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CORPORATE & COMMERCIAL ALERT

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The issues with issues: A refresher on issuing shares where timing is an issue

As the restrictions on economic activity ease and companies attempt to get their businesses back up and running, many private companies will be looking for quick cash injections. If borrowing from a bank is not immediately possible, or if one of the reasons for the cash injection is to settle bank debt, it may be necessary to raise capital by offering shares to third party investors or to existing shareholders. An advantage of equity funding is that it does not negatively affect a company's solvency and liquidity and in fact bolsters a company's assets, which allows it to meet the solvency and liquidity test and to continue making distributions or giving financial assistance if required.

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CLIFFE DEKKER HOFMEYR

The issues with issues: A refresher on issuing shares where timing is an issue

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As the restrictions on economic activity ease and companies attempt to get their businesses back up and running, many private companies will be looking for quick cash injections. If borrowing from a bank is not immediately possible, or if one of the reasons for the cash injection is to settle bank debt, it may be necessary to raise capital by offering shares to third party investors or to existing shareholders. An advantage of equity funding is that it does not negatively affect a company's solvency and liquidity and in fact bolsters a company's assets, which allows it to meet the solvency and liquidity test and to continue making distributions or giving financial assistance if required.

Unfortunately, the process of issuing shares can prove to be a more complicated and delayed process than expected and, where a company needs funds urgently, these delays can be painful and in cases where no other viable options exist, even fatal to a business. Below is a refresher on some of the considerations that need to be kept in mind before issuing shares and the possible complications that may arise and potentially cause delays where an issue of shares needs to be implemented urgently.

Are there enough shares?

A company must ensure that there are enough shares available for issue and if not, it must increase its authorised shares.

This entails a creation of further shares through an amendment to the memorandum of incorporation by a special resolution of shareholders or by the board as contemplated in section 36(4) for the Companies Act, 2008 (Companies Act).

In both cases, the amendment must be filed with the Companies and Intellectual Property Commission (CIPC) and the filing can take some time to be completed. Prior to lockdown, such filings were taking up to 10 business days to be processed and we anticipate that there may be some delays due to backlogs once the CIPC is fully functional.

In order to expedite share increases, the CIPC has created a fast track way to increase the number of authorised shares through an E-services function available on the CIPC website. The function is fully automated, no documents are required to be submitted and the increase of shares is intended to occur immediately. Although this function seems to be ideal for emergency issues of shares, sections 16 and 36 of the Companies Act require that for a company to amend its memorandum of incorporation (whether by shareholders resolution or board resolution) it must file a 'Notice of Amendment'. When using the E-Services function, no provision is made for any documents to be submitted and there is no way to file a Notice of Amendment. Accordingly, it is arguable that an increase of shares in this manner may not be in compliance with the Companies Act and a company could run the risk of issuing unauthorised shares if the increase is ever challenged. As such, and until this anomaly is corrected, companies are cautioned against using this function to create additional authorised shares.

In the case of a company with par value shares, before an increase in the number of par value shares of the same class can occur, the company must first convert all par value shares to no par value shares.

CLIFFE DEKKER HOFMEYR

The issues with issues: A refresher on issuing shares where timing is an issue*...continued*

It is important to remember that issuing additional shares can also have consequential effects such as a change of control requiring regulatory approvals or a change in shareholding triggering a mandatory offer to minority shareholders.

This also entails an amendment to the memorandum of incorporation to be filed with the CIPC and the same timing issues will arise.

The pre-emptive process

A private company's shareholders will generally have the right to first be offered the opportunity to subscribe for shares before any shares can be issued. These pre-emptive rights apply automatically by virtue of section 39 of the Companies Act or are specifically catered for in a company's memorandum of incorporation where section 39 is excluded. The memorandum of incorporation will usually set out the process through which the company must make such offers as section 39 provides little guidance on the process. In the case of a specified process, these provisions tend to include time periods not catered for emergency funding requirements, and the full process must be followed unless all shareholders agree to waive their pre-emptive rights. If all shareholders are on board, no problem - but this isn't always the case.

A pre-emptive process will still need to the followed where a company proposes to issue a separate class of shares from those already in issue, unless the memorandum of incorporation specifies otherwise.

A pragmatic approach

A possible solution could be that the emergency funds are loaned to the company, subject to the loan becoming immediately repayable at a premium interest rate if the loan is not converted to shares through an issue within a specified period. This could be used as an incentive to the company and its shareholders to complete the issue of shares, despite any regulatory delays. One could also consider issuing hybrid debt instruments with voting rights (such as voting debentures), under section 43 of the Companies Act, as these are typically not subject to the same restrictions as the issue of shares.

It is important to remember that issuing additional shares can also have consequential effects such as a change of control requiring regulatory approvals or a change in shareholding triggering a mandatory offer to minority shareholders.

The best option

The need for emergency funding will not always have been anticipated and as a result, companies often fail to deal with the concept and the appropriate process in their constitutional documents. In order to get around having to follow a full pre-emptive process, companies should consider catering for an expedited share issue process in certain circumstances in their memoranda of incorporation, for example a mechanism whereby a majority or supermajority of shareholders can by consent waive compliance with the pre-emptive rights. Where it appears that the number of authorised shares may become an issue, companies should attend to an increase in advance or create a class of shares that can be customised by the board, without the filing of an amended memorandum of incorporation.

Kate Anderson

CLIFFE DEKKER HOFMEYR

WEBINAR INVITATION

BUYER POWER AND PRICE DISCRIMINATION UNDER THE COMPETITION ACT, RELATED INCOME TAX INCENTIVES AND BEE CONSIDERATIONS.

DATE: Tuesday, 2 June 2020 TIME: 13h00 - 14h00

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