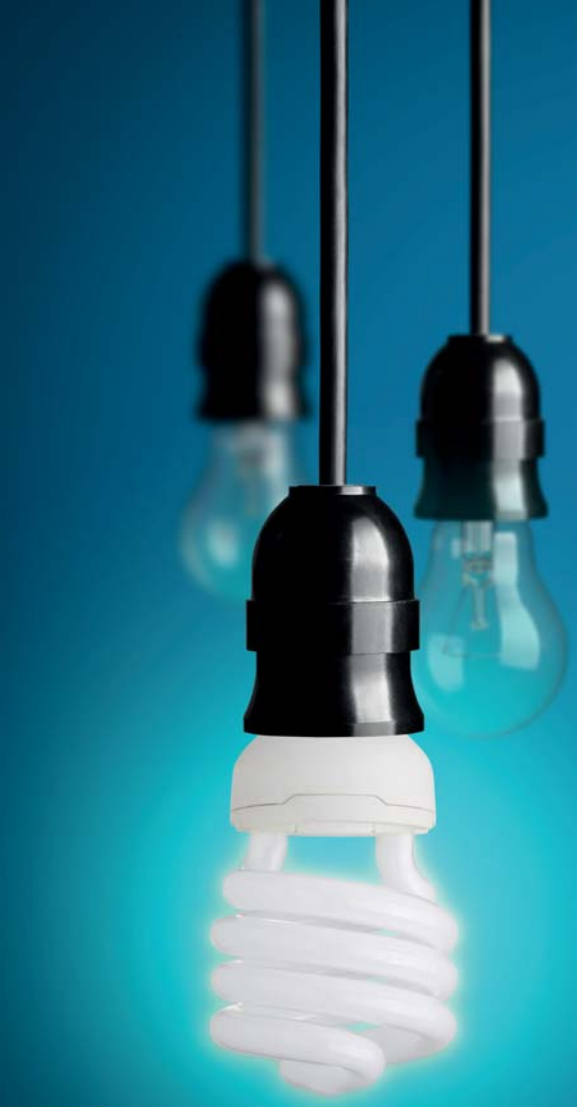

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CORPORATE AND COMMERCIAL ALERT

IN THIS **ISSUE**

THE CONCEPT OF CONTROL IN THE COMPANIES ACT

Understanding how and when persons are "related" to one another under the Companies Act, No 71 of 2008 (Companies Act) is fundamental in assessing whether certain provisions of the Companies Act apply to, and regulate, a transaction to which a company is a party. The term "related" is prevalent throughout the Companies Act and triggers, for instance, the rules relating to issues of shares to related persons (s41(1)) and financial assistance in connection with the acquisition of shares or to related persons (ss44 and 45).

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THE CONCEPT OF CONTROL IN THE COMPANIES ACT

A person controls a juristic person if "that first person has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary commercial practice, would be able to exercise an element of control referred to [in the listed bright line tests]".

Understanding how and when persons are "related" to one another under the Companies Act, No 71 of 2008 (Companies Act) is fundamental in assessing whether certain provisions of the Companies Act apply to, and regulate, a transaction to which a company is a party. The term "related" is prevalent throughout the Companies Act and triggers, for instance, the rules relating to issues of shares to related persons (s41(1)) and financial assistance in connection with the acquisition of shares or to related persons (ss44 and 45).

Pretoria High Court judgment considered this catch-all provision in the Companies Act, and its findings are very interesting insofar as the question of de facto control is concerned.

"Related" is defined in s2 read with s3 of the Companies Act. In respect of juristic persons the question essentially turns on control: juristic persons are related if one controls the other, or if they have a common controller. What then is "control"? There are certain "bright line" tests for control, for example if a majority of voting rights at shareholder or board level are controlled. Thus clearly holding companies and their subsidiaries are related, and co-subsidiaries. But there is also a general (and often overlooked) "catch-all" form of control referred to in s2(2)(d): a person controls a juristic person if "that first person has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary commercial practice, would be able to exercise an element of control referred to [in the listed bright line tests]". One encounters the same catch-all provision in competition law as well (for purposes of merger control). A recent unreported Pretoria High Court judgment considered this catch-all provision in the Companies Act, and its findings are very interesting insofar as the question of *de facto* control is concerned (*De Klerk v Ferreira and Others* (35391/14) [2017] ZAGPPHC 30 (2 February 2017)).

