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CORPORATE & COMMERCIAL **ALERT**

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Package deals and pre-emptive rights in respect of shares

Pre-emptive rights in respect of shares in private companies are a notoriously thorny matter and often give rise to contentious issues and disputes between shareholders. One such issue is the legality and effect of combining or stapling (Stapling) assets to shares that are subject to a right of pre-emption. This is often referred to as a "*Package Deal*".

KENYA

Amendments by Business Laws Act facilitate ease of doing business in Kenya

The Business Laws (Amendment) (No. 2) Act, 2021 (the Act) which came into force on 30 March 2021, makes amendments to various statutes to facilitate the ease of doing business in Kenya, including the Law of Contract Act, the Companies Act and the Insolvency Act. We consider below some of the amendments introduced by the Act.

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Package deals and pre-emptive rights in respect of shares

Shareholders should not allow their co-shareholders wide and unfettered discretion to Staple unrelated assets to shares that are subject to a right of pre-emption.

Pre-emptive rights in respect of shares in private companies are a notoriously thorny matter and often give rise to contentious issues and disputes between shareholders. One such issue is the legality and effect of combining or stapling (Stapling) assets to shares that are subject to a right of pre-emption. This is often referred to as a "*Package Deal*".

Pre-emptive rights in respect of shares in a private company are either:

- rights of pre-emption that restrict the transferability of issued shares (Share Transfer Pre-emptive Rights); or
- rights of pre-emption that confer on a shareholder the right to be offered a percentage of any new shares that a company proposes to issue, before those shares are offered to persons that are not shareholders of that company.

We will only focus on Share Transfer Pre-emptive Rights for the purposes of this discussion.

Section 8(2)(b) of the Companies Act 71 of 2008 requires that the transferability of shares in a private company must be restricted but does not prescribe any substantive or procedural requirements. Companies often address this requirement by including Share Transfer Pre-emptive Rights in their memoranda of incorporation (MOI).

The content of Share Transfer Pre-emptive Rights is contractual in nature and will be the product of negotiations between shareholders. The flexibility afforded to shareholders and companies allow for the incorporation of various commercial considerations in Share Transfer Pre-emptive Rights provisions. For example, the parties can provide for and regulate matters such as offer triggers, the offer process, valuation methodologies, pricing, the Stapling of assets, and so on.

As a point of departure, shareholders should not allow their co-shareholders wide and unfettered discretion to Staple unrelated assets to shares that are subject

Package deals and pre-emptive rights in respect of shares*...continued*

It must, however, be cautioned that it is not uncommon for shareholder disputes to arise in instances where the MOI does not expressly allow for, or require, a shareholder to Staple shareholder loans to Affected Shares.

to a right of pre-emption (Affected Shares). There are, however, circumstances in which shareholders would be well advised to consider - if an offeror shareholder (Offeror) should be allowed (or forced) - to Staple assets to Affected Shares in a pre-emptive right offer process (Offer).

The first example relates to the Stapling of shareholder loans to Affected Shares. The shares and shareholder loans held by a person in and against a company are collectively referred to as equity. In the context of private companies, it is not unusual for shareholders to contribute a significant part their equity in the form of shareholder loans. Therefore, should an Offeror wish to exit its investment in a company, such Offeror would no doubt wish to dispose of its equity as a Package Deal.

The Stapling of shareholder loans to Affected Shares is generally not controversial, and one will often find that MOIs are drafted to prohibit a shareholder from selling shares in a company unless in one and the same transaction, that shareholder disposes of a proportionate part of its shareholder loans. It must, however, be cautioned that it is not uncommon for shareholder disputes to arise in instances where the MOI does not expressly allow for, or require, a shareholder to Staple shareholder loans to Affected Shares. The latter can be a material impediment to shareholders wanting a clean exit or to realise maximum value on an investment.

The second example relates to scenarios where a shareholder holds securities (such as shares, preference shares, debentures, etc.) and loans in and against the subsidiaries, the holding company and/or related persons of a company. There may be situations in which an Offeror may wish to get a clean break from a group of companies and to Staple its securities and loans in and against the group companies to Affected Shares. Similarly, a third-party purchaser may also wish to offer and/or proceed with a Package Deal to maximise its investment in a group.

Although example two is less common, there may be circumstances in which it may be advisable to afford shareholders limited discretion as to whether or not to Staple securities and loans held in and against group companies to Affected Shares.

