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DISPUTE RESOLUTION ALERT

IN THIS ISSUE

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Pressure points and hurdles when removing a director by the shareholders

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The removal of a director, by way of the shareholders' inherent right to do so by an ordinary resolution, (section 71 of the Companies Act 2008) is the typical initial go-to remedy when a breakdown in the relationship amongst shareholders and directors arise. The remedy should in theory be straightforward, but the Companies Act contains several pressure points and hurdles that shareholders must be aware of and overcome before they can remove a director from office. These pressure points and hurdles are substantive and procedural in nature, and if not complied with can result in the removal being declared invalid by a court of law.

It is thus important that shareholders acquaint themselves with the provisions of the Companies Act to ensure that the removal process is managed and implemented correctly.

The shareholders' meeting

The first step in the removal process is to convene a shareholders' meeting to vote on the removal of the affected director. In terms of section 61(3) of the Companies Act, either the board or any other person specified in the company's memorandum of incorporation (MOI) or rules may call a shareholders' meeting if one or more written and signed demands for such a meeting are delivered to the company.

The prescriptive nature of section 61 means that, unless something else is provided for in the MOI, shareholders cannot directly and unilaterally convene a meeting, even when the board fails to call the demanded meeting. This was confirmed in the case of *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) where the court held that the board of a company has a duty to convene a meeting when a notice in terms of section 61(3) of the Companies Act has been served.

When the board of a company fails to carry out its duty to convene a meeting, then the only option available to the shareholders is to approach a court of law in terms of section 61(12) of the Companies Act for an order directing a date and time to convene the meeting. In *Heatherview Estate Extension 24 Homeowners Association v Mahlatse Trading Enterprise CC and Others* (22616/2019) [2019] ZAGPPHC 180 the court stressed that where the shareholders or members convene a meeting, it is unlawful and "*their remedy, where the directors refuse or fail to convene a meeting on request in terms of s61(3) lies in subsection (12) i.e. to approach a court*".

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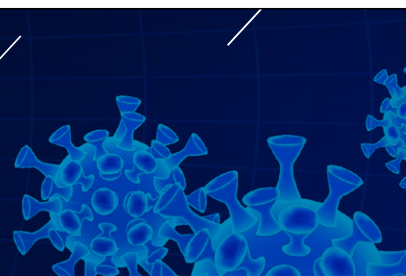

Pressure points and hurdles when removing a director by the shareholders*...continued*

Section 71(2)(b) of the Companies Act states that before the shareholders of a company consider a proposed resolution to remove an affected director, the director must be afforded a reasonable opportunity to make representations before the resolution is put to a vote.

Reasons for the proposed removal should preferably be given

Section 71(2)(b) of the Companies Act states that before the shareholders of a company consider a proposed resolution to remove an affected director, the director must be afforded a reasonable opportunity to make representations before the resolution is put to a vote.

Section 71(2)(b) of the Companies Act is not clear as to whether reasons must be given to the affected director for purposes of making the representations to the shareholders. Certainly nothing in the section expressly says so (contrast this with the process relating to removal by the board, under section 71(3), which clearly provides that removal can only be made certain, narrow grounds). This has caused much debate as to whether reasons are indeed required, and if so, what the threshold for the adequacy or rationality of those reasons is. In the rather controversial decision of *Pretorius and Another v Timcke and Others* (15479/14) [2015] ZAWCHC 215 the court explained that by not knowing the reasons for the proposed removal, a director could not exercise his or her right to be heard as he or she would be in the dark on what the issues are. The court further explained that *"rules of natural justice and the fundamental principle of audi alterem partem presupposes the right to place facts and evidence before the decision maker. A prelude to the exercise of the right includes the right to obtain information, particulars or documents so as to place the affected person in a position to meet the case that needs be answered."*

The court's interpretation of section 71(2)(b) of the Companies Act places an onus on the shareholders to ensure that the reasons for the proposed removal are put to the affected director, and thus it is best to do so, even if the judgment is open to criticism.

The affected director must receive notice of the shareholders' meeting

Making representations to the shareholders before the resolution is put to a vote is intertwined with the requirement that the affected director must receive notice of the shareholders' meeting by the board of directors to adequately prepare for the meeting.