The *De Klerk* case specifically concerned the unfair prejudice / oppression remedy in s163 of the Companies Act. More specifically, that remedy may be invoked by a shareholder against the company or anyone "related" to the company. As it turned out, to cut a long story short (and leaving aside for the time being the details of the parties' dispute in question), a key question that was distilled in the case was whether a close corporation (CC), namely Plantsaam, held in equal shares by two business partners (De Klerk and Ferreira), was related to a company, namely Benjo, the shares of which were also held 50/50 by those same partners (and the partners were also the only two directors of the company). The CC and company would be related if they had a common controller. Importantly, there was no majority holding in either the CC or the company, thus the bright line tests were not applicable. There was an agreement in place that the affairs of the CC would be managed on the basis of consensus. But on the facts and in practice, the one partner (Ferreira) was left to manage the two entities almost to the exclusion of the other, passive partner (De Klerk). The court described the position as follows:

> The question for determination under section 2(2)(d), therefore, is whether in the present case Ferreira had the ability to materially influence the policy of Benjo and Plantsaam in a manner comparable to a person

THE CONCEPT OF CONTROL IN THE COMPANIES ACT

CONTINUED

While both De Klerk and Ferreira had equal de jure control, it is evident that Ferreira had de facto control and the greater capacity to materially influence the policy of both companies.

who would be able to exercise the element of control in the majoritarian situations envisaged in the other subparagraphs of section 2(2). The provision takes "control" beyond the ordinary corporate law principles of voting control. The purpose of the provision is to provide *inter alia* for a circumstance where the controlling person does not have majority voting power but has an element of control comparable to a person who would. Whether a person has control will depend on the circumstances. The question is unavoidably a factual one. It can include the situation where the controlling person, a minority or equal shareholder, has de facto control to materially influence the policy of the company, akin to a person who has de jure majority control. Thus, it is possible for a person to control a juristic person despite not having de jure control or the majority of controlling votes in the company...

It is common cause that over the years Ferreira had exclusive control of the financial affairs, the management and day to day running of the two companies. The history of the dispute between De Klerk and Ferreira places it beyond doubt that De Klerk had minimal access to the financial records, source documents and correspondence of both companies and played a limited role in their functioning and performance. He invested capital and gave advice and direction, but control of the daily operations of both companies was vested primarily in Ferreira over a period of years. While both De Klerk and Ferreira had equal de jure control, it is evident that Ferreira had de facto control and the greater capacity to materially influence the policy of both companies.

Importantly, Ferreira's *de facto* exclusive control was not as of right, or legally inevitable: At least in respect of the CC, where the agreement said that decisions would be made on a consensus-basis, De Klerk had every legal and contractual right at any stage to rein Ferreira in, to insist that he be involved and that decisions be made by a vote of members. However, on the facts he did not do so and as it transpired, after years of being the factual managing director of both entities, Ferreira acquired almost exclusive knowledge and expertise in respect of the entities' operational and financial affairs, thus essentially leaving De Klerk at his mercy. Ferreira had factual, and arguably positive (as opposed to merely negative), control.

Whether purely factual control is sufficient for there to be an "ability" to materially influence policy was also addressed, albeit in the different context of competition law,

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THE CONCEPT OF CONTROL IN THE COMPANIES ACT

CONTINUED

Certainly what the De Klerk case does is to reaffirm the importance of the advice that in any analysis of the applicability of a Companies Act provision where relatedness is of relevance, one cannot simply end the inquiry at: "Are the companies in a holding - subsidiary relationship?"

in the quite recent Competition Appeal Court case of *Caxton and CTP Publishers and Printers v Media 24 Proprietary Limited and Others* (136/CAC/March 2015) [2015] ZACAC 5 (25 November 2015)). There the court held that "ability" implies a power that is sourced in an agreement or similar legal instrument – the factual state of affairs of how a company is actually being managed, and whether parties choose to exercise their management rights under an agreement, is not the question.

How one then reads *De Klerk* with *Caxton*, and whether there is a tension between the approaches in the two cases, is debatable. Certainly what the *De Klerk* case does is to reaffirm the importance of the advice that in any analysis of the applicability of a Companies Act provision where relatedness is of relevance, one cannot simply end the inquiry at: "Are the companies in a holding - subsidiary relationship?" That is merely one of the forms of control – a form which entails a majoritarian position: The catch-all in s2(2)(d), however, goes further and involves an assessment of all relevant facts and circumstances pertaining to the relationship between the parties.

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