The judgment by the Western Cape Division of the High Court in the matter *Plattekloof RMS Boerdery (Pty) Ltd v Dahlia Investment Holdings (Pty) Ltd and Another* (7836/2020) [2021] ZAWCHC is the most recent South African authority on the effect of Package Deals on the position of a holder of pre-emptive rights. The judgment provides valuable insights into the considerations that our courts may deem relevant in relation to disputes on the subject matter.

In the *Plattekloof* case, the court was confronted with a dispute in which the owner of a farm comprising eight registered portions wished to dispose of all eight portions as one indivisible transaction to a third-party purchaser.

Package deals and pre-emptive rights in respect of shares*...continued*

In order to minimise the risk of disputes in respect of Package Deals, shareholders are advised to carefully provide for circumstances in which Package Deals are allowed and the manner in which Offers must be presented to holders of pre-emptive rights.

The applicant in the matter leased two of the eight portions from the owner, and in terms of a lease agreement between the parties, the applicant was granted a pre-emptive right in respect of the two leased portions. The primary question in this case was the determination of the applicant's position in terms of the pre-emptive rights clause when the pre-emptive property became the subject of an offer to purchase or a contract of sale as an integral part of a larger package.

Without going into the facts and *ratio decidendi* of the *Plattekloof* case, we have highlighted a few key principles of general application, which may be of assistance in the context of Share Transfer Pre-emptive Rights:

The effect of a Package Deal on the position of the holder of pre-emptive rights, and the remedies available to such person, will ultimately depend on the wording and construction of the particular pre-emptive right provisions.

A critical question is whether the pre-emptive right provisions impose negative or *positive obligations* on an Offeror in favour of the holder of the pre-emptive rights?

For example, the court indicated that a *negative obligation* on an Offeror may take the form of an obligation not to conclude an agreement of sale with a third-party offeror without first offering the pre-emptive property to the holder of the pre-emptive right on the same terms and conditions as the third-party offer. In such a case it is arguable that the holder of the pre-emptive right must consider the entire Package Deal and it may not be justifiable to carve out the pre-emption property from the Package Deal.

An example of a *positive obligation* would be an obligation on the Offeror to first offer the specific pre-emptive property to the holder of the pre-emptive rights on the terms that the Offeror proposed to dispose of it. In this scenario the holder of the pre-emptive rights will not be bound to consider the entire Package Deal.

The South African jurisprudence relating to the effect of Package Deals on the position of a holder of pre-emptive rights is limited and unlikely to be of meaningful assistance in a dispute with a nuanced factual matrix.

In summary, the decision whether to allow for the Stapling of assets to Affected Shares is a commercial matter that shareholders must decide on. In order to minimise the risk of disputes in respect of Package Deals, shareholders are advised to carefully provide for circumstances in which Package Deals are allowed and the manner in which Offers must be presented to holders of pre-emptive rights.

Abrianne Marais and Etta Chang

KENYA

Amendments by Business Laws Act facilitate ease of doing business in Kenya

The Law of Contract Act has been amended to provide expressly that a company incorporated under the Companies Act can now execute a document relating to an interest in land without using a common seal.

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Execution of contracts relating to an interest in land

The Law of Contract Act has been amended to provide expressly that a company incorporated under the Companies Act can now execute a document relating to an interest in land without using a common seal. Such a document will be validly executed if it is signed on behalf of the company by two authorised signatories or by a director of the company in the presence of a witness who attests the signature.

The Companies Act has also been cleaned up to remove hangover provisions relating to the use of the common seal abroad by companies that were incorporated before 2015.

Other entities that are not companies and which require to use the common seal by virtue of law, or their constitutional documents will still be able to do that when executing such documents.

Virtual or hybrid meeting

A company can now undertake either a physical, virtual or hybrid general meeting pursuant to the provisions of the Companies Act. This will come as a great relief for companies that wish to hold meetings whilst complying with the restrictions relating to the COVID-19 pandemic and is in keeping with increased use of digital communication platforms.

The inclusion of virtual and hybrid general meetings into the Companies Act codifies the guidelines issued by the Business Registration Service in 2020 and thus ensure that all companies can now conduct virtual or hybrid meetings, not just companies whose articles of association permit the conduct of virtual or hybrid meetings.

A virtual general meeting is a meeting where all the members join and participate through electronic means whereas a hybrid meeting as the name suggests is a meeting where some participants are in the same physical location while other participants join the meeting through electronic means. Electronic means is deemed to include video conference, audio conference, web conference or such other electronic means.

In setting up these sorts of meetings, companies are required to ensure, among other things, that notices for virtual or hybrid general meetings to members specify the means of joining and participating in the meeting.

