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CORPORATE & COMMERCIAL ALERT

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Can companies trade recklessly during COVID-19?

In response to the declaration by President Cyril Ramaphosa of a national state of disaster on 15 March 2020, the Companies and Intellectual Property Commission (CIPC) issued Practice Notice 1 of 2020 (Practice Note) on 24 March 2020, in terms of which CIPC temporarily suspended some of the powers afforded to it under section 22 of the Companies Act 71 of 2008 (Companies Act). The Practice Note lapses 60 days after the national state of disaster has been lifted.

Inside information – when are you "infected"?

It goes without saying that insider trading is one of the biggest threats to maintaining the integrity of our securities markets, especially when the markets are volatile (as they recently have been, to unprecedented degrees, due to the impact of the COVID-19 pandemic). Section 78 of the Financial Markets Act 19 of 2012 (FMA) contains a number of prohibitions on insider trading and disclosures of inside information by insiders.

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Can companies trade recklessly during COVID-19?

Under section 22(1) of the Companies Act, a company is prohibited from carrying on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

In response to the declaration by President Cyril Ramaphosa of a national state of disaster on 15 March 2020, the Companies and Intellectual Property Commission (CIPC) issued Practice Notice 1 of 2020 (Practice Note) on 24 March 2020, in terms of which CIPC temporarily suspended some of the powers afforded to it under section 22 of the Companies Act 71 of 2008 (Companies Act). The Practice Note lapses 60 days after the national state of disaster has been lifted.

Under section 22(1) of the Companies Act, a company is prohibited from carrying on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. Section 22(2) of the Companies Act empowers CIPC to issue a notice to a company to show cause why the company should be permitted to continue carrying on its business, or to trade, as the case may be, if CIPC has reasonable grounds to believe that a company is:

- unable to pay its debts as they become due and payable in the normal course of business; or
- carrying on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

If the company fails, within 20 business days, to satisfy CIPC that it is not engaging in the aforementioned conduct, or that it is able to pay its debts as they become due and payable in the normal course of business, CIPC may issue a compliance notice to the company, requiring it to cease carrying on its business or trading.

Section 22(2) contemplates two distinct positions. In the first instance, a company is prohibited from trading under commercially insolvent circumstances (i.e. the company is unable to pay its debts as they become due and payable in the normal course of business). In the second instance, a company is prohibited from carrying on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

The Practice Note only considers the first instance by providing that "*the Commission will not invoke its powers under section 22 of the Companies Act, in the case of a company which is temporarily insolvent and still carrying on business or trading.*" Presumably, if a company is carrying on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose, or if the company's temporary insolvency is caused by circumstances other than COVID-19, CIPC may continue to issue section 22 notices.

Whilst the Practice Note provides some relief to companies, it does not in itself suspend the operation of section 22 of the Companies Act, only CIPC's response to companies trading under temporary insolvent circumstances caused by COVID-19. This leniency is arguably granted by CIPC to allow companies to trade out of its commercial insolvency. However, the general prohibition placed on companies by section 22(1) remains in force and companies must be vigilant not to open itself up to potential claims by third parties.

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Can companies trade recklessly during COVID-19?*...continued*

Whilst the Practice Note provides some relief to companies, it does not in itself suspend the operation of section 22 of the Companies Act, only CIPC's response to companies trading under temporary insolvent circumstances caused by COVID-19.

The Practice Note, for example, has no effect on section 218(2) of the Companies Act, which provides third parties with a right to pursue *"any person"* (including the company, its directors, officers, employees, etc.) who contravened any provision of the Companies Act that caused the third party to suffer damages as a result of that contravention.

In addition, it is unclear what the effect of the Practice Note is on directors' personal liability under section 77(3)(b) of the Companies Act. Section 77(3)(b) of the Companies Act provides for a claim against the directors of a company *"by or on behalf of the company for losses sustained by the company as a direct or indirect consequence of the director having acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1)"*.

Whilst the above may be technically accurate, the Practice Note will be of no practical benefit if it cannot at least be utilised by the company or its directors to supplement or amplify a defence to an action brought under sections 77(3)(b) or 218(2), as read with section 22, of the Companies Act.

Having regard to the above, however, it is abundantly clear that companies are not permitted to trade recklessly during COVID-19 (or at all). The Practice Note only affords protection from the CIPC in those limited circumstances where companies are temporarily insolvent as a result of COVID-19 and continue carrying on business or trading.

If you would like to understand the potential risks facing your business as a result of COVID-19, please contact us. You can also stay up to date with our latest COVID-19 news here.

Jaco Meyer and Willem Jacobs

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Inside information – when are you *"infected"*?

The attribution of inside information to a corporate shareholder may grow into something of a controversial topic in the coming weeks and months, for instance in the scenario where a major or institutional shareholder is represented by a nominee director on the board of the listed investee company.