Once the shareholders' demand has been served on the board of the company to convene a shareholders' meeting, the board (as the convenor of the shareholders' meeting) must meet to resolve to authorise the convening of the shareholders' meeting and must invite the affected director to that board meeting even if the affected director will have to recuse themselves prior to the board deliberating and deciding on the matter. This means that when a board of directors' meeting is being held, all board members must receive notice as provided for in section 73(4)(b) of the Companies Act. This admittedly makes for a potentially very awkward and fractious encounter with the affected director at the board meeting, but procedure must be strictly adhered to in director removal cases.

In conclusion, shareholders must be careful to faithfully comply with the Companies Act to successfully remove a director from office. Any misstep or non-application of the Companies Act can render any removal of a director from office suspectable to being set aside by a court of law.

Yaniv Kleitman and Neha Dhana

A (temporary) positive 'spread' for JP Markets as SCA dismisses liquidation order

The Financial Markets Act 19 of 2021 (FMA), read with its regulations, clearly stipulates that a person may not act, advertise or hold itself out as an ODP unless authorised by the Financial Sector Conduct Authority (FSCA) in terms of the FMA by means of an ODP license.

The Supreme Court of Appeal (SCA) judgment of *JP Markets v FSCA* [2021] ZASCA 148 is the latest precedent dealing with state institutions' attempts to wind-up private companies on just and equitable grounds.

JP Markets SA (Pty) Ltd (JP Markets) holds a Category 1 financial services provider license (FSP license), in terms of the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS Act). This license allows it to render financial advisory and intermediary services in respect of derivative instruments to clients.

After much consideration and debate, the court found that the evidence proved JP Markets in fact trades in over the counter (OTC) derivatives and is therefore an OTC derivative provider (ODP).

An ODP is defined as *"a person who as a regular feature of its business and transacting as principal: (a) originates, issues or sells OTC derivatives; or (b) makes a market in OTC derivatives"*. The Financial Markets Act 19 of 2021 (FMA), read with its regulations, clearly stipulates that a person may not act, advertise or hold itself out as an ODP unless authorised by the Financial Sector Conduct Authority (FSCA) in terms of the FMA by means of an ODP license.

In 2020 the FSCA filed for liquidation of JP Markets, claiming it was just and equitable to do so. The grounds for the application related to (i) the fact the JP Markets did not hold an ODP license; and (ii) that there had been various trader/client complaints in relation to JP Markets.

The *court a quo* granted the liquidation application. JP Markets appealed to the SCA to have the liquidation order set aside.

The main issues before the SCA were whether the FSCA:

- met its statutory jurisdictional requirements to exercise power to institute an application for liquidation; and, if so
- whether it had made out a proper case for the winding-up of JP Markets on just and equitable grounds.

It was clear from the evidence that JP Markets was in fact an ODP. It was not licensed to trade as such. It had submitted an application to the FSCA for a license, but the application was only submitted on 21 August 2020, after the liquidation application had been launched in July 2020. At the date of the appeal hearing before the SCA, no decision had been taken by the FSCA in relation to the application.

Context

To place the matter in context, the ODP license regulations were only introduced in February 2018. A grace period for ODP license applications was extended until 14 June 2019. Due to the nature of its trading platform, JP Markets was not certain whether it qualified and/or was required to hold an ODP license.

During and after the 14 June 2019 grace period, JP Markets' internal and external compliance officers, as well as its sole shareholder and directing mind consulted

A (temporary) positive 'spread' for JP Markets as SCA dismisses liquidation order*...continued*

To establish its legal standing to launch its application to wind-up JP Markets, the FSCA raised section 38B(1) of the FAIS Act.

with the FSCA and the South African Reserve Bank as to whether it required an ODP license. When it received confirmation that it did require an ODP license, JP Markets commenced its application process in February 2020, and in June 2020 paid the licensing fee of R50,000 prior to the submission of its application.

The day after JP Markets in June 2020 paid the ODP licensing fee, the FSCA provisionally suspended JP Markets' FSP license until 30 September 2020. JP Markets was therefore prohibited from conducting new business in terms of the FAIS Act. Queries were raised by JP Markets as to whether the suspension related to new clients, or all new business (even if for existing clients, who would be prejudiced by the inability to make deposits). It was advised that the matter would be given further attention.

Numerous interviews were conducted by the FSCA with JP Markets' sole shareholder and managing director. These interviews were not finalised by the time the liquidation application was launched. However, during the last interview JP Markets was informed that that it could not conduct any new business in respect of new or existing clients.

