DLA CLIFFE DEKKER HOFMEYR

SUMMER 2012

FINANCE AND BANKING MATTERS

IN THIS ISSUE

The dangers of "Alternate Trustees"

Many investment funds are formed as trusts. The participants in these trusts (often pension funds, banks and long term insurers) make capital contributions to the trust, and these capital contributions are then used by the trust to acquire investments.

The trust deeds of these trusts often entitle the participants to appoint at least one trustee of the trust since the trustees will normally be the persons who will, whether on the recommendation of an investment committee or otherwise, take the final decision as to whether the trust will acquire or dispose of an investment (or take other decisions relating to the management of the trust's investments).

It is not then uncommon for the participants to require that the trust deed has a provision stating that a quorum for any meeting of the trustees will not exist unless the trustee appointed by that participant is present. This makes sense as a participant may otherwise have concerns that a meeting could be held to consider the acquisition or disposal of an investment (or other material issue), and its interests, via the trustee appointed by it, are not represented during that meeting and in any vote taken by the trustees at that meeting. This could influence its willingness to be a participant in the trust. At the same time, a participant cannot be allowed to frustrate the running of the trust, which is why the trust deed would then usually have a provision allowing for the meeting to be adjourned until another day and the trustees then present at such a reconvened meeting would constitute a quorum.

A difficulty arises, however, when the trustees need to meet to consider an issue (which in some instances may be under urgent circumstances), and take a decision in respect of that issue and a trustee appointed by a participant is not available for whatever reason to attend that meeting.

A possible seeming solution to this problem would be for the trust deed to allow for a trustee to appoint an alternate trustee to attend the meeting and to vote in their stead, much in the same way that a director of a company may appoint an alternate director to attend and vote at a board meeting in his or her stead.

Participants in funds structured as trusts should in fact ensure that the trust deed does not contain such a provision as South African common law requires that decisions regarding the attainment of trust objects must be made by the relevant trustees of that trust and no one else. A trustee cannot empower another person to exercise a general discretion that the law vests in him (see Hoosen NO v Deedat 1994 (4) SA 425 (SCA)).

The risk then of a provision in a trust deed allowing for the appointment of alternate trustees, is that a decision taken by trustees of that trust, including such an alternate trustee, would be invalid and of no force and effect.

Very often, however, the relevant participant may be comfortable for the trustees to meet and to take a decision without its appointed

continued

trustee being present, but the other trustees would first have to hold a meeting (knowing already that it won't be quorate), before being able to hold the reconvened meeting (which would then be quorate).

A way of getting around this problem is for the trust deed to provide that a quorum for a trustees meeting would not exist without the trustee appointed by a participant being present (so that in the first instance the participant has the comfort that a meeting cannot proceed without its appointed trustee being present), but for the trust deed to then go on to say that the participant may, however, consent to a meeting proceeding without their appointed trustee being present.

This mechanism still affords the participant protection (since only the participant would have the power to consent to the meeting proceeding) but still allows the flexibility of the trustees meeting as initially planned without delay, if the participant basically waives its quorum protection.

A participant may be willing to waive this protection for any number of reasons, and it would be useful for the trust deed to be sufficiently flexible to allow for this, but not for the appointment of alternate trustees.

Stephen Gie

The interplay between financial assistance and distributions in the context of financing transactions

In financing transactions, it is commonplace for a lender to require the borrower to provide security for its repayment obligations. Such security could, for example, take the form of a guarantee issued by the borrower's subsidiary (the Guarantor) in favour of the lender, guaranteeing the borrower's repayment obligations.

While the provision of such guarantee would in all likelihood constitute financial assistance as contemplated in s44 and/or s45[1] of the Companies Act, 2008 (the Act), the question arises whether the provision of such guarantee would, in addition, constitute a "distribution" as contemplated in the Act. In our view, it does.

A "distribution" is defined in the Act[2] to include, among others, "…a direct or indirect…(b) incurrence of a debt or other obligation by a company for the benefit of one or more holders of any shares of that company or of another company within the same group of companies…".

