COPYRIGHT AND CITATION CONSIDERATIONS FOR THIS THESIS/ DISSERTATION

How to cite this thesis

SHAREHOLDER PROTECTION UPON THE ISSUANCE OF FURTHER SHARES

by

MARIA ELIZABETH VAN BILJON
(920 420 432)

MINOR DISSERTATION
Submitted in partial fulfilment of the requirements for the degree of

MASTER OF LAWS (LLM)
in
CORPORATE LAW
in the
FACULTY OF LAW
at the
UNIVERSITY OF JOHANNESBURG

SUPERVISOR: PROFESSOR K. VAN DER LINDE

FEBRUARY 2016
ABSTRACT

Three distinctive interests of a shareholder may be impacted on the further issuance of shares, namely a shareholder’s residual right to ultimately share in the net assets of the company, a shareholder’s right to participate in the management of a company and lastly the value of a shareholder’s interest may be diluted.

Various mechanisms exist to protect these distinctive interests of shareholders, which include limiting the authorised share capital of a company; limiting the authority of the board to issue shares; the application of pre-emptive rights; regulating the consideration required and imposing fiduciary duties on directors.

This dissertation evaluates the protection afforded to shareholders as provided for in the Companies Act 71 of 2008 and the JSE Listings Requirements. To determine if the protection afforded to shareholders upon the issue of further shares in South African law is sufficient and in line with international trends, the protection afforded to shareholders in the jurisdictions of New Zealand and the United Kingdom have been evaluated.

Despite criticisms raised and recommendations made, the Companies Act 71 of 2008 overall, balances the authority afforded to the directors when issuing further shares of the company and when required, limits such authority, to provide sufficient protection to shareholders when a company issues further shares.

KEY TERMS

Authorised share capital; Pre-emptive rights; Consideration; Fiduciary Duties; Shareholder protection
# TABLE OF CONTENTS

1. Introduction .................................................................................................................. 1

2. Share issues in South Africa .......................................................................................... 4
  2.1 The act ...................................................................................................................... 4
  2.1.1 Authorised share capital ..................................................................................... 6
  2.1.2 Authority to issue shares .................................................................................... 8
    2.1.2.1 Section 38 of the act: Issuing shares .............................................................. 8
    2.1.2.2 Section 41 of the act: Shareholder approval for issuing shares in certain cases 9
    2.1.2.3 Section 42: Options for subscription of securities and section 43: Securities other than shares .................................................................................. 16
  2.1.3 Pre-emptive rights .............................................................................................. 16
  2.1.4 Consideration ...................................................................................................... 19
  2.1.5 Fiduciary duties .................................................................................................. 20
  2.1.6 Liability and validity of actions ......................................................................... 21

3. Share issues and the JSE Listings Regulations .............................................................. 22

4. A comparative perspective ........................................................................................... 23
  4.1 New Zealand ........................................................................................................... 23
    4.1.1 Authorised share capital .................................................................................. 24
    4.1.2 Authority to issue shares .................................................................................. 24
    4.1.3 Pre-emptive rights .......................................................................................... 25
    4.1.4 Consideration ................................................................................................... 26
    4.1.5 Fiduciary duties ............................................................................................... 27
    4.1.6 Liability and validity of actions ....................................................................... 27
  4.2 United Kingdom ....................................................................................................... 28
    4.2.1 Authorised share capital .................................................................................. 28
    4.2.2 Authority to issue shares .................................................................................. 29
    4.2.3 Pre-emptive rights .......................................................................................... 30
    4.2.4 Consideration ................................................................................................... 32
    4.2.5 Fiduciary duties ............................................................................................... 33
    4.2.6 Liability and validity of actions ....................................................................... 34

5. Conclusion .................................................................................................................... 34
  5.1 Ex ante protection mechanisms .............................................................................. 35
    5.1.1 Authorised share capital .................................................................................. 35
    5.1.2 Authority to issue shares .................................................................................. 35
    5.1.3 Pre-emptive rights .......................................................................................... 36
    5.1.4 Consideration ................................................................................................... 37
  5.2 Ex Post protection mechanisms .............................................................................. 38
5.2.1 Fiduciary duties ................................................................. 38
5.2.2 Liability and validity of actions ........................................... 38
5.3 The JSE Listings Requirements ............................................... 38
5.4 Final analysis ........................................................................ 39
6. Bibliography .......................................................................... 40
7. Abbreviations ....................................................................... 44
SHAREHOLDER PROTECTION UPON THE ISSUANCE OF FURTHER SHARES

1. Introduction

Share capital is a mechanism through which equity funding of the company is raised and which also establishes rights, duties and legal relationships. A fundamental characteristic of the modern company, is the division of an undertaking into shares: "A share in a company consists of a bundle, or a conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends ...", and in the case of voting shares, the entitlement to participate in the general meeting of the company.

Accordingly, a shareholder is induced to invest in a company because of her anticipation to participate in the earnings and assets of a company as well as her right to participate in the governance of the company. As a result, it is important to shareholders that share capital is regulated. Potential conflicts may arise between the interests of shareholders and the company as a result of actions and resolutions taken by the company that has the effect of changing the share capital structure of the company, eg the issuing of further shares, the reorganisation of existing capital, or the reduction or return of capital. Different approaches are followed in various jurisdictions to protect shareholders’ interests in these instances. This dissertation will only analyse the impact of the issuing of further shares and will not assess the impact of reorganisation of existing capital, or the reduction or return of capital.

The relative interests of existing shareholders may be significantly diluted upon the issuing of further shares and may result in "share watering". The concept of "share watering" is explained by Blais –

---

1 Van der Linde “The regulation of conflict situations relating to share capital” 2009 SA Merc LJ 33 38.
2 Van der Linde “Par-value shares or no-par-value shares - is that the question?” 2007 SA Merc LJ 473.
3 Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others 1983 (1) SA 276 (A) 288.
4 Van der Linde (n 1) 37-38.
5 Blais “Shareholder’s protection from share watering caused by the additional issue of shares: pre-emptive rights” 1961 19 U.T. Fac. L. Rev. 43.
6 Blais (n 5) 46.
7 Van der Linde (n 1) 42.
8 Van der Linde (n 1) 42.
“Share watering involves the dilution of three distinct interests of the shareholder: the dilution of his eventual participation in the assets of the company; secondly, the dilution of his participation in the management of the company; and thirdly, dilution of the book value of his shares.”

Therefore, three distinct interests of a shareholder may be impacted by the further issuance of shares, a shareholder’s residual right to ultimately share in the net assets of the company, a shareholder’s right to participate in the management of a company and lastly the value of a shareholder’s interest may be diluted.

Various mechanisms exist to protect these distinctive interests of shareholders, which include –

- limiting the authorised share capital of a company – this may aid to protect shareholder’s interests as it provides a limit for the potential dilution of a shareholder’s interests;
- limiting the authority of the board to issue shares – shareholder protection can be enhanced if restrictions are placed on such board powers;
- the application of pre-emptive rights – an opportunity for existing shareholders to subscribe for a further issuance of shares will prevent potential dilution of the shareholder’s interests, provided she has the financial means and the willingness to invest more money in the company;
- regulating the consideration required – regulating the adequacy of the consideration for which shares are offered to non-shareholders, will aid in preventing a dilution in the value of the shareholder’s interests; and
- imposing fiduciary duties on directors – may require directors to only issue further shares for a valid business purpose and any breach of a director’s fiduciary duties may result in sanctions against the respective director.

---

9 Blais (n 5) 46.
11 See discussion by Myners “Pre-emption rights: Final report a study by Paul Myners into the impact of shareholders’ pre-emption rights on a public company’s ability to raise new capital.” 2005 1 10-11 on monetary value and importance of consideration when issuing shares.
The issuance of shares can facilitate the raising of capital for a company, or the listing of a company on a stock exchange, the alignment of interests between the company and eg its employees and/or service providers, making the power to issue shares, important to directors too. Such powers may however also be used by the board to change the balance of control of existing shareholders, or even shift it to persons outside the company who were not shareholders prior to the issue, or serve the self-interests of a director or unduly benefit a director. Accordingly, Delport states that “[w]ith the perfect division between ownership and control in a company format, there needs to be some control over who issues the shares ...” He explains that the powers conferred on the board to manage and control the business of the company is either through the constitution ie memorandum of incorporation or the Companies Act no. 71 of 2008 (“act”), and accordingly should be regulated. Myners emphasises that “[s]hareholder control is of greatest significance when the interests of shareholders and managers diverge.” This is supported by Ganor where she explains that the power to issue shares is open to abuse by the board of directors and can be used amongst other things to “dilute shareholders to advance inefficient self-promoting goals”.

It therefore becomes clear that a balance must be struck between protecting the interests of shareholders and allowing the board sufficient control to efficiently and effectively manage the business and affairs of a company. General principles will be evaluated but it is understood that there is no one size fits all as various factors will influence the needs of a particular company, such as the nature of the entity, the industry, the size, the goals of the shareholders, that of the directors, to mention but a few. It is therefore assumed that flexibility to regulate this delicate balance is essential.