It goes without saying that insider trading is one of the biggest threats to maintaining the integrity of our securities markets, especially when the markets are volatile (as they recently have been, to unprecedented degrees, due to the impact of the COVID-19 pandemic). Section 78 of the Financial Markets Act 19 of 2012 (FMA) contains a number of prohibitions on insider trading and disclosures of inside information by insiders. The attribution of inside information to a corporate shareholder may grow into something of a controversial topic in the coming weeks and months, for instance in the scenario where a major or institutional shareholder is represented by a nominee director on the board of the listed investee company.

The relevant definitions set out in section 77 of the FMA are:

> *"inside information", which means " specific or precise information, which has not been made public and which-*
>
> *(a) is obtained or learned as an insider; and*
>
> *(b) if it were made public, would be likely to have a material effect on the price or value of any security listed on a regulated market or of any derivative instrument related to such a security"; and*
>
> *"insider", which means "a person who has inside information –*
>
> *(a) through*
>
> *(i) being a director....of an issuer of securities listed on a regulated market.....to which the inside information relates; or*
>
> *(ii) having access to such information by virtue of employment, office or profession; or*
>
> *(b) where such person knows that the direct or indirect source of the information was a person contemplated in paragraph (a)".*

As an aside, one can separately debate whether projections and profit forecasts (listed companies' boards and management will no doubt be running these on a constant basis, trying to predict the impact of the COVID-19 pandemic) are necessarily "*inside information*" in the first place, given the "*materiality*" and "*specificity*" requirements in the definition. For present purposes it should be accepted that forecasts can indeed be "*inside information*", depending on various factors which we will not delve into right now. In order for dealing in securities to constitute the offence of insider trading in terms of section 78 of the FMA, the person who deals in the securities, whether directly or indirectly or through an agent, must be an "*insider*". This by definition requires "*knowingly*" being "*in possession*" of inside information when trading. Accepting for present purposes that the offence can apply to juristic persons, when does a juristic person knowingly "*possess*" inside information in respect of another company?

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Inside information – when are you "infected"?*...continued*

The identification of the directing mind is primarily a constitutional question, depending in the first instance upon the powers entrusted to a person by the governance and internal decision-making documents and structures of an organisation.

This is an area of market abuse law which still needs to be fully thrashed out and developed in the courts. Considering that companies can only operate and acquire knowledge through natural persons, the applicable doctrine to answer this legal question is likely to be the tried and tested "*directing mind doctrine*", which is applied in a wide range of areas of the law in determining whether acts, omissions or knowledge of information may be imputed to a corporate organisation. Whilst "*Chinese walls*" defences are not expressly recognised or regulated in the FMA, it is arguably the case that the directing mind doctrine leads us to substantially the same point, and that it will remain as important as ever that investor companies keep and observe their systems in place in this regard.

In terms of the directing mind doctrine, the acts and omissions, intentions, purposes and knowledge of particular natural persons are those of the company if, within their appropriate sphere, such persons are an "*embodiment*" of the company itself and accordingly their minds are the company's mind, their knowledge is the company's knowledge and their intention is the company's intention. The question is, who was/were the directing mind of the company in relation to that matter – and indeed the last few words are apparently of key importance, as indications are that the doctrine is applied on an activity-specific and transaction-specific basis (e.g. *Consolidated News Agencies v Mobile Telephone Networks 2010* (3) SA 382 (SCA)).

The identification of the directing mind is primarily a constitutional question, depending in the first instance upon the powers entrusted to a person by the governance and internal decision-making documents and structures of an organisation.

Once the directing mind of a company in relation to a decision has been identified, the next question is whether the individual or group of individuals (e.g. board of directors or committee) which comprise the directing mind had knowledge of the information in question. Accordingly, if the individual or group of individuals who are the "*directing mind*" of the company possess certain inside information, the company can be deemed to have such possession of inside information. What about the case of a large board of directors where perhaps only one or two directors possess the inside information – is the whole board then "*tainted*"? This remains an intriguing and largely untested area. It seems perhaps intuitive that at least a majority of the directors need to possess the information before there is attribution to the board (and thus the company) as a whole, but this should certainly not be viewed as an immutable principle: in every case the particular director's role, influence and input should be considered. Recusal of the relevant director(s) from any decision-making process in respect of dealing in the listed securities may be the best advice in most circumstances, to the extent practicable.

Considering that there is no specific authority relating to this principle in the context of the market abuse provisions of the FMA, the directing mind doctrine must be cautiously applied on a case-by-case basis, as it is dependent on the applicable facts and decision-making structure and culture of the organisation. Therefore directors of investor companies who have cross-directorships in listed investee companies need to be wary of their potential insider status.

Yaniv Kleitman and Gopolang Kgaile

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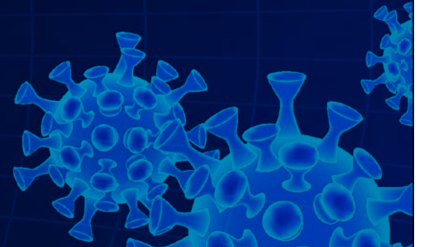
CDH'S COVID-19 RESOURCE HUB



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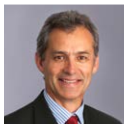

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