In the above example, the Guarantor is, by issuing a guarantee in favour of the lender, incurring an obligation (ie an obligation to repay the borrower's debt to the lender should the borrower fail to comply with its repayment obligations) for the benefit of a holder of shares in the Guarantor (ie the borrower). The Guarantor will accordingly be required to comply with the provisions of s46 of the Act which provides, among others, that:

"(1) A company must not make any proposed distribution unless-

(a) the distribution -

(i) is pursuant to an existing legal obligation of the company, or a court order; or

(ii) the board of the company, by resolution, has authorised the distribution;

(b) it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution; and

(c) the board of the company, by resolution, has acknowledged that it has applied the solvency and liquidity test, as set out in s4, and reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.

(2) When the board of a company has adopted a resolution contemplated in ss(1)(c), the relevant distribution must be fully carried out, subject only to ss(3).

continued

[1] *Whether the issuance of a guarantee would fall within the ambit of s44 and/or 45 of the Act, would depend on the specific nature of the business of the Guarantor and the transaction concerned.*
[2] *Subsection (b) of the definition of "distribution" in s1 of the Act.*

(3) If the distribution contemplated in a particular board resolution, court order or existing legal obligation has not been completed within 120 business days after the board made the acknowledgement required by ss(1)(c), or after a fresh acknowledgement being made in terms of this subsection, as the case may be -

(a) the board must reconsider the solvency and liquidity test with respect to the remaining distribution to be made pursuant to the original resolution, order or obligation; and

(b) despite any law, order or agreement to the contrary, the company must not proceed with or continue with any such distribution unless the board adopts a further resolution as contemplated in ss(1)(c).

(4) If a distribution takes the form of the incurrence of a debt or other obligation by the company, as contemplated in paragraph (b) of the definition of 'distribution' set out in s1, the requirements of this section -

(a) apply at the time that the board resolves that the company may incur that debt or obligation; and

(b) do not apply to any subsequent action of the company in satisfaction of that debt or obligation, except to the extent that the resolution, or the terms and conditions of the debt or obligation, provide otherwise…".

It is important to note that in the above example, it is the issuing (ie execution) of the guarantee itself that constitutes the "distribution". As such, at the time that the board of the Guarantor resolves to issue such guarantee, the requirements of s46 of the Act must be satisfied[3]. In addition, the guarantee must be executed within 120 business days after the board of the Guarantor made the acknowledgement contemplated in s46(1)(c) of the Act, failing which, the board must reconsider the solvency and liquidity test as contemplated in s46(3) above.

When considering the requisite corporate authorisations required for the implementation of a financing transaction and in particular, the provision of security therefor, lenders and security providers alike should be mindful of the interplay between the financial assistance and distribution provisions of the Act. In many instances, it may become apparent that there is a need not only to obtain board and shareholders resolutions for the purposes of satisfying the financial assistance prescripts of the Act in relation to the provision of the security concerned, but to obtain board resolutions authorising the distribution constituted thereby as well.

Kerry-Lee Carew

[3] Section 46(1) read with s46(4) of the Act.

Section 45 of the Companies Act, 2008: loans and other financial assistance to directors only?

The Companies Act, 2008 (the new Act) came into effect on 1 May 2011, amid much anticipation among economic stakeholders and participants, given the fact that the effective date had been deferred a number of times.

From the onset, it is important to not merely take note of, but to reconcile oneself with the fact that the Act is not a mere revamp of the Companies Act, 1973 (the old Act) but that it is an entirely new creature of statute with only a few reminiscent characteristics of the old Act. Section 45 of the Act is one such example.

Loans or other financial assistance to directors

At first glance, one might think that s45 of the Act is similar to s226 of the old Act.

However, a closer reading of s45 will reveal that it not only replaces s226 of the old Act, 1973 but goes further and broadens its scope of application by addressing not only loans to directors but also inter-company loans, loans between related and inter-related persons, guarantees for loans or other obligations and security for any debt or obligation. This makes the title of s45 of the Act somewhat misleading.

continued

This broadened scope of application is referred to as "financial assistance".

A company may provide direct or indirect financial assistance to:

- a director or a prescribed officer of the company; or
- a related company or a director of a related company; or
- an inter-related company or a director of an inter-related company; or
- a related or inter-related corporation or a member of a related or inter-related corporation; or
- any person related to such company, corporation, director, prescribed officer or member as mentioned above, if its board approves the assistance and the shareholders of the company have passed a special resolution, adopted within the previous two years, which approved such assistance either for a specific recipient, or generally for a category of potential recipients, and the specific recipient falls within that category.