12 Delport (n 10) 1056 mentions raising funding, the ability to list and to facilitate Broad-Based Black Ownership transactions as only some of the number of reasons that the ability to issue shares may be important to shareholders.


14 See Van der Linde “Pre-emptive rights in respect of share issues” 2008 SA Merc LJ 510 517 and Ganor (n 13) 702-743.

15 Delport (n 12) 1056.

16 Delport (n 12) 1056.

17 Myners (n 11) 12.

18 Ganor (n 13) 702–703 provides examples such as issuing further shares to enable the directors to disregard the will of the shareholders, prevent take-overs and to entrench themselves. She elaborates and discusses various strategies and tactics that may be deployed by a board which can be considered an abuse of power, which falls outside the ambit of this dissertation.
Against the backdrop of the above, this dissertation will evaluate the protection afforded to shareholders as provided for in the act and the JSE Listings Requirements. The protections afforded to shareholders upon the issue of further shares in selected other jurisdictions have been evaluated,\(^{19}\) to determine if the protection afforded to shareholders in South African law is sufficient and in line with international trends.

2. **Share issues in South Africa**

2.1 The act

The recent South African company law reform highlighted the need for improved shareholder protection, as evidenced by the South African company law for the 21st century: guidelines for corporate law reform.\(^{20}\)

The act brought about various amendments to the position in terms of the 1973 Act and the common law that applied then. Section 7 of the act in particular provides that the purposes of the act are, inter alia, to “(i) balance the rights and obligations of shareholders and directors within companies” and “(j) encourage the efficient and responsible management of companies …”\(^{21}\)

Section 5(1) of the act states that the act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7, whilst section 158(1)(b) provides that in the event of determining a matter brought before it in terms of the act, or making an order contemplated in terms of the act:

“… the Commission, the Panel, the Companies Tribunal or a court must promote the spirit purpose and objects of this Act; and if any provision of this Act, or other document in terms of this Act, read in its context, can be reasonably construed to have more than one meaning, must prefer the meaning that best promotes the spirit and purpose of this Act, and will best improve the realisation and enjoyment of rights.”

---

\(^{19}\) An assessment of the impact of share issuances on creditors has not been included and falls outside the scope of this dissertation.

\(^{20}\) GG 26493 (23-06-2004) 17 21 which commented that “…the South African Companies Act is thirty years old, largely out of line with modern business practices and deficient in some critical areas, notably in the area of shareholder protection…”, hereinafter “policy document.”

\(^{21}\) See the policy document (n 20) 21.
Accordingly, section 7 is an important basis for the application of the act and emphasises the balance to be attained between protecting shareholders and enabling the directors to give effect to their rights and obligations, which includes managing the ‘business’ and ‘affairs’ of the company.

Pretorius et al explain that typically “...directors are the ‘controlling mind’ of a company, who manage it and act on its behalf...”, they further explain that the courts are reluctant to interfere with the board’s powers in this regard but will, in limited instances, hold that residual powers are held by shareholders in general meeting. It is submitted that a certain measure of autonomy and discretion must be afforded to the board in order to effectively manage the business and affairs of the company but in order to protect the interests of the company and its shareholders a level of control over the board is required.

Section 66(1) of the act confirms that the business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the act or the company’s memorandum of incorporation provides otherwise. This provision gives the board wider powers than was previously the case in two respects: first because the power is derived from statute and not the company’s constitution, it is subject to less shareholder control; and

---

22 See Pretorius, Delport, Havenga and Vermaas Hahlbo’s Company Law through the Cases (1999) 336–337

“A company acts through two bodies. One is the company in general meeting ... The other is the board of directors, elected by the general meeting and normally entrusted with the management of the company. The relationship between the board and the general meeting is contractual. It is based on the articles which determine the extent of the powers conferred on the board. The board’s powers are usually extensive with few powers save those conferred by statute retained exclusively by the company in general meetings. The shareholders cannot interfere with a power conferred by the articles on the directors, except by altering the articles.”


24 Delport et al “Hochsberg on the Companies Act 71 of 2008” (2013) 250(1) “The significance of the power to manage the business and affairs in terms of s 66 is two-fold. In the first instance this power (and obligation) is new original and not delegated (from the shareholders through the Memorandum of Incorporation) as it was under the 1973 Act (through the articles)...” Delport continues to reference the Navigator Property Investments (Pty) Ltd v Silver Lakes Crossing Shopping Centre (Pty) Ltd and Others [2014] par 31 case and states that: “Secondly the ultimate power in the company is now with the board of directors, and not with the shareholders”

secondly the power extends to both the “business” and “affairs” of the company. The 1973 act had no similar provision and the division of powers was regulated in the company’s articles of association, which typically only referred to managing the “business” of the company. It seems that a positive duty to manage the company is now imposed on directors and it is uncertain whether, but unlikely that the memorandum of incorporation can exclude all management functions. Accordingly, in the context that the board of directors have the power to manage the ‘business’ and ‘affairs’ of the company and that shareholders may in very limited instances interfere with such board powers, the protection afforded to shareholders upon the further issue of shares needs to be evaluated.

2.1.1 Authorised share capital

Section 36(1)(a) and (b) of the act requires that the classes, number of shares and the preferences, rights and limitations of each class of share be set out in the memorandum of incorporation of a company. Section 36(2)(b) of the act in turn, states that unless the memorandum of incorporation provides otherwise, the board of a company may amend “…the authorisation and classification of shares, the number of authorised shares of each class, and the preferences, rights, limitations and other terms associated with each class…”

Such amendment may only be done in the manner contemplated in subsection 3 of the act which permits the board to amend the authorised capital of any class of shares to a higher or lower number, reclassify authorised unissued shares, to classify authorised unclassified shares and determine the preferences, rights and limitations of “blank shares” prior to the issue of such

26 Ex Parte Russlyn Construction (Pty) Ltd 1987 (1) SA 33 34, Didcott J explained that “the termination of a company’s very existence was not the managing of the business of the company but rather the antithesis of management.” He continued and stated that “the decision to seek the company’s liquidation was one lying beyond the power of management.” The notion that “business” and “affairs” of a company are two distinguishable concepts as explained by Didcott J, was confirmed in the case of Ex Parte New Seasons Auto Holdings (Pty) Ltd 2008 345 where Horwitz J explained that: “… the business of the company is to be managed by its directors, who are then vested with all the powers which relate to the business of the company, other than those specifically provide[d] for.” He continues with approval to Didcott J and states “… the article refers to the “business” of the company, not the “affairs” thereof.

27 Delport et al (n 24) 250(2).

28 s 36 of the act.
shares. The powers of the board as contemplated in subsection 3 of the act, may be restricted in the company’s memorandum of incorporation. Subsection 4 of the act requires the board to file a notice of amendment of the company’s memorandum of incorporation setting out such amendments. Accordingly, the power to amend the authorised share capital of a company also lies with the board, this is an alterable provision and this power can be removed and/or limited in the memorandum of incorporation.

Section 152(6)(b) of the act, provides that a business rescue practitioner may amend a company’s memorandum of incorporation, regardless of any provision contained in sections 16, 36 or 37 of the act, to authorise, and to determine the preferences, rights, limitations and other terms of any securities that are not otherwise authorised, subject to an approved business rescue plan which envisage the issue of such securities.

One of the functions of authorised share capital, is to limit the maximum number of shares a company may issue without amending its share capital, accordingly, limiting “the potential disturbance of the proportionate interests of shareholders” when issuing further shares. Authorised capital therefore, offers some protection against potential dilution of their relative interests. If this power is delegated to the board of directors, ie the memorandum of incorporation does not restrict the powers of the board to amend share capital, flexibility is increased. Increased flexibility however, negates some of the shareholder protection.

---

29 Davis et al Companies and other Business Structures in South Africa (2011) 279. Blank shares being shares without any classification and/or rights, preferences and/or limitations attached to it.

30 Delport et al (n 24) 136, s 36(2) of the act. In addition to the board’s ability to amend the authorised share capital of the company, s 36 of the act also allows the shareholders, by special resolution, to amend the authorised share capital of the company through the amendment of the memorandum of incorporation.


32 Van der Linde (n 10) 254.

33 Van der Linde (n 10) 254 explains with reference to authorised share capital that “The level of protection a shareholder enjoys is determined by two factors. First, it depends on the ratio between issued and unissued shares. If a company has a very high number of authorised but unissued shares, the stakes of existing shareholders can be substantially eroded without an increase in authorised capital. The second factor is the ability of a shareholder to influence any decision to increase the authorised capital.”

34 Van der Linde (n 10) 254.
Minorities will also have limited protection where amendments to authorised capital are made by special resolution, as they will not be able to block the passing thereof.\footnote{Van der Linde (n 10) 254.}

2.1.2 Authority to issue shares

The authority to issue shares is dealt with in section 38, which provides a general authority to the board to issue shares, section 41 which restricts the board’s general power to issue shares and requires shareholder approval for certain issuances, section 42 which deals with options for subscription of securities and section 43 which deals with securities other than shares.