Distribution of Assets realised from a floating charge

The Insolvency Act has been amended to provide a window for a lender to oppose the setting aside of a portion of the company assets subject to a floating charge for the satisfaction of unsecured debts. The portion of assets that are to be made available for the satisfaction of unsecured debts presently is twenty per centum. The new amendment presents for unsecured creditors a return to the former potentially perilous existence where they would not recover any money from an insolvent company although the criteria for accessing the window by the holder of a floating charge is anything but straightforward.

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Amendments by Business Laws Act facilitate ease of doing business in Kenya...*continued*

There are further changes to the Insolvency Act and the effect of these will be considered in a separate alert.

In opposing the distribution, the liquidator or administrator will require to apply to court on the ground that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits. In addition, the holder of the floating charge will also be required to apply to the court on the grounds that the distribution will unfairly harm its interests. The High Court will then determine if the distribution should not be made or allow distribution subject to such conditions as it considers appropriate.

Business rescue moratorium

The categories of companies that are eligible to apply for a moratorium has been expanded to include those that are "*financially distressed*". What amounts to financial distress has not been defined and it remains to be seen how it will be applied. The companies that are illegible to apply for a moratorium remains largely the same expect that the illegibility of companies having liability outstanding under an agreement of one billion shillings or more has been removed.

Where a moratorium is in place, the Insolvency Act has been amended to provide that is will not be possible to appoint an administrative receiver. This clarifies previous suggestions that the appointment of an administrative receiver could be considered in certain cases as this was not expressly prohibited by statute.

The process for applying for a moratorium has also changed to provide that a person will now also need to provide, among other things, a document describing why a moratorium should be granted. Such reasons may include evidence that it will assist in achieving an informal restructuring or other agreement with creditors or entering a formal insolvency procedure that could lead to the rescue or efficient liquidation of the company. An officer to be known as a monitor, previously provisional liquidator, but still an insolvency practitioner will be appointed to "monitor" the company.

The moratorium if obtained will be for a short and likely unrealistic 30 days, but this can be extended for a further period of at least 30 days if the court considers it desirable to do so in order to achieve the aims for which the moratorium was originally granted.

There are further changes to the Insolvency Act and the effect of these will be considered in a separate alert.

Payment of training levies

The Industrial Training Act has been amended to provide that the payment of training levies due under a training levy order by a business will be remitted at the end of the financial year of the business, but not later that the 9th day of the month following the end of the financial year. This is a change from the previous requirement to pay these levies monthly although practical reasons may necessitate a person to opt for monthly payments particularly where there are routine frequent changes to the employees.

Sammy Ndolo

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CLIFFE DEKKER HOFMEYR

OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:

Willem Jacobs
National Practice Head
Director
Corporate & Commercial
T +27 (0)11 562 1555
M +27 (0)83 326 8971
E willem.jacobs@cdhlegal.com

David Thompson
Regional Practice Head
Director
Corporate & Commercial
T +27 (0)21 481 6335
M +27 (0)82 882 5655
E david.thompson@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Mmatiki Aphiri
Director
T +27 (0)11 562 1087
M +27 (0)83 497 3718
E mmatiki.aphiri@cdhlegal.com

Roelof Bonnet
Director
T +27 (0)11 562 1226
M +27 (0)83 325 2185
E roelof.bonnet@cdhlegal.com

Tessa Brewis
Director
T +27 (0)21 481 6324
M +27 (0)83 717 9360
E tessa.brewis@cdhlegal.com

Etta Chang
Director
T +27 (0)11 562 1432
M +27 (0)72 879 1281
E etta.chang@cdhlegal.com

Vivien Chaplin
Director
T +27 (0)11 562 1556
M +27 (0)82 411 1305
E vivien.chaplin@cdhlegal.com

Clem Daniel
Director
T +27 (0)11 562 1073
M +27 (0)82 418 5924
E clem.daniel@cdhlegal.com

Jenni Darling
Director
T +27 (0)11 562 1878
M +27 (0)82 826 9055
E jenni.darling@cdhlegal.com

André de Lange
Sector head
Director
Agriculture, Aquaculture
& Fishing Sector
T +27 (0)21 405 6165
M +27 (0)82 781 5858
E andre.delange@cdhlegal.com

Werner de Waal
Director
T +27 (0)21 481 6435
M +27 (0)82 466 4443
E werner.dewaal@cdhlegal.com

John Gillmer
Joint Sector head
Director
Private Equity
T +27 (0)21 405 6004
M +27 (0)82 330 4902
E john.gillmer@cdhlegal.com