The board must further be satisfied that:

- the company will meet the solvency and liquidity test immediately after having provided the financial assistance; and
- the proposed terms under which the financial assistance is to be given are fair and reasonable to the company.

Applied to a set of facts, a South African Holding Company "A" (Holdco A) guarantees the bank loan made to its subsidiary operating in Botswana. Holdco A will need to comply with s45 before providing the guarantee since the subsidiary is a "person", which includes a "juristic person", which in turn includes a foreign company such as the subsidiary registered in Botswana (which is not a "company" as defined in the Act).

Take another example:

Subsidiary company "B" (Subco B) lends money to its unrelated minority shareholder. The minority shareholder also holds a small stake in subsidiary company "C" (Subco C), Subco B's sister company. The loan by Subco B to the unrelated minority shareholder will require s45 consent as it is financial assistance to a member of a related corporation.

Deon Wilken and Lizelle Bouwer

The provision of financial assistance by a security SPV

In funding transactions where there is either more than one Lender, or one Lender only but that Lender intends selling down, it is usual to create security in the following way:

- a Security SPV is formed which then provides a guarantee to the Lender(s), guaranteeing the payment obligations of the Borrower towards the Lender;
- the Borrower indemnifies the Security SPV against claims made under the guarantee; and
- security is then provided by the Borrower for its obligations under the indemnity.

It therefore follows that if the guarantee is void, the above security structure would fail and the Lenders are effectively unsecured.

In terms of s45 of the Companies Act, 2008 (the Act), a company may provide financial assistance to a related company provided that:

- the particular provision of financial assistance is pursuant to a special resolution of the shareholders adopted within the previous two years which approved such assistance either for the specific recipient, or generally for a category of potential recipients, and the specific recipient falls within that category; and
- the board is satisfied that immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test, and that the terms under which the financial assistance is proposed to be given are fair and reasonable to the company.

continued

The provision of a guarantee would constitute financial assistance for the purposes of s45.

By applying s2 (specifically s2(2)(d)) of the Act - which sets out the way to determine whether parties are related - it is arguable that

- a Security SPV and a single Lender; or
- a Security SPV and any Lender which exercises more than 50% of the voting rights under an inter-creditor agreement,

are related parties, as such a Lender would normally have the ability to materially influence the policy of the Security SPV in that the Security SPV would customarily be required to act in accordance with the instructions of such a Lender.

Therefore, to overcome any potential threat to the security structure described above, the requirements of s45 should be satisfied by the Security SPV, and importantly, this should be done before the funding transaction is implemented as s45 does not appear to allow for the ratification of the financial assistance after it has been provided.

Stephen Gie

Section 39 of the Companies Act, 2008: shareholder pre-emptive rights

One of the new aspects introduced into South African corporate law by the Companies Act, 2008 (the Act) is a statutory pre-emptive right in favour of the existing shareholders of a private or personal liability company when it proposes to issue shares.

In terms of s39(2) of the Act, if a private company (and although not mentioned in this operative section, presumably a personal liability company as well) proposes to issue any shares (other than in certain circumstances as mentioned below), each shareholder of that private company has a right, before any other person who is not a shareholder of that company, to be offered and, within a reasonable time to subscribe for, a percentage of the shares to be issued equal to the voting power of that shareholder’s general voting rights immediately before the offer was made.

Except to the extent that a private or personal liability company’s memorandum of incorporation provides otherwise, in exercising this pre-emptive right, a shareholder may subscribe for fewer shares than the shareholder would be entitled to subscribe for, and shares not subscribed for by a shareholder within a reasonable time may be offered to other persons to the extent permitted by the memorandum of incorporation.

From a financing point of view, this would require attention where a company wishes to issue, for example, preference shares to a funder. In particular, the transaction documents, such as the preference subscription agreement, may then need to include as a condition precedent the waiving of this right by the shareholders of the company. Even before then though, when the company is negotiating the preference share funding with a funder, it should ensure that none of its shareholders would wish to in fact exercise their s39(2) pre-emptive right, and so to take up a portion of the preference shares to be issued. If they did, this could potentially influence whether the funder would still have appetite for the deal as it may not be interested in subscribing for a lower number of preference shares (being those remaining after the shareholders have taken up a portion of them).

Section 39(3) provides that a private or personal liability company’s memorandum of incorporation may also limit, negate, restrict or place conditions upon this pre-emptive right with respect to any or all classes of shares of that company.