2.1.2.1 Section 38 of the act: Issuing shares

Section 38 of the act regulates the issue of shares and states that the board may resolve to issue shares in accordance with section 36,\footnote{s 38(1) of the act. Cassim \textit{et al} (n 31) 222 explains that s 38 is a departure from the 1973 Act. In order for the board to issue shares, s 221 and s 222 of the 1973 Act, the approval of shareholders was generally required. The origins of s 221 of the 1973 Act was most likely the result of the Van Wyk de Vries Commission which commented “…that there was ‘a strong body of opinion to the effect that directors should not have unlimited powers, whether derived from the articles or a resolution by the company in meeting, to issue shares.’ It pointed out that: “…the issue by the company of further shares is a matter which directly affects the interests of each holder of shares in that company and is in respect distinguishable from ordinary managerial acts by the directors performed in carrying on the business of the company.” Delpor (n 12) 1065 explains that s 222 of the 1973 Act operated in exclusion of s 221 of the 1973 Act, s 222 of the 1973 Act was aimed at addressing “insider” issues, and the ambit thereof was much wider than s 221 of the 1973 Act. Insider issues in respect of options on shares or debentures convertible into shares were addressed in s 223 of the 1973 Act.} other than share issuances as contemplated in section 41.\footnote{S 41 of the act is discussed in 2.1.2.2. See Cassim \textit{et al} \textit{The Law of Business Structures} (2012) 168.} It also allows for retroactive authorisation of shares that have not been authorised in accordance with section 36, or shares issued in excess of the number of authorised shares of any particular class.\footnote{s 38(2) of the act. Ratification is required within 60 business days after the date on which the shares were issued.} Section 38(3) of the act provides that if a resolution seeking to retroactively authorise the issue of shares is not adopted when it is put to a vote, to the extent
that the issuance exceeds authorised share capital, the issue is null and void.\textsuperscript{39} The company is required to reimburse the fair value of the consideration received in respect of the shares issued in excess, together with interest.\textsuperscript{40} Any certificate evidencing a share so issued is nullified, and any entry in a securities register in respect of such an issue, is void. Section 38(3)(d) of the act provides that a director may incur personal liability for any loss, damages or costs incurred in terms of section 77(3)(e)(ii) of the act,\textsuperscript{41} if she was present at the board meeting and failed to vote against an issue of shares by the company, despite knowing that such shares had not been authorised in terms of section 36.\textsuperscript{42}

Section 152(6)(a) of the act overrides section 38 of the act and allows a business rescue practitioner despite section 38 of the act and to the extent necessary, to give effect to an adopted business rescue plan, to issue any authorised securities.\textsuperscript{43}

2.1.2.2 Section 41 of the act: Shareholder approval for issuing shares in certain cases

The effect of section 41 of the act is that it restricts the board’s power to issue shares in terms of section 38 based on qualitative and quantitative criteria.\textsuperscript{44}

Section 41(1) of the act deals with the qualitative criteria and provides that, subject to certain exemptions set out in section 41(2) of the act, the issue of shares or securities convertible into shares, or grant of options, or a grant of any other rights exercisable for securities to certain

\textsuperscript{39} Delport et al (n 24) 172(2) notes that there is uncertainty in the case of shares being issued to multiple shareholders which subsequently is not ratified and becomes a nullity. Such issues will become void, as there is no similar provision to that of section 97 of the 1973 Act, which provided that the court could validate the allotment of issue of shares. It is submitted, that in the absence of a similar provision, such issuance of shares will be void.

\textsuperscript{40} S 38(3)(b) of the act.

\textsuperscript{41} S 77(3)(e)(ii) of the act provides that a director may incur personal liability for any loss, damages or costs incurred. A detailed discussion of s 77 of the act falls outside the scope of this dissertation.

\textsuperscript{42} S 1 of the act defines “knowing”, “knowingly” or “knows”, “when used with respect to a person, and in relation to a particular matter, means that the person either— (a) had actual knowledge of the matter; or (b) was in a position in which the person reasonably ought to have— (i) had actual knowledge; (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter” and s 41(5) of the act.

\textsuperscript{43} Cassim et al (n 31) 907-908 and Sharrock et al (n 31) 291.

\textsuperscript{44} Delport (n 12) 1061.
subscribers must be approved by special resolution.\textsuperscript{45} Such subscribers include directors, future directors, prescribed officers, future prescribed offers ("certain subscribers"), and any person related, inter-related or nominated by certain subscribers.\textsuperscript{46}

Section 41(2) of the act provides for specific exceptions to the requirement of obtaining approval by special resolution, these exceptions include issues in terms of an underwriting agreement, proportionate offers which were made to all the shareholders or all the shareholders of that particular class, employee share schemes and in terms of an offer to the public as contemplated in section 95(1)(h) and section 96 of the act.\textsuperscript{47}

Section 41(1) of the act manages to identify particular "risky" issuances where a conflict of interest arises and appropriately addresses these,\textsuperscript{48} by requiring shareholder approval for such issuances. The exceptions contained in section 41(2) of the act are logical and practical,\textsuperscript{49} as it specifically addresses situations where a conflict of interest is not a concern and, accordingly, no shareholder approval is required.

The quantitative criteria require approval by special resolution of the shareholders, regardless of the potential subscribers when any issue of shares, securities convertible into shares, or rights exercisable for shares in a transaction or series of integrated transactions,\textsuperscript{50} will

\textsuperscript{45} S 41 of the act. Delport \textit{et al} (n 24) 181 "It would appear that the shareholders can only approve or not approve, and cannot prescribe different terms of the transaction."

\textsuperscript{46} In terms of s 41(6) of the act, issues of options and grants to persons who become a director or prescribed officer more than six months subsequent to acquiring a particular right or option will not be subject to s 41.

\textsuperscript{47} Cassim \textit{et al} (n 37) 168

\textsuperscript{48} Van der Linde (n 1) 38, Van der Linde (n 10) 320, Cassim \textit{et al} (n 37) 168.

\textsuperscript{49} Van der Linde "The regulation of share capital and shareholder contributions in the Companies Bill" 2009 \textit{TSAR} 39 48.

\textsuperscript{50} S 41(4)(b) of the act states that: "a series of transactions is integrated if (i) the consummation of one transaction is made contingent on consummation of one or more of the other transactions; or (ii) if the transactions are entered into within a 12-month period, and involve the same parties, or related persons; and – (aa) those transactions involve the acquisition or disposal of an interest in one particular company or asset; or (bb) taken together, they lead to substantial involvement in a business activity that did not previously form part of the company’s principal activity." Delport \textit{et al} (n 24) 181 comments that: "It is not clear how the acquisition or disposal in a company or asset on the one hand or transactions that lead to a substantial involvement in a business activity that did not previously form part of the company’s principal activity must be interpreted conjunctive with the 30% voting requirement and seems to be more apposite in competition law and/or take-overs."
be equal to, or will exceed 30% of the voting power of all the shares of that class held by shareholders immediately before the transaction.\textsuperscript{51}

Section 41(4) of the act describes the calculation of voting power as envisaged in section 41(3) as follows:

"(a) for purposes of determining the voting power of the shares issued and issuable as a result of a transaction or series of integrated transactions, the voting power of shares is the greater of-

(i) the voting power of the shares to be issued; or

(ii) the voting power of the shares that would be issued after giving effect to the conversion of convertible shares and other securities and the exercise of rights to be issued;"

I am in agreement with Van der Linde, who highlights that although the principle to subject substantial issues to shareholder approval is sound,\textsuperscript{52} section 41(3) restricts itself to the internal impact within a specific class of shares and ignores the impact on the total voting power in the company.\textsuperscript{53} She submits that the emphasis should rather have been on the impact of total voting rights rather than a specific class and that the threshold of 30% may be reduced.\textsuperscript{54}

\textsuperscript{51} s 41(3) of the act. Delport \textit{et al} (n 24) 181 comments that because "... subsection (3) does not state clearly, as in the case of sub-s (1), that the special resolution must be by the shareholders of the company. It could be argued that, in contrast with sub-s (1) which concerns the interest of the company and the shareholders as a whole, sub-s (3) only concerns the interests of that particular class.” Delport \textit{et al} (n 24) 181 continues to explain that the act does not explicitly provide for meetings to be held by a class of shareholders in contrast to a class of creditors as catered for in s 155, although it could be implied from s 114 and s 115 of the act.

\textsuperscript{52} Van der Linde (n 49) 48, Van der Linde (n 10) 320.

\textsuperscript{53} Van der Linde (n 49) 48, Van der Linde (n 10) 320.

\textsuperscript{54} Van der Linde (n 49) 48 explains this rationale with reference to a similar provision contained in s 6.21(f)(1)(ii) of the American Model Business Corporation Act, however this section is in reference to the total voting power of all the issued shares of the company and sets a much lower threshold of 20 per cent. Van der Linde illustrates her concerns with an example, similar to the following two scenarios discussed here. For example, in scenario 1, Company A has a total issued share capital of 10 Class A ordinary shares and 90 Class B ordinary shares, each ordinary share, regardless of class has 1 voting right per share. The board elects to issue a further 45 Class A ordinary shares, which will result in the existing Class A ordinary shares voting rights being reduced by 31.0% (calculated as (1-((10/145)/(10/100)))), however each existing ordinary share’s voting power has only reduced by 0.3% (calculated as (1-((100/145)/(100/100)))). Since the existing Class A ordinary shares voting rights have been diluted by 30% or more, s 41(3) applies and a special resolution approving the issue is required. In scenario 2, Company
Other issues noted by Van Der Linde, is that the application of this section in respect of an issue of shares of a new class is uncertain as the new issue would result in an infinite increase in the voting power of that class, as prior to the issue it would be nil. She continues to state that an argument can be made that the section will only apply in the case where shares of the same class have been issued previously as it could be argued that the provision presupposes some existing voting power.

Section 41(3) of the act fails to protect shareholders against dilution in the instance where non-voting shares, entitled to distributions in priority or pari passu with the existing shares are issued, as no shareholder approval is required in these instances, since section 41 of the act is only triggered when the issue impacts voting rights.

Delport notes that in contrast to section 41(1) of the act the “securities” category has been omitted from section 41(3) of the act, which could be a mistake, as securities can have voting power, for example debentures, and submits that this can be addressed with an amendment to include “voting” securities as a category.

The effect of section 41(3) of the act is that it requires a special resolution by all shareholders, which may be detrimental to a particular class. Delport suggests that the remedy for this type of abuse could be section 163 of the act in which the court can be approached for relief by shareholders and directors from oppressive or unfairly prejudicial conduct or conduct that unfairly disregards the interests of the applicant. Delport notes that the section does not

---

B has a total issued share capital of 100 ordinary shares each with 1 voting right per share. The board elects to issue a further 42 ordinary shares, which will result in the existing ordinary shares voting rights being reduced by 29.6% (calculated as (1-((100/142)/(100/100))), however each existing ordinary share’s voting power has reduced by 3.0% (calculated as ((1-((100/142)/(100/100))))100.)). Since the existing ordinary shares voting rights have been diluted by less than 30%, s 41(3) will not apply and a special resolution approving the issue is not required. However the dilution in scenario 2, which does not require a special resolution, has a far more severe diluting impact on the voting rights of the existing shareholders.

55 Van der Linde (n 49) 48.
56 Van der Linde (n 49) 48.
57 Van der Linde (n 49) 48.
58 Delport (n 12) 1062, Van der Linde (n 1) 48.
59 Delport (n 12) 1062. In Peel and others v Hamon J&C Engineering (Pty) Ltd and others 2013 (GSJ) par 53.1 referring to s 163 of the act, the court held that a far wider basis of relief may be sought as opposed to its predecessor, s 252 of the 1973 Act, due to the introduction of a new ground, namely conduct “that unfairly disregards the interests of” the applicant. The court also highlights that the relief may now be granted to shareholders and also to directors, unlike the s 252 which only allowed shareholders to apply for such relief. In the subsequent case of Grancy Property Limited v Manala 2013 (SCA) 121 the court
explicitly state that the interests of the applicant should be disregarded or affected in her capacity as shareholder or director. In *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others* the court specifically stated that it must affect the applicant in her capacity as shareholder:

"The test, however, is whether the acts or omissions that unfairly prejudiced the applicant's interests resulted in affecting the applicant in his capacity as a shareholder. The precise question is whether the harm which the applicant has suffered is something he or she is entitled to be protected from."  

Section 41(5) of the act provides that a director may incur personal liability for any loss, damages or costs incurred in terms of section 77(3)(e)(ii) of the act, if she was present at the board meeting and failed to vote against an issue by the company referred to in section 41, despite knowing that such an issue is inconsistent with section 41.

The general view is that issues in terms of section 36 of the act will relate to legal capacity of the company, whilst non-compliance with section 41 of the act rather deals with the authority to issue shares, accordingly the validity of the share issue in terms of section 41, is in question on the basis of the lack of authority. Based on the aforementioned and the principles in section

confirmed that the concept of “interests” is much wider than the concept of “rights” and referred to Cassim *et al* (n 31) 771 - 772. Cassim *et al* explain that the fundamental corporate law principle still applies where the minority undertakes to be bound by the decisions of the majority shareholders. Accordingly, relief will not be automatic if acts prejudicially affect shareholders or directors, or which disregard their interests. Affected shareholders or directors will have to demonstrate that the ‘conduct’ is not only prejudicial or disregardful but also that it is unfairly so, in order to be granted relief by a court.

---

60 Delport (n 10) 1062.
61 [2013] 2 All SA 190 (GNP) par 17.5 the test applied by the court was as a result of the fact that “interests” is not defined in the act. As explained in par 2 above, whenever one is required to interpret and apply the act regard must be had to the purposes as set out in s 7 of the act which includes balancing the rights and obligations of shareholders and directors within companies.
62 A detailed discussion of s 77 of the act falls outside the scope of this dissertation.
63 A contract is *ultra vires* the company when the conclusion is beyond its legal capacity. It must be distinguished from a contract that was concluded beyond the authority of director(s), as different principles may be applicable to the two scenarios. A comprehensive analysis of the legal principles and consequences of acting beyond the legal capacity of a company or without authority is beyond the scope of this dissertation.
64 Delport *et al* (n 10) 1063 agrees that this is the only logical deduction to be inferred from s 38 which provides that the resolution to issue shares is made by the board of the company and “references in s 41 to an issue of shares must be read in this context.”
218(1) of the act, it is submitted that non-compliance with section 41 is ratifiable, as ratification is not expressly excluded, neither is it explicitly stated that such non-compliance will render such issue void.

The principles in respect of ratification as it applies to section 41 are uncertain. The Turquand or ‘indoor management rule’ prevents a company from resiling from a contract on the basis of non-compliance with an internal requirement of the company when dealing with an innocent outsider. Support for the view that issuing securities without the required approval should not be invalid or void because of the Turquand rule, but only unenforceable, can be found in case law. Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd v Gobel laid down the principle that the application of the Turquand rule in these circumstances would preclude the protection that the legislature had envisaged for shareholders in these circumstances.

Section 20(7) of the act provides that –

“A person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in

---

65 See par 2.1.6 of this dissertation for a discussion on section 218.
66 Delport (n 10) 1064; Delport et al (n 24) 222.
67 Delport “Companies Act 71 of 2008 and the “Turquand” Rule” THRHR (2011) 132 134. Delport continues to explain that the Turquand rule will only operate in respect of an outsider, if such outsider had no knowledge of such non-compliance or was not aware of facts that would result in a reasonable person inquiring regarding such compliance ie an innocent outsider.
68 In Farren v Sun Service SA Photo Trip Management (Pty) Ltd 2003 (C) 441 the court dealt with s 228 of the 1973 Act, which is the predecessor of s 163 of the act, and explained that the section provides protection to shareholders in a company, where control of the company is placed in the hands of its directors. The Court agreed with the decision of Alley and others NNO v Courtesy Wholesalers (Pty) Ltd 1996 (N) 134 which held that since subsequent ratification by shareholders is possible, an agreement not having been approved by shareholders does not automatically render it invalid or void. The court held in par 14: “If it is accepted that the objective of the legislature was to protect the shareholders, then surely that intention should be given effect to, for otherwise “admitting the application of the Turquand rule may resolve the dilemma, but will nullify the efficacy of section 228 and will defeat the object of the legislature.” The court held that by implication, the Turquand rule would effectively neutralise the objectives of s 228, whilst the purpose of s 228 was specifically to limit the powers of directors, accordingly this could never have been the intention of the legislature.
69 2011 (5) SA 1 (SCA) 553 The court held that applying the Turquand rule would deprive shareholders from the intended protection as envisaged in s 228 of the 1973 Act and result in s 228 of the 1973 Act serving no purpose. The court accordingly ruled that “the Turquand rule does not override the requirements of section 228 of the act, and that estoppel did not operate to preclude the respondents from relying on it.”
making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.”

The provisions of section 20(7) of the act and the principles of the *Turquand* rule appear to be very similar and many scholars are of the view that section 20(7) of the act is in fact a codification of the *Turquand* rule. Delport and Van der Linde disagree, Delport explains that what is codified, is not the whole *Turquand* rule, while Van der Linde points out some “differences or modifications” between section 20(7) of the act and the *Turquand* rule. Van der Linde submits that section 20(7) of the act explicitly includes “formal and procedural requirements set by the Companies Act”, while the Turquand rule does not apply in respect of legislative requirements. She continues and specifically states that, it is questioned whether innocent outsiders can rely on section 20(7), with reference to provisions in the act such as section 41, where shareholder protection is important, and accordingly, shareholder approval is required. Van der Linde continues to state that the requirement for shareholder approval as contemplated in the act and/or company’s memorandum of incorporation, whether it be an ordinary resolution, special resolution or even unanimous assent, cannot be relegated to a “formal and procedural” requirement, as one cannot assume for it to have been resolved, if there has been no attempt at adopting a resolution. Accordingly, the narrower interpretation and application of s 20(7) of the act as suggested by Van der Linde, would avoid the result that statutory shareholder protection will be eroded when dealing with an innocent outsider.

Accordingly, it is submitted that share issues in contravention of section 41, which are not ratified, will be void due to lack of authority.


71 Delport (n 67) 136, Van der Linde (n 70) 841 submits that despite the many similarities between the *Turquand* rule and s 20(7) of the act, s 20(7) cannot be regarded as a statutory incorporation of the common law *Turquand* rule.

72 Van der Linde (n 70) 841.

73 Van der Linde (n 70) 842 - 843.

74 See Delport et al (n 24) 180 for discussion on view that this could lead to inequitable results, as there is no equivalent for section 97 of the 1973 Act in the act. Delport (n 67) 137 submits that it is not clear that s 20(7) of the act prevents the company from risiling as is the case with the *Turquand* rule.
2.1.2.3 Section 42: Options for subscription of securities and section 43: Securities other than shares

Section 42 of the act stipulates that “the company may” issue options for the allotment or subscription of authorised shares or other securities of the company as opposed to section 40, where the “board may” and section 43 of the act where the “board may authorise the company”. It is submitted that section 42 of the act deals with the authority of directors, rather than legal capacity.

The principles related to ratification and the consequences of such issue not being ratified will apply mutatis mutandis as discussed in paragraph 2.1.2.2 above. It should be noted that section 42(3) of the act, also requires a decision to issue the authorised shares into which such security/option may be converted. Accordingly, if not ratified in terms of section 38(2) of the act, it may result in a legal capacity issue if such options result in more shares deemed to be issued than authorised.

Except to the extent provided for otherwise in the memorandum of incorporation, section 43(2) of the act authorises the board to issue debt instruments, which may be voting debentures. The quantitative restrictions contemplated in section 41(3) of the act will not be triggered in respect of issuances in terms of section 43(2) of the act, as explained earlier.

Section 42(4) of the act provides that a director may incur personal liability for any loss, damages or costs incurred in terms of section 77(3)(e)(ii) of the act, if she was present at the board meeting and failed to vote against the granting of any option or right, despite knowing that the shares has not been authorised in terms of section 36 of the act in respect of any shares for which an option could be exercised or into which any securities could be converted.

2.1.3 Pre-emptive rights

Section 39 of the act regulates the subscription of shares and in particular provides for pre-

---

75 s 42 of the act.
76 See discussion of s 66(1) in par 2 of this dissertation. Since the board of directors is given the authority to exercise all of the powers and perform any of the functions of the company to the extent permissible in the act or the memorandum of incorporation.
77 See par 2.1.1 and 2.1.2.1 for a discussion on s 36 and s 38 respectively.
78 See discussion par 2.1.2.2.
79 A detailed discussion of s 77 of the act falls outside the scope of this dissertation.
emptive rights. The approach taken in the act is an “opt-out” for private and personal liability companies, in other words the default position is that pre-emptive rights will apply to private and personal liability companies, unless the memorandum of incorporation specifically limits, negates, restricts and/or places conditions on the pre-emptive rights provided for in section 39(2) of the act. Whilst an “opt-in” approach is taken with state owned and public companies, the default position being that no pre-emptive rights apply, except as otherwise contemplated in the memorandum of incorporation.

The pre-emptive rights afforded in terms of section 39(2), require that a company first offer the shares the company proposes to issue, to existing shareholders in proportion to their voting rights immediately prior to such issue. Should shareholders elect to subscribe, such subscription must be within a reasonable time. Section 39(4) of the act, which is an alterable provision, allows a shareholder to subscribe for fewer shares than the number of shares which she is entitled to in terms of section 39(2) of the act, and provides that, to the extent that existing shareholders do not take up the offer to subscribe for the shares so offered within a reasonable time, such shares can be offered to any person other than an existing shareholder. Since it is alterable, the memorandum of incorporation may be customised to eg prevent that any shares may be taken up by third parties, or require that shares not taken-up must be offered back to existing shareholders, who have taken up their shares and who have indicated a willingness to take up more than their proportionate share. Such “excess shares” are to be offered on the same basis as in section 39(2).

---

80 Cassim et al (n 31) 77 “The distinction between the s 39 pre-emptive rights and a pre-emptive right restricting the transferability of shares in terms of s 8(2)(b) is that the former is concerned with the issue of shares, while the latter is related to the transfer of shares.” Van der Linde (n 14) 511 distinguishes between the pre-emptive right as contemplated in s 39 of the act which deals with the issues of shares by the company ie subscriptions and refers to it as “issue pre-emptives”, whilst pre-emptives in respect of s 8(2)(b) of the act, which deals with the disposal of shares by existing shareholders, she refers to “transfer pre-emptives”. In order to satisfy the requirements for a private company, restrictions must be placed on the disposal of shares, i.e. transfer pre-emptives must exist and, unless excluded by the memorandum of incorporation, compliance is required with issue pre-emptive rights of the existing shareholders to subscribe for new shares. Cassim et al (n 31) 173.

81 s 39(3) of the act.

82 s 39(1) of the act. Some views are that an “opt-in” provision applies in respect of public companies in the recognition of the procedural difficulties associated with the implementation of pre-emptive rights.

83 Van der Linde (n 49) 48 “Regardless of the class of shares being issued, all existing shareholders are entitled to subscribe for them in proportion to their voting rights.”
“It is clear that the primary purpose is to discourage external shareholders rather than to encourage preservation of the relative interests of existing shareholders. This is why selective issues to existing shareholders will not trigger the pre-emptive rights.”

Pre-emptive rights shall not apply to shares issued in terms of conversion rights, shares issued for future consideration as contemplated in section 40(5) to (7) or capitalisation shares. It is unfortunate that section 39(2) of the act applies regardless of the nature of the consideration, as this may have the unintended effect of hampering mergers and amalgamations where shares are often issued in exchange for other shares or property.

Other criticisms against section 39 of the act include the fact that pre-emptive rights can be avoided if shares are issued for future consideration. The motivation for excluding future consideration is unclear. It is also submitted that pre-emptive rights can be applied other than proportionally.

Section 39 of the act does not provide any sanctions for non-compliance, Cassim submits that this is possibly the case as “…pre-emptive rights set out in the company’s memorandum of incorporation are legally binding on both the company and on shareholders inter se by virtue of s 15(6).”

Although a detailed discussion of the impact of business rescue provisions falls outside the scope of this dissertation, it is worthwhile noting that section 152(7) of the act explicitly states that pre-emptive rights in respect of share issuances as provided for in section 39 of the act, do not apply if the shares are issued in terms of a business rescue plan, except to the extent that the approved business plan provides otherwise.

---

84 Van der Linde (n 10) 257.
85 s 39(1) of the act. Van der Linde (n 10) 341 states that “In theory capitalisation shares and bonus shares are synonyms.”
86 Van der Linde (n 49) 49, Delport et al (n 24) 174, 320.
87 Van der Linde (n 49) 49. One possibility considered was that the exclusion was provided to facilitate Broad-Based Black Economic Empowerment transactions, however if this was the intention a specific exclusion should rather apply to such transactions.
88 Delport et al (n 24) 174.
90 Delport et al (n 24) 174 explains that the exclusion of pre-emptive rights in respect of the issue of shares, applies as contemplated in business rescue proceedings only in the case of the statutory pre-emption rights (ie s 39) and not contractual pre-emptive rights, Cassim et al (n 31) 908, Sharrock (n 31) 291.
2.1.4 Consideration

In terms of Section 40 of the act, the board is required to determine the consideration and the terms for which authorised shares may be issued. Existing shareholders could be prejudiced if shares are issued for inadequate consideration, as it will dilute the value of their existing shareholding.\footnote{Cassim et al (n 31) 168.} Section 40(1) of the act provides that authorised shares may only be issued upon a determination by the board that such consideration is adequate. Accordingly, and as explained by Delport et al,\footnote{Delport et al (n 24) 177.} the board is required to make two decisions, whether that which is offered in exchange for the subscription qualifies as consideration and, secondly, if it is considered consideration, whether it is adequate. The definition of consideration as contained in section 1 of the act is defined broadly and includes “anything of value” - cash or non-cash. The definition of consideration as set out in section 1 of the act is very broad and includes anything of value and services, not only money.\footnote{Cassim et al (n 31) 169.} Cassim et al submit that section 40 does provide some protection to shareholders where the consideration is not paid in full at the date of issuance,\footnote{Cassim et al (n 31) 169.} despite the unlimited power that the board has to regarding the type of consideration. Section 40(5) of the act requires that to the extent that the shares are not fully paid up, it is held in trust, Section 40(6) provides safeguards against not receiving the consideration by providing that the shares may only be transferred if very specific conditions are satisfied.\footnote{See also Van der Linde (n 10) 355 discussion on similar provision contained in the Companies Bill 2007.}

Section 40(3) of the act provides that the only basis upon which a determination by the board related to the adequacy of the consideration can be contested,\footnote{Cassim et al (n 31) 169 explain that s 40(3) has incorporated the approach taken in the past, as the adequacy of the consideration for the issue of shares, may only be challenged in respect of a breach of one or more of the fiduciary duties of a director and states that “... in the past the courts have been reluctant to inquire closely into the value of such consideration unless it was obviously inadequate or there was evidence of fraud or of an absence of any bona fide valuation of the consideration.”. Please refer to par. 2.1.5 for a more detailed discussion on directors’ fiduciary duties.} is based on the directors’ fiduciary duties. As set out in section 76, a director may be held personally liable in terms of section 77 of the act, if she breached her fiduciary duties. “However, I must emphasise that the
consequences of a successful challenge regarding the adequacy of consideration on the validity of the issue and allotment are not addressed in the Companies Bill.\footnote{Van der Linde (n 10) 359.}

Section 152(6)(a) of the act overrides section 40 of the act and allows a business rescue practitioner despite section 40 of the act, and to the extent necessary, to give effect to an adopted business rescue plan, to determine the consideration for the issue of authorised securities.\footnote{Cassim \textit{et al} (n 31) 907-908, Sharrock \textit{et al} (n 31) 291.}

2.1.5 Fiduciary duties

Section 76(3)(a) and (b) of the act requires that a director of a company,\footnote{Cassim \textit{et al} (n 31) 525 state that s 76(3)(a) of the act only codifies without changing the common law and resolves any doubt that a director’s duty to exercise her powers for a ‘proper purpose’ is an independent duty and not encapsulated in the duty to exercise their powers in good faith. Cassim \textit{et al} continue stating: “The legal principles relating to the ‘proper purpose’ duty are in effect an attempt by the courts to control or restrain the exercise by directors of the discretionary powers conferred on them.”} acting in her capacity as director, must perform her functions and exercise her powers as such, for the benefit of what she believes is the best interest of the company and also for a ‘proper purpose’.\footnote{Havenga “Directors’ exploitation of corporate opportunities and the Companies Act 71 of 2008” 2013 \textit{TSAR} 257 the common law rule that a director, in her capacity as a fiduciary, must act in the best interest of the company, is well established. The best interests of the company are understood to mean “the collective interests of present and future shareholders.”}

There is no formal definition of ‘proper purpose’, however Cassim \textit{et al} explain that at common law ‘proper purpose’ “... has always been taken to mean that directors must exercise their powers for the objective purpose for which the power was given to them and not for a collateral or ulterior purpose.”\footnote{Cassim \textit{et al} (n 31) 525.}

Good faith, being a subjective duty, and ‘proper purpose’, an objective duty, are therefore two “separate and distinct, and yet cumulative”, duties as described by Cassim \textit{et al}.\footnote{Cassim \textit{et al} (n 31) 525−526 “The existence of subjective good faith is insufficient to save the purported exercise of power, if the power was exercised for a collateral purpose. Unlike the duty of good faith, which is subjective, the test for ‘proper purpose’ is objective.”}

There are various cases dealing with a director’s fiduciary duty to issue shares for a ‘proper purpose’.\footnote{Hogg \textit{v} Cramphorn \textit{Ltd} and Others 1966 All ER 420 427; Cassim \textit{et al} (n 31) 526.} The \textit{Hogg v Cramphorn Ltd} case held that, irrespective of whether or not directors
acted in good faith and in the best interests of the company,\textsuperscript{104} if the primary purpose of an issuance of shares was to ensure that the board retained control of the company and not for the purpose to raise capital, the fiduciary power of the directors was used for an improper purpose. It should be noted that issuing shares to raise capital is not the only issuance of shares that would constitute an issue for a ‘proper purpose.’\textsuperscript{105}

In *Extrasure Travel Insurances Ltd v Scattergood*,\textsuperscript{106} the court developed a four step test to be applied in determining whether or not the requirement for ‘proper purpose’ was satisfied and stated that a claimant is not required to prove a director was dishonest or that she knew she was pursuing an ulterior purpose.\textsuperscript{107} The four steps include to:

“...identify the particular power that is being challenged; identify the proper purpose for which the power was given to the directors; identify the substantial purpose for which the power was in fact exercised; and decide whether the purpose was proper.”\textsuperscript{108}

2.1.6 Liability and validity of actions

Section 218(1) of the act provides that unless the act specifically declares an agreement, resolution, provision of an agreement, memorandum of incorporation, or rules of a company void, an agreement, resolution or provision, will not be considered void in the absence of a court declaring it as such.

Therefore, unless a section explicitly states that an action by the company is void, if such action is in contravention of the act or of the memorandum of incorporation, a court order will have to be obtained to declare such action void.

Of all the sections discussed above, only section 38(3) contains an explicit statement, that if shares are issued in excess of the authorised capital, and such issuance is not retroactively authorised, it is a nullity.

Section 218(2) of the act states that a person who contravenes the act, will be liable to any person for any loss or damage suffered by that person as a result of that contravention, unlike

\textsuperscript{104} 1966 All ER 420 427.
\textsuperscript{105} See eg *Howard Smith Ltd v Ampol Petroleum* 1974 All ER 1126; *Punt v Symons* [1903] 2 Ch 506.
\textsuperscript{106} [2003] BCLC 598 par 92.
\textsuperscript{107} Cassim et al (n 8031) 527 explain that where there are multiple reasons for the exercise of a director’s power it is complex to determine the substantial or dominant purpose for exercising power, however if it is determined that the dominant purpose is improper, the exercise of the power must be found to be voidable by the court.
\textsuperscript{108} *Extrasure Travel Insurances Ltd v Scattergood* (n 106) 92.
section 77 of the act that limits liability to the company only. Therefore, section 218(2) allows shareholders and/or innocent outsiders to claim from directors any losses suffered and/or damages incurred in respect of a contravention of the act. This allows innocent outsiders who are unable to rely on section 20(7) and who are able to prove a causal link between the losses suffered and/or damages incurred by them as a result of a director’s contravention of the act when issuing shares to claim such losses and/damages from the directors.

3. **Share issues and the JSE Listings Regulations**

The JSE Limited Listings Requirements contains specific provisions dealing with the issuance of further shares.\textsuperscript{109} In respect of aspects such as the authorised capital of a company, paragraph 10.5(d) of the JSE Limited Listings Requirements Schedule 10: Requirements for the MOI requires the approval by special resolution of ordinary shareholders for any amendments to the memorandum of incorporation, save where such an amendment is ordered by a court in terms of sections 16(1)(a) and 16(4) of the Act. Unlike the act, which allows for a lower threshold in order to pass a special resolution,\textsuperscript{110} the special resolution threshold is set at 75% or higher in the JSE Listings Requirements.\textsuperscript{111}

In respect of pre-emptive rights, paragraph 10.1 of the JSE Limited Listings Requirements Schedule 10: Requirements for the MOI requires that unless securities are to be issued for an acquisition of assets, existing shareholders be offered the equity securities *pro rata* to their existing dealings, except if directors are authorised by shareholders in a general meeting to issue unissued securities, and/or grant options to subscribe for unissued securities, as the directors in their discretion deem fit.\textsuperscript{112} Paragraph 3.30 in turn requires *pro rata* rights offers to existing shareholders to subscribe for share issues offered *in lieu* of cash,\textsuperscript{113} similar to section 39, only to the extent that the shares are not taken up by the existing shareholders, may they

\textsuperscript{109} JSE Listings Requirements par 3.30 - 3.32; JSE Listings Requirements Schedule 10: Requirements for the MOI par 10.1; 10.3 and 10.5(d).

\textsuperscript{110} s 65(9) and s 65(10) of the act.

\textsuperscript{111} See definitions in JSE Listings Requirements.

\textsuperscript{112} This paragraph is subject to such corporate actions having been approved by the JSE and being subject to the JSE Listings Requirements.

\textsuperscript{113} Par 5.50 of the JSE Listings Requirements states that an issue for cash, is an issue of equity securities for cash (or the extinction of a liability, obligation or commitment, restraint, or settlement of expenses) and must comply with par 5.50 to par 5.57. A detailed analysis of the JSE Listings Requirements falls outside the scope of this dissertation.
then be offered to non-shareholders, or to existing shareholders on a basis other than a *pro rata* offer. This is a departure from section 39(2) of the act which provides that pre-emptive rights apply regardless of the nature of the consideration. As discussed earlier in this dissertation,\(^{114}\) to facilitate mergers and amalgamations, the JSE Listings Requirements approach is preferred. Also related to pre-emptive rights are paragraphs 3.31 and 3.32 of the JSE Limited Listings Requirements. Paragraph 3.31 of the JSE Limited Listings Requirements in certain circumstances allows the registrar to dispense with compliance with this requirement, whilst paragraph 3.32 of the JSE Limited Listings Requirements permits shareholders by way of ordinary resolution, to waive their pre-emptive right in respect of a specific issue of equity securities for cash, or a general issue of equity securities for cash for a fixed period of time and in accordance with such general authority. As discussed earlier on,\(^ {115}\) such a waiver, without compromising the protection afforded by pre-emptive rights to shareholders, is practical and allows for better efficiency when the circumstances so require.

As far as the validity of actions by the company is concerned, it is noteworthy that paragraph 10.3 of the JSE Limited Listings Requirements provides that despite sections 20(2) and 20(6) of the act, shareholders are prohibited from passing a resolution that would lead to the ratification of an act that is contrary to the JSE Listings Requirements, unless otherwise agreed with the JSE.

4. *A comparative perspective*

The exact content and scope of the regulation and related protections associated with the issue of shares differ from jurisdiction to jurisdiction. A high level comparison of the relevant regulations in New Zealand and the United Kingdom is discussed below.

4.1 New Zealand

Share issuances and the regulation thereof are addressed in section 41 to section 51 of the New Zealand Companies Act of 1993 ("New Zealand Companies Act").\(^ {116}\) This dissertation assesses the most pertinent sections contained in the New Zealand Companies Act related to share issuances below. If unanimous consent is obtained from shareholders and others who are

\(^{114}\) See par 2.1.3.

\(^{115}\) See par 2.1.3.

\(^{116}\) Taylor *et al* *Company and Securities Law in New Zealand* (2013) 640.
granted rights and powers similar to that of shareholders, compliance with sections 42, 44 and 45 of the New Zealand Companies Act may be waived.\textsuperscript{117}

4.1.1 Authorised share capital

The New Zealand Companies Act has abolished the notion of authorised share capital.\textsuperscript{118} It is submitted that authorised share capital provides limited protection to shareholders upon the issue of further shares,\textsuperscript{119} and that the introduction of pre-emptive rights and the imposition of specific duties on directors with regard to the fairness of share issues,\textsuperscript{120} could provide shareholders with significant protection from dilution without requiring authorised share capital.\textsuperscript{121}

4.1.2 Authority to issue shares

Section 42 of the New Zealand Companies Act places the authority to issue shares “at any time, to any person, and in the number it thinks fit” with the board subject to the New Zealand Companies Act and the constitution of the company. Schedule 2(b) provides that the powers conferred on directors in terms of section 42 cannot be delegated.

The authority to issue shares are not unlimited, approval of affected ‘interest groups’ are required as well as general approval from shareholders in the form of a special resolution in the event that the constitution limits the board’s power to issue shares in terms of section 42.\textsuperscript{122} In the event of non-compliance with the constitutional limits, directors will incur criminal liability but the issuance of shares will not be rendered void.\textsuperscript{123}

\textsuperscript{117} Taylor \textit{et al} (n 116) 640.

\textsuperscript{118} Van der Linde (n 2) 478.

\textsuperscript{119} See discussion at par. 2.1.1.

\textsuperscript{120} Van der Linde (n 10) 321.

\textsuperscript{121} Van der Linde (n 10) 151.

\textsuperscript{122} Taylor \textit{et al} (n 116) 642. S 116 of the New Zealand Companies Act defines the term ‘Interest groups’. S 2 of the New Zealand Companies Act defines a special resolution as a resolution passed by 75% of the shareholders or such higher percentage as contemplated in the constitution.

\textsuperscript{123} S 44(1), 44(5) and 44(6) of the New Zealand Companies Act. S 44(1) states that the board may issue shares despite s 42 but subject to obtaining approval for the issue in the same manner as required for an amendment to the constitution which would allow for such issuance. S 44(5) explicitly states that non-compliance with this section will not invalidate the issuance of shares. S 44(6) in turn, provides that every
Section 44(4) of the New Zealand Companies Act places a further potential, limitation on the authority to issue shares, as this section requires that if an issuance results in the alteration of shareholders’ rights, the board is required to obtain the approval of the “interest group” in accordance with section 117 of the New Zealand Companies Act, unless the issue is subject to pre-emptive rights or is expressly permitted by the constitution.\textsuperscript{124}

4.1.3 Pre-emptive rights

Section 45 of the New Zealand Companies Act deals with pre-emptive rights and states –

“(1) Shares issued or proposed to be issued by a company that rank or would rank as to voting or distribution rights, or both, equally with or prior to shares already issued by the company must be offered for acquisition to the holders of the shares already issued in a manner and on terms that would, if accepted, maintain the existing voting or distribution rights, or both, of the holders. (2) An offer under subsection (1) must remain open for acceptance for a reasonable time. (3) The constitution of a company may negate, limit, or modify the requirements of this section.”

The application of pre-emptive rights is not excluded in the case of non-cash consideration.\textsuperscript{125} The provision addresses issues that may impact either voting or distribution rights, or both and affords shareholders the right to subscribe for the new issue \textit{pro rata} with the effect that they will maintain their voting or distribution rights, or both. Importantly, subsection 3 provides for an “opt-out” option as pre-emptive rights may be excluded, limited or modified by the constitution. If unanimous assent of shareholders is obtained as provided for in section 107(2) of the New Zealand Companies Act, pre-emptive rights may be waived.

In Taylor \textit{et al} the law commission noted that a shareholder knowingly accepts the risks of her class rights being diluted if the constitution amends and/or restricts the application of pre-emptive rights.\textsuperscript{126} S 44 of the New Zealand Companies Act, is one example of a safeguard. This section requires shareholder approval by special resolution when amending the constitution.

\textsuperscript{124} Van der Linde (n 10) 127 - 128.

\textsuperscript{125} Van der Linde (n 10) 321.

\textsuperscript{126} Taylor \textit{et al} (n 116) 641 s 44 of the New Zealand Companies Act, is one example of a safeguard. This section requires shareholder approval by special resolution when amending the constitution.
In the case where subsequent amendments to the application of pre-emptives are contemplated, section 117(3) of the New Zealand Companies Act provides sufficient safeguards against dilution, in that it considers the issuance of shares ranking pari passu or in priority to existing shares, as a change in the constitution, if such issuance is not subject to pre-emptive rights as imposed by section 45, or specifically authorised in the constitution.

4.1.4 Consideration

Section 47 of the New Zealand Companies Act governs consideration for share issues and subsection (1)(c) requires a resolution by the board confirming that “... in its opinion, the consideration for and terms of the issue are fair and reasonable to the company and all existing shareholders.”\textsuperscript{127} The issuance of shares will be void in the absence of the section 47(1)(c) required board resolution, as it is a precondition for issuing of the shares.\textsuperscript{128}

Subsection (1)(d) requires additional formalities to be satisfied in the case of non-cash consideration. Further procedural requirements from the directors are set out in the clause. “This can be contrasted with the position in New Zealand were the shares are treated as paid up but the directors have to make a fresh adequacy determination when it receives further consideration.”\textsuperscript{129}

Section 84(5) of the New Zealand Companies Act permits the board in the case where a shareholder has failed to pay the consideration in respect of the issuance of shares, to refuse or delay the registration of a transfer of shares to the shareholder. Section 100(2) of the New Zealand Companies Act, in turn explicitly states in respect of unpaid consideration in relation to the issue of shares, that the person to whom the shares was issued or any other person who assumed liability for the unpaid consideration at the time of issue, remains liable therefore, and such liability will not transfer to subsequent holders of the share.

Non-compliance with section 47 is considered an offence, and a director is liable upon conviction to the penalty set in section 374(2), which amounts to a fine not exceeding the

\textsuperscript{127} S 47(1)(b) of the New Zealand Companies Act requires that the board must “determine the reasonable cash value of the consideration for the issue.” Taylor et al (n 116) 642 Consideration is defined very broadly and includes non-cash consideration. In terms of s 47(1)(c) and (d), in addition to the board being required to pass a board resolution resolving that the consideration in respect of the share issuance is fair and reasonable to the company and all existing shareholders, the board is also required to certify same.

\textsuperscript{128} Van der Linde (n 10) 127.

\textsuperscript{129} Van der Linde (n 10) 354.
statutory prescribed limit, whilst section 107(2) provides that shares may be issued otherwise than as contemplated in section 42, section 44 or section 45, if all entitled persons' have agreed to, or concurred with such an issuance.\textsuperscript{130}

4.1.5 Fiduciary duties

Section 133 of the New Zealand Companies Act requires that "A director must exercise a power for a 'proper purpose'. The New Zealand Companies Act does not define the term proper purpose,\textsuperscript{131} however the legal principles applied are similar to that applied in South Africa.\textsuperscript{132} Taylor\textit{ et al} submits that there may be an advantage in invoking the statutory duty\textit{ ie} section 133, rather than the common law duty, as section 177(4) preserves the ability to ratify a breach of the common law duty,\textsuperscript{133} whilst there is no authority that allows ratification of a breach of section 133.

4.1.6 Liability and validity of actions

Section 17(1) of the New Zealand Companies Act regulates the validity of actions by the company. It explicitly states that no such action shall be invalid solely because the company did not have the capacity, the right or the power to do the act. Subsection 2(b) in turn states that amongst other things, subsection 1 will not restrict a shareholder, director or other entitled person's right to obtain an injunction that restrains a company and/or director from engaging in conduct that contravenes the New Zealand Companies Act and/or constitution of the company,\textsuperscript{134} or in the case where a director breached a duty owed to a shareholder or former shareholder, restricting such shareholder or former shareholder from bringing action against such director.\textsuperscript{135}

\textsuperscript{130} Van der Linde (n 10) 129.

