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CORPORATE & COMMERCIAL **ALERT**

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To dispose or not to dispose... that is not the only question

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To dispose or not to dispose... that is not the only question

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Companies often find themselves entering into disposal transactions which are possibly subject to the provisions of s112 of the Companies Act, No 71 of 2008 (Act), whether by selling a division of its business, disposing of its shares in a subsidiary or even undertaking an internal restructure.

Section 112 requires, amongst other things, that a special resolution be adopted by the shareholders of the company where a company is disposing of the whole or a greater part of its assets or undertaking (business). This may seem simple enough, but there is real devil in the detail and, for a number of reasons, companies find themselves missing or falling short of the requirements of s112. The consequences of non-compliance with s112 and dealing with those consequences deserves more attention than what is discussed in this article, but suffice it to say that a failure to comply with s112 is highly problematic. Rather, the purpose of this article is to caution companies against making a shallow investigation in relation to disposals by asking the right questions.

When a company intends disposing of its assets, the following questions should be asked:

1. **"Is the transaction exempt from the applicability of s112?"**

   In order to answer this, one must determine whether the transaction falls into one of the categories of s112(1). Where a disposal constitutes a transaction (i) that is pursuant to a business rescue plan, (ii) between a wholly-owned subsidiary and its holding company or (iii) between or among two or more wholly-owned subsidiaries of the same holding company, then s112 does not apply and no further enquiry needs to be made.

   Often, where a group is undertaking an internal restructure, a common mistake is to overlook s112 by virtue of the transaction taking place between members of the same group, even where all the parties are not wholly owned subsidiaries. One small minority shareholding is sufficient to make s112 apply.

2. **"Does the transaction constitute a disposal by the company of the whole or a greater part of its assets or undertaking?"**

   It will be clear when a company intends on selling all of its assets or business, but where a company is disposing of only some of its assets or business, it is often not clear whether such portion constitutes a 'greater part of the assets or undertaking'. In order to make the determination, the assets being sold must be valued. Subsection 4 provides that "Any part of the undertaking or assets of a company to be disposed of, as contemplated in this section, must be fairly valued, as calculated in the prescribed manner, as at the date of the proposal, which date must be determined in the prescribed manner".

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It is worth remembering at this point that s115(2)(b) of the Act seeks to regulate disposals at a group level, using the same tests as are applicable to s112 on a consolidated basis.

While s1 of the Act defines the term "all or the greater part of the assets or undertaking" (more than 50% of the gross assets or business, fairly valued), the term 'fairly valued' is not defined, and there is no 'prescribed manner' stipulated in the Act or its regulations.

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Anyone who has had any involvement with a determination of value will know that it is more art than science, and that it consists only of opinions derived from informed estimates based on financial information available in the circumstances. To add to the uncertainty, valuations are often based on internally prepared management accounts where audited financial statements are not available at the right time. As a result, two bona fide calculations of fair value can easily determine that the same disposal is or is not subject to s112. Getting an expert opinion that s112 does not apply does not provide a definitive answer, it only helps in assessing the risk.

3 **"Does the special resolution comply with the requirements of s112, read with s115?"**

Once it has been determined that s112 applies, we must turn our attention to the requirements of compliance with s112, read with s115.

The wording of the s112(2): "A company may not dispose of all or the greater part of its assets or undertaking unless -... the disposal has been approved by special resolution of the shareholders in accordance with s115" implies that shareholders must approve the disposal before it is implemented. The ability of shareholders to subsequently ratify a disposal is, at best, doubtful. This means that the seller and purchaser need to get their call on whether s112 applies correct at the start – there is no way of fixing compliance after the event.

For shareholder approval in accordance with s112 and s115, a special resolution must be passed at a meeting of the shareholders after the company has given the prescribed notice, which notice must contain the prescribed information including the precise terms of the transactions to be considered at the meeting and the provisions of sections 115 and 164 of the Act.

To dispose or not to dispose... that is not the only question...*continued*

The upshot of all of this is that disposals need to be carefully evaluated and implemented with caution where the provisions of s112 might apply.

Due to time constraints and accessibility to shareholders, it is often decided to bypass the holding of a meeting and instead to pass shareholder resolutions in writing, by a so-called "round robin resolution", something which the Act specifically allows for. However, s115 provides that the special resolution to be passed must be passed "at a meeting called for that purpose" which appears to prescribe that a company is obliged to hold a meeting. Accordingly, a conservative view (and, given the consequences, it is difficult for a robust view to be taken), is that a round robin resolution will not suffice.

Section 112(5) further provides that a resolution "is effective only to the extent that it authorises a specific transaction." This means that, even if the shareholders have duly passed a special resolution, at a meeting, having been given the prescribed notice and information, the resolution can still fall short of the requirements of s112 if it doesn't approve the 'specific transaction'. There is some scope for debate as to exactly what detail must be before the shareholders for the resolution to be an approval of a specific transaction, but there is some case law guidance that all of the specific terms of the transaction need not be approved and that this provision is aimed rather at preventing the directors of a company from obtaining a general authority to affect any disposal in the future. Again, we are left with some uncomfortable uncertainty.

The upshot of all of this is that disposals need to be carefully evaluated and implemented with caution where the provisions of s112 might apply. It is also easy to see why s112 creates such angst and makes otherwise sensible and pragmatic advisors prone to severely conservative outbreaks.

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