So, as part of its due diligence process, a funder should be mindful to review the memorandum of incorporation of the company to determine the extent to which this right may or may not apply, and so the extent to which this right may or may not require attention, either in or outside of the applicable transaction documents.

When potentially providing preference funding to a public or state-owned company, s39(1) requires consideration. It says that this pre-emptive right does not apply in respect of public or state-owned companies, except to the extent that the company's memorandum of incorporation provides otherwise. So even though s39(2) refers only to private companies, a funder dealing with a public or state-own company would still need to undertake the same due diligence exercise as with a private company as the memorandum of incorporation of a public or state-own company may have been amended to insert such a pre-emptive right.

This pre-emptive right provision does not apply in all instances, and s39(1)(b) sets out the exceptions. These include in respect of an issue of shares in terms of options or conversion rights or the issuing of capitalisation shares.

Section 39(2) should therefore, in summary, just be a flag for preference share funding arrangements, or in any other instances where a funder may subscribe for shares in a company.

Stephen Gie and Gillian Wildey

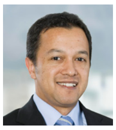
CONTACT US

For more information about our Finance and Banking practice and services, please contact:

Ludwig Smith
Director
National Practice Head
T + 27 (0)11 562 1103
E ludwig.smith@dlacdh.com

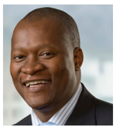
Joz Coetzer
Director
T + 27 (0)11 562 1500
E joz.coetzer@dlacdh.com

Stephen Gie
Director
T + 27 (0)11 562 1389
E stephen.gie@dlacdh.com



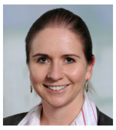
Adnaan Kariem
Director
T + 27 (0)21 405 6102
E adnaan.kariem@dlacdh.com

Nathisha Maharaj
Director
T + 27 (0)11 562 1196
E nathisha.maharaj@dlacdh.com



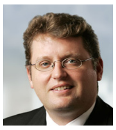
Mashudu Mphafudi
Director
T + 27 (0)11 562 1093
E mashudu.mphafudi@dlacdh.com

Jackie Pennington
Director
T + 27 (0)11 562 1131
E jackie.pennington@dlacdh.com



Jennifer Stolp
Director
T + 27 (0)11 562 1409
E jennifer.stolp@dlacdh.com

Jerome Veldsman
Director
T + 27 (0)21 405 6035
E jerome.veldsman@dlacdh.com



Deon Wilken
Director
T + 27 (0)11 562 1096
E deon.wilken@dlacdh.com

Craig Whitley
Director
T + 27 (0)11 562 1095
E craig.whitley@dlacdh.com

Kerry-Lee Carew
Senior Associate
T + 27 (0)11 562 1193
E kerry-lee.carew@dlacdh.com

Roelf Horn
Senior Associate
T + 27 (0)21 405 6036
E roelf.horn@dlacdh.com

Mike Mclaren
Senior Associate
T + 27 (0)11 562 1197
E mike.mclaren@dlacdh.com

Preshan Singh-Dhulam
Senior Associate
T + 27 (0)11 562 1192
E preshan.singh@dlacdh.com

Muhammed Ahmed-Bobat
Associate
T + 27 (0)21 481 6496
E muhammed.bobat@dlacdh.com

Lizelle Bouwer
Associate
T + 27 (0)11 562 1199
E lizelle.bouwer@dlacdh.com

Candace Hennessy
Associate
T + 27 (0)11 562 1421
E candace.hennessy@dlacdh.com

Jenni Darling
Associate
T + 27 (0)11 562 1188
E jenni.darling@dlacdh.com

Phetole Modike
Associate
T + 27 (0)11 562 1190
E phetole.modike@dlacdh.com

Marc Naidoo
Associate
T + 27 (0)11 562 1241
E marc.naidoo@dlacdh.com

Gillian Wildey
Associate
T + 27 (0)11 562 1191
E gillian.wildey@dlacdh.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

JOHANNESBURG

1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg
T + 27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@dlacdh.com

CAPE TOWN

11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town
T + 27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@dlacdh.com

5th floor Protea Place Protea Road Claremont 7708, PO Box 23110 Claremont 7735 South Africa
Dx 5 Cape Town
T + 27 (0)21 683 2621 F +27 (0)21 671 9740 E ctn@dlacdh.com