Jay Govender
Sector Head
Director
Projects & Energy
T +27 (0)11 562 1387
M +27 (0)82 467 7981
E jay.govender@cdhlegal.com

Johan Green
Director
T +27 (0)21 405 6200
M +27 (0)73 304 6663
E johan.green@cdhlegal.com

Ian Hayes
Director
T +27 (0)11 562 1593
M +27 (0)83 326 4826
E ian.hayes@cdhlegal.com

Peter Hesseling
Director
T +27 (0)21 405 6009
M +27 (0)82 883 3131
E peter.hesseling@cdhlegal.com

Quintin Honey
Director
T +27 (0)11 562 1166
M +27 (0)83 652 0151
E quintin.honey@cdhlegal.com

Brian Jennings
Director
T +27 (0)11 562 1866
M +27 (0)82 787 9497
E brian.jennings@cdhlegal.com

Rachel Kelly
Director
T +27 (0)11 562 1165
M +27 (0)82 788 0367
E rachel.kelly@cdhlegal.com

Yaniv Kleitman
Director
T +27 (0)11 562 1219
M +27 (0)72 279 1260
E yaniv.kleitman@cdhlegal.com

Justine Krige
Director
T +27 (0)21 481 6379
M +27 (0)82 479 8552
E justine.krige@cdhlegal.com

Johan Latsky
Executive Consultant
T +27 (0)11 562 1149
M +27 (0)82 554 1003
E johan.latsky@cdhlegal.com

Nkcubeko Mbambisa
Director
T +27 (0)21 481 6352
M +27 (0)82 058 4268
E nkcubeko.mbambisa@cdhlegal.com

Nonhla Mchunu
Director
T +27 (0)11 562 1228
M +27 (0)82 314 4297
E nonhla.mchunu@cdhlegal.com

Ayanda Mhlongo
Director
T +27 (0)21 481 6436
M +27 (0)82 787 9543
E ayanda.mhlongo@cdhlegal.com

William Midgley
Director
T +27 (0)11 562 1390
M +27 (0)82 904 1772
E william.midgley@cdhlegal.com

Tessmerica Moodley
Director
T +27 (0)21 481 6397
M +27 (0)73 401 2488
E tessmerica.moodley@cdhlegal.com

OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:

Anita Moolman
Director
T +27 (0)11 562 1376
M +27 (0)72 252 1079
E anita.moolman@cdhlegal.com

Jerain Naidoo
Director
T +27 (0)11 562 1214
M +27 (0)82 788 5533
E jerain.naidoo@cdhlegal.com

Francis Newham
Executive Consultant
T +27 (0)21 481 6326
M +27 (0)82 458 7728
E francis.newham@cdhlegal.com

Gasant Orrie
Cape Managing Partner
Director
T +27 (0)21 405 6044
M +27 (0)83 282 4550
E gasant.orrie@cdhlegal.com

Verushca Pillay
Director
T +27 (0)11 562 1800
M +27 (0)82 579 5678
E verushca.pillay@cdhlegal.com

David Pinnock
Joint Sector head
Director
Private Equity
T +27 (0)11 562 1400
M +27 (0)83 675 2110
E david.pinnock@cdhlegal.com

Allan Reid
Sector head
Director
Mining & Minerals
T +27 (0)11 562 1222
M +27 (0)82 854 9687
E allan.reid@cdhlegal.com

Megan Rodgers
Sector Head
Director
Oil & Gas
T +27 (0)21 481 6429
M +27 (0)79 877 8870
E megan.rodgers@cdhlegal.com

Ludwig Smith
Director
T +27 (0)11 562 1500
M +27 (0)79 877 2891
E ludwig.smith@cdhlegal.com

Ben Strauss
Director
T +27 (0)21 405 6063
M +27 (0)72 190 9071
E ben.strauss@cdhlegal.com

Tamarin Tosen
Director
T +27 (0)11 562 1310
M +27 (0)72 026 3806
E tamarin.tosen@cdhlegal.com

Roxanna Valayathum
Director
T +27 (0)11 562 1122
M +27 (0)72 464 0515
E roxanna.valayathum@cdhlegal.com

Roux van der Merwe
Director
T +27 (0)11 562 1199
M +27 (0)82 559 6406
E roux.vandermerwe@cdhlegal.com

Charl Williams
Director
T +27 (0)21 405 6037
M +27 (0)82 829 4175
E charl.williams@cdhlegal.com

BBBEE STATUS: LEVEL TWO CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI
CVS Plaza, Lenana Road, Nairobi, Kenya. PO Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114 E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA