Restructuring in a minefield

There is much to think about when planning a restructure of the ownership of a company, particularly for lawyers: Keren Oliver of Cox Yeats Attorneys provides the inside edge

Not only do the usual obstacles imposed by company legislation and the Takeover Regulation Panel need to be surmounted, but at least until 1 May 2013 parties to proposed transactions must mind the interplay between existing articles of association and the new Companies Act. Here are some of the issues arising in the context of an issue and buyback of shares:

If the restructure is going to involve an issue of shares, one of the first things to determine is whether the shares can simply be issued to the new shareholder or whether they first need to be offered to the existing shareholders pro rata. For private companies, the new Companies Act automatically applies this anti-dilution mechanism.

However, a private company that has replaced its articles of association with a Memorandum of Incorporation (MoI) and in the process of doing so, negated the pre-emptive right to subscribe for shares, will not have to concern itself with this requirement. Public companies are exempt outright.

Private companies issuing to new shareholders who will pay for their shares in increments in future, such as on the receipt of dividends, will not have to offer the new shares to existing shareholders – smoothing the way for black economic empowerment buy-ins and employee share schemes.

Unlike under the old Companies Act, directors have the power to issue shares without shareholder approval. Shareholder approval will be required in a number of circumstances including when new shares are to be issued to directors, executive management[1], or persons who will become directors or executive managers in the ensuing six months, or when there is going to be a 30% shift in voting power as a result of the issue.

Companies that have not yet changed their articles of association will remain bound, until 1 May 2013, by any stipulation in their articles that issues must be pre-authorised by shareholders (this is common).

What about a buyback? This seemingly straightforward corporate action can take on a life of its own. In its simplest form, the board approves a buyback after satisfying itself that the purchasing company will be solvent after paying the selling shareholders for their shares.

Taking it one step further, buybacks from directors and executive management require prior shareholder approval. Buybacks of more than 5% of the issued shares of any class oblige the company to retain an independent expert to produce a report to the board and the shareholders on the merits of the deal, in addition to obtaining director and shareholder approval. In these cases, shareholders objecting to the proposed buyback have scope to hold up or derail the buyback in court or force the company to repurchase all their shares at fair value.

Now into the realm of regulatory red tape: public companies as well as certain private companies are subject to the Takeover Regulation Panel when implementing a buyback and will have to obtain approval or an exemption from the Panel in respect of the transaction at some expense.

Buybacks resulting in a shareholder who used to hold less than 35%, now holding 35% or more of the voting rights attaching to the company's securities[2], will, subject to a few exceptions, force that shareholder to offer to buy out the remaining shareholders.

Public companies that remain public simply because they have more than 50 shareholders should consider taking the opportunity afforded by the new Companies Act to convert to a private company, which may now have any number of shareholders.

Conversion could simplify the restructure significantly and reduce the cost thereof due to the exemption of most private companies from the oversight of the Takeover Regulation Panel.

Conversion is a relatively simple process: the founding documents of the company simply need to be changed to alter the company's name ending and to restrict the transferability and public offering of its securities.

If the articles of association have not yet been replaced with an MoI in line with the new Companies Act, and if time is not short, it is worthwhile achieving both ends at once.

In light of the complexities of compliance and the need to complete ownership restructures in line with commercial deadlines, the conclusion of the matter – and the advice – is to know how to categorise the elements of the restructuring and the company in question. Or to know someone who knows!

References

1. This is a reference to 'prescribed officers', a term that is broadly defined in the Companies Regulations 2011 and which usually encompasses the top tier of management.
2. The term 'securities' includes, but is not limited to shares and debt instruments.

Cox Yeats Attorneys based in Umhlanga has, in collaboration with LexisNexis, produced a book titled, A Practical Guide to the Companies Act, *which focuses on private companies and offers practical guidance on how to deal with new concepts and requirements under the Companies Act No. 71 of 2008.*

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