On 7 July 2020 FSCA launched the liquidation application.

To establish its legal standing to launch its application to wind-up JP Markets, the FSCA raised section 38B(1) of the FAIS Act - the FSCA had received more than a hundred complaints from clients of JP Markets. These complaints related to failed payments and interrupted access to JP Markets' online trading platform, resulting in losses to clients.

The FSCA instructed an investigation to be conducted into the complaints. Although the information gathered through investigation "*informed*" the liquidation application, the investigation was still ongoing at the time the application was launched.

The evidence presented in the application proved that JP Markets was operating as an ODP without the requisite license.

The FSCA also claimed that there was a conflict between the interests of JP Markets and its clients.

These issues, as well as the treatment by JP Markets of its "*toxic*" clients, formed the main grounds of the liquidation application.

Critically, it was noted by the SCA that JP Markets only became aware of the client complaints to the FSCA after the launching of the liquidation application.

The court a quo granted the liquidation application on just and equitable grounds, finding that (i) the FSCA found standing for its application in section 38B of the FAIS Act as well as section 96 of the FMA; and (ii) JP Markets failed to obtain an ODP license, it had persisted in continuing to operate as an ODP dispute the lack of the requisite license, and it had acted with obfuscation in its dealings with the FSCA.

Assessing applicability of FAIS and/or FMA

The SCA was doubtful that section 38B of the FAIS Act could be applied in this matter.

In summary, the section reads that if, after a supervisory on-site inspection or an investigation, the FSCA considers that the interest of an FSP or of members of the public so require, the FSCA may apply to court for the winding-up of the FSP.

A (temporary) positive 'spread' for JP Markets as SCA dismisses liquidation order*...continued*

The SCA also considered whether the authority under section 38B related only to section 157(1)(d) of the Companies Act 71 of 2008 (Companies Act), not section 81 (which lists only a certain class of persons, which the FSCA is not). The SCA found that a final decision on these issues was, however, not necessary.

The SCA found that in this instance the liquidation application did not concern the conduct of JP Markets as an FSP or the protection of the interests of clients or the public in respect of financial advisory or intermediary services. It did not. *"There is much to be said for the view that the section envisages the winding-up of and FSP qua FSP"* (page 9, paragraph 21).

The SCA also considered whether the authority under section 38B related only to section 157(1)(d) of the Companies Act 71 of 2008 (Companies Act), not section 81 (which lists only a certain class of persons, which the FSCA is not). The SCA found that a final decision on these issues was, however, not necessary.

It then turned to consider the applicability of section 96 of the FMA.

Section 96(2)(a)(i) states that after a supervisory on-site inspection or investigation has been conducted, the FSCA may, in order to fulfill the objectives of the FMA, apply to the court under section 81 of the Companies Act for the winding-up of a company. The FSCA were to be treated as if they were a creditor for the relevant company.

In this case there was no on-site inspection, so the issue then turned to the (still ongoing) investigation. The question being whether the investigation referred to in section 96 needed to be completed before the FSCA was authorised to launch the liquidation application. JP Markets contended that the word *"after"* in the provision meant that the investigation did need to be complete.

The SCA found that the interpretation contended to by JP Markets faced difficulties at *"every level of interpretation"*:

- In the interpretation of the provision, there was nothing that lead to the conclusion that finality in the investigation was required, just that it had to have commenced (albeit still incomplete).
- In the context of the provision – there was nothing especially when read with its resulting remedies in section 96(2)(a) to (e). A single on-site inspection was sufficient to invoke the remedies, whether a formal or final result was reached. The same should be applicable to an inspection.
- Such an interpretation was unbusinesslike, leading to insensible results. Evidence can be obtained during an ongoing (incomplete) investigation which would justify or require the FSCA to take the actions referred to in section 96(2)(a) to (e).

The SCA also found that JP Markets' contention that the Promotion of Administrative Justice Act 3 of 2000 (PAJA) required the investigation to be complete was also misplaced. PAJA is not applicable to section 96(2)(a)(i) in that it does not, on its own, affect the rights of any person or have a direct, external legal effect.

The SCA therefore found that the court a quo was correct in finding that section 96 of the FMA was applicable in this matter.

A (temporary) positive 'spread' for JP Markets as SCA dismisses liquidation order*...continued*

The court found that the determination of whether it would be just and equitable to wind-up a company in terms of section 96 was "*inextricably linked to the achievement of the objects of the FMA*".

Evaluating the wind-up

The next question was whether, in the circumstances, it was just an equitable to wind-up JP Markets, as per section 81 of the Companies Act.

Although not a closed list, the court confirmed that the traditionally applied categories constituting just and equitable grounds applied to shareholder applicants – e.g. deadlock in the management of company's affairs and disappearance of company's substratum. In other words none of the traditional categories applied to the current matter.

This notwithstanding, the SCA held that the traditional categories did not equate to a closed list. In the case before it the court found that the determination of whether it would be just and equitable to wind-up a company in terms of section 96 was "*inextricably linked to the achievement of the objects of the FMA*" (listed under section 2 of the FMA).

"*The manifest purpose of the FMA is to serve public interest*". To this end the SCA applied the dictum applied by the SCA in the case of *Recycling and Economic Development Initiative of South Africa NPC v Minister of Environmental Affairs* [2019] ZASCA 1:

> *"There is one more reason why it was not just and equitable to wind-up the appellants: the court had to be satisfied that the Minister had no alternative means to address complaints before resorting to the drastic expedient of winding-up the appellants. The court a quo did not address this requirement."*

The court evaluated the objectives of the FMA, being to:

(a) ensure that the South African financial markets are fair, efficient and transparent;

(b) increase confidence in the South African financial markets by-

  (i) requiring that securities services be provided in a fair, efficient and transparent manner; and

  (ii) contributing to the maintenance of a stable financial market environment;

(c) promote the protection of regulated persons, clients and investors;

(d) educe systemic risk; and

(e) promote the international and domestic competitiveness of the South African financial markets and of securities services in the Republic.'

In the current instance it was observed by the SCA that JP Markets was a solvent company and a substantial concern, which employed 70 permanent employees and paid in excess of R1 billion to thousands of clients during the period of three months preceding the liquidation application. It was not disputed that its own cash equity amounted to about R220 million.

The FSCA had not refused to make the client complaints against JP Markets available to it. In relation to those complaints, JP Markets opined that the 100 dissatisfied clients was not an accurate representation of its 300,000 clients.

A (temporary) positive 'spread' for JP Markets as SCA dismisses liquidation order*...continued*

The court found that the application to liquidate JP Markets prior to the determination of its ODP licence application would not achieve the objects of the FMA.

It further contended that it did not arbitrarily deny withdrawal requests or cause unnecessary delays, however, in limited cases where prohibited trading had been identified profits were withheld and client's deposits were refunded. Instances of interruption of access to trading platforms were caused by circumstance beyond JP Markets' control – e.g. global lockdowns resulting from COVID-19 pandemic. Affected clients were restored to positions in which they would have been before the market halt.

Furthermore, the court found that no evidence was presented that clients of JP Markets were unaware that they were transacting with JP Markets, therefore no conflict of interest arose, as alleged by the FSCA. Traders are free to accept or decline spreads offered, it was not objectionable to quote differentiated spreads to clients that had been regarded as "*toxic*".

Considering all the interactions between JP Markets and the FSCA leading up to the liquidation application, the court found that it could not be said that JP Markets was "*guilty of obfuscation*".

The evidence before the SCA therefore did not establish that the business of JP Markets constituted a systemic risk to its clients or to financial markets generally.

The only remaining issue therefore was that JP Markets had been conducting business as an ODP without a license.

In this regard, JP Markets had proved, on evidence from the FSCA itself, that other OTC derivative brokers were trading without an ODP license. From the eight ODPs known to operate on the same business model, only one had submitted an application for an ODP license. Despite this, the FSCA had not taken any action against any of the other ODPs.

JP Markets had applied for an ODP license. This application was still pending at the time of the appeal hearing.

Conclusion

The court found that the application to liquidate JP Markets prior to the determination of its ODP licence application would not achieve the objects of the FMA. The appeal was therefore successful, and the liquidation order was set aside. The winding-up of JP Markets was found to be neither just nor equitable as the objects of the FMA could be achieved by alternative remedies.

Warning shot

The court did say that if JP Markets' ODP licence were to be refused, the FSCA could then apply to obtain an order to prohibit JP Markets from conducting business as an ODP. This is a warning shot not only to JP Markets but to all other entities trading without the necessary licenses, and should be seriously heeded, failing which there may be far reaching consequences for the entity involved – including potential liquidation.

Belinda Scriba and Simone Nel

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