder approval for:

- issues of shares, convertible securities or share options to directors and other specified persons such as those related to the company or any director (related parties);
- financial assistance for share subscriptions or purchases; and
- loans or other financial assistance to directors or related parties.

In addition, the Act provides shareholders with "appraisal rights" in certain circumstances, namely any shareholder who votes against a resolution proposed by the company to:

- amend its MOI by altering the terms of a class of shares in a manner materially adverse to the rights or interest of holders of shares of that class; or
- amend its MOI to materially and adversely alter the preferences, rights, limitations or other terms of a class of shares; or
- subject to complying with certain procedural requirements, demand that the company purchases its shares and compensates it in cash for "the fair value" of the shares it holds.

The Act regulates transactions affecting the rights of a company's creditors by requiring the application of a solvency and liquidity test. Companies must satisfy the solvency and liquidity test if they wish to:

- make a distribution (which includes share re-acquisitions);
- give financial assistance for share subscriptions or purchases;
- provide financial assistance to directors;
- provide intra-group loans and guarantees; or
- amalgamate or merge with another company.

Fundamental Transactions

The Act contains provisions governing transactions resulting in the creation of business combinations, referred to as "fundamental transactions". These provisions apply to all companies whether or not they fall within the jurisdiction of the Panel or not. Fundamental transactions include:

- disposals of all or the greater part of a company's assets or undertaking;
- amalgamations or mergers; and
- schemes of arrangement.

Each type of fundamental transaction must comply with the following basic requirements:

- a special resolution of the company must be passed at a meeting, approving the relevant transaction together with a similar special resolution of the holding company (where the transaction constitutes a disposal of the major part of the holding company's assets); and
- a quorum of at least 25% of all votes must be present at the meeting.

Even if the special resolution was adopted by the shareholders, the company may not implement the relevant transaction without the approval of the High Court if:

- at least 15% of the votes cast at the meeting opposed the resolution; and
- a shareholder who voted against the resolution requires (within five business days after the vote) the company to obtain court approval; or
- the court on application by any opposing shareholder (within 10 business days after the vote) grants that person leave to apply to court for a review of the transaction.

The Act provides for statutory mergers of companies through the mechanism of amalgamation or merger. The implementation of an amalgamation or merger of companies is subject to compliance with additional requirements, including:

- a written agreement must be entered into dealing with specified matters;
- the company must give notice to all known creditors after the merger resolution has been adopted; and
- a notice of merger or amalgamation must be filed with the Commission.

Schemes of arrangement include the re-organisation of the company's share capital, by way of a:

- consolidation, division, expropriation of securities, the exchange of securities; or
- re-acquisition of securities; or
- a combination of the above.

The implementation of a scheme is subject to the company appointing an independent expert to prepare a report to the board on the proposed scheme which must be sent to the shareholders.

Any shareholder who votes against a resolution proposed by the company to approve a fundamental transaction may, subject to complying with certain procedural requirements, exercise "appraisal rights" and demand that the company purchases its shares and compensates it in cash for "the fair value" of those shares.

Takeovers and offers regime

Takeovers and offers are governed by the Act and the Takeover Regulations (collectively, the Takeover Provisions). The Takeover Provisions apply to "affected transactions" involving a "regulated company" or its securities. Regulated companies are public companies and state-owned companies as well as private companies if the percentage of the issued shares transferred in the preceding 24 months exceeds 10% of the private company's issued shares (other than among related or inter-related persons).

Affected transactions include the "fundamental transactions" referred to above and the following other transactions:

- an acquisition of a beneficial interest in any voting securities of a regulated company;
- the intention to acquire a beneficial interest in the remaining voting securities of a regulated company not already held by a person or persons acting in concert;
- a mandatory offer; and
- a squeeze out.

The Takeover Provisions require a person to notify a regulated company if it acquires or disposes of shares in that regulated company which acquisition or disposal results in the acquiror holding (or no longer holding) a beneficial interest in the shares of the company of 5% or any further whole multiple of 5% (whether directly or indirectly, or individually or in concert with others).

The Takeover Provisions further provide that if a person acting alone or two or more related/inter-related/concert parties acquire a beneficial interest of 35% or more in the shares issued by a regulated company, that person or parties must give notice to the holders of the remaining securities offering to acquire any remaining securities on the same terms ("mandatory offer").

The Takeover Provisions also contain a remedy for the compulsory acquisition of a minority shareholding on a takeover (referred to as a "squeeze out"). The offeror must have acquired, within four months of the date of the offer, 90% of the securities in the regulated company to which the offer relates to trigger the squeeze out.

Finally, the Takeover Provisions also regulate partial offers and comparable offers.

Conclusion

A range of investment vehicles are available in South Africa, offering differing degrees of flexibility and subject to varying levels of regulation. The company, as the most common form of investment vehicle, is regulated in a manner which seeks to promote enterprise while protecting the interests of its stakeholders.

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