\textsuperscript{131} Taylor\textit{ et al} (n 116) 377 comment that the failure to define 'proper purpose' is unsatisfactory as this is considered to be the most troublesome duty of all the codified directors' duties.

\textsuperscript{132} Taylor\textit{ et al} (n 116) 377 - 383 reference the \textit{Howard Smith Ltd v Ampol Petroleum Ltd} and \textit{Hogg v Cramphorn} to illustrate the duty of directors to exercise their powers for a 'proper purpose' and the legal principles which will be applied by the courts to assess such duty similarly to that applied in South African courts. See par 2.1.5 above of this dissertation.

\textsuperscript{133} Taylor\textit{ et al} (n 116) 382.

\textsuperscript{134} s 164 of the New Zealand Companies Act.

\textsuperscript{135} s 169 of the New Zealand Companies Act.
Issues which do not comply with section 44 or section 45 of the New Zealand Companies Act are not considered invalid. Section 175(1)(a) and (k) of the New Zealand Companies Act in turn provides that such issuance is subject to section 174 of the New Zealand Companies Act relief as it is considered to be unfairly prejudicial.\textsuperscript{136} Section 174 of the New Zealand Companies Act allows the court to make any order it deems fit, which includes requiring the company to purchase the applicant’s or another person’s shares.

4.2 United Kingdom

4.2.1 Authorised share capital

The concept of authorised share capital has been abolished,\textsuperscript{137} accordingly there is no limit on the number of shares that a company can allot, any issue of shares is however subject to compliance with the United Kingdom Companies Act, which includes the directors’ power to allot shares, pre-emptive rights and giving notice to the registrar. The United Kingdom Companies Act throughout various sections requires that a ‘statement of capital’ be filed with the registrar in respect of any capital alterations.\textsuperscript{138}

\textsuperscript{136} S 175(1) state that non-compliance with any of the sections of the New Zealand Companies Act as listed in the section, is considered to be unfairly prejudicial for the purposes of s 174 of the New Zealand Companies Act.

\textsuperscript{137} Van der Linde (n 2) 485, Van der Linde (n 10) 70, Alcock \textit{et al} \textit{Companies Act 2006: The New Law} (2007) 171, Davies \textit{et al} \textit{Gower and Davies’ Principles of Modern Company Law} (2012) 285 explain that “In fact, the requirements for authorised capital had more to do with relations between directors and shareholders than with creditors. The directors could not issue more than the amount of the company’s authorised capital without returning to the shareholders for approval of an increase in the authorised amount. However, if the authorised capital was set at a high level, as it normally was, this was not a significant restraint to directors. Shareholder control of share issues is now effected by other sections of the Act and since shareholders, if they wish, can put stronger controls in the company’s constitution, authorised capital is not needed for the protection of shareholders either.”

\textsuperscript{138} For example, s 10, s 555(3), s 644, s 649(1) of the United Kingdom Companies Act, Alcock \textit{et al} (n 137) 174 explain that: “The statement of capital must state: (a) the total number of shares in the company; (b) the aggregate nominal value of the [those] shares; (c) for each class of shares (i) prescribed particulars of the rights attached to the shares, (ii) the total number of shares of that class, and (iii) the aggregate nominal value of shares of that class; and (d) the amount paid up and the amount (if any) unpaid on each share[s] (whether on account of the nominal value of the shares or by way of premium.)
4.2.2 Authority to issue shares

Section 549 of the United Kingdom Companies Act states that directors are only authorised to allot shares or grant rights to subscribe for, or convert any security into shares, in the case of a private company with a single class of shares, if such issuance is in compliance with section 550, or if permitted by the articles or by resolution, as contemplated in section 551 of the United Kingdom Companies Act.\(^\text{139}\) Section 550 of the United Kingdom Companies Act grants directors the power to allot shares or grant rights to subscribe for or convert any security into shares unless expressly prohibited by the articles,\(^\text{140}\) whilst section 551 of the United Kingdom Companies Act only affords such authority to the directors if authorised in the articles or by resolution of the company. Therefore, directors will automatically have such authority unless expressly provided for otherwise in the articles as far as private companies with one class of shares are concerned and in all other cases, directors will only have such authority if expressly provided for in the company’s articles or by resolution of the company.\(^\text{141}\) Ferran explains that the Company Law Review Steering Group recommended that “statutory requirements for shareholder authorisations of share allotments should not apply to private companies” with one class of shares,\(^\text{142}\) as this “did not reflect the needs and practice of most private companies,” and there is no risk of amending the relative power of different classes of shares. Davies et al continue and explain that, other than in the case of a private company with only one class of shares:

---


\(^{140}\) Alcock et al (n 137) 172, Ferran (n 139) 132, historically the United Kingdom’s companies’ legislation was silent on the authority to issue shares and the matter was left to be regulated in the articles of association by companies themselves. The power to issue shares was considered to be part and parcel of the general managerial powers of directors, the principal constraint of an abuse of such powers, being the fiduciary duties of directors.

\(^{141}\) Alcock et al (n 137) 173, Van der Linde (n 10) 44, Mayson et al (n 139) 171 – 172 explain that: “Authority may be given either for a particular allotment (or grant of subscription or conversion of rights) or generally (ss 551(2)). Authority may be renewed or further renewed by ordinary resolution of the members but never for more than five years at a time (s 551(4)(a)).”

\(^{142}\) (n 139) 132. Davies et al (n 137) 877 support this view by stating that the requirement for shareholder consent is considered an unnecessary formality because of the greater overlap of directors and shareholders in private companies with one class of shares.
share, shareholder consent, in one form or another, is still required for the allotment of shares.143

Section 554 of the United Kingdom Companies Act, requires that a company registers an allotment of shares within 2 months of the date of allotment, failure to comply with this section could result in a criminal liability being imposed on the Company and every officer in default. This requirement is in addition to filing of the return of allotments with the registrar.144

Section 549(4) and subsection (5) of the United Kingdom Companies Act provides that a director will be guilty of an offence if he or she knowingly contravenes and/or permits a contravention of section 549 of the United Kingdom Companies Act.145 Section 549(6) of the United Kingdom Companies Act states that the validity of an allotment or other transaction will not be affected as a result of a breach of this section.146

4.2.3 Pre-emptive rights

Section 561 of the United Kingdom Companies Act regulates pre-emption rights to existing shareholders and provides that:

“(1) A company must not allot equity securities to a person on any terms unless – (a) it has made an offer to each person who holds ordinary shares in the company to allot to him on the same or more favourable terms a proportion of those securities that is as nearly as practicable equal to the proportion in nominal value held by him of the ordinary share capital of the company, and (b) the period during which any such offer

---

143 (n 137) 877. They continue to explain at 393-394 that “Despite the flexibility which British company law gives the company to divide decision-making powers between shareholders and the board, there are a number of situations where the legislation requires shareholder approval of the board’s decision (and sometimes even permits the shareholders to initiate a decision). The main category of such cases is where decision is likely to have an impact upon the shareholders’ legal or contractual rights, even if the practical impact of that change on the member in a particular case is small (as with many changes to the articles). Without giving an exhaustive list of such situations, the following can be said to constitute the main examples of this policy: alterations of the company’s articles, …. * decision to issue shares or to disapply pre-emption rights on issuance …. All these provisions place limits on the extent to which the articles may authorise the board to proceed solely on its own initiative.”

145 Alcock et al (n 137) 172, Ferran (n 139) 131, Davies et al (n 137) 877.
146 Alcock et al (n 137) 172, Mayson et al (n 139) 171, Davies et al (n 137) 877.
may be accepted has expired or the company has received notice of the acceptance or refusal of every offer so made."147

The ratio in which new shares are to be offered to existing shareholders is based on the nominal value of the ordinary shares held by that shareholder prior to the issuance.

The exceptions to the application of pre-emptive rights as contemplated in section 561 of the United Kingdom Companies Act are contained in sections 564 to 566 of the United Kingdom Companies Act, and exempts bonus issues, issues that are wholly or partly paid for with non-cash consideration and securities held under an employees' share scheme. Sections 567 and 568 of the United Kingdom Companies Act contain the exclusions. More flexibility is provided to private companies through section 567 of the United Kingdom Companies Act which allows private companies to "opt-out" of the application of pre-emptive rights in its articles or even disapply it in the case of a private company with only one class of shares as contemplated in section 569 of the United Kingdom Companies Act.148 Section 568 of the United Kingdom Companies Act allows pre-emptive rights in relation to a specific class of shares, to take precedence over the general pre-emptive rights afforded in section 561 of the United Kingdom Companies Act.

Section 563 of the United Kingdom Companies Act imposes joint and several liability on the company and any officer who knowingly contravened or permitted the contravention of section 561 of the United Kingdom Companies Act to compensate any person to whom an offer should have been made in accordance with section 561 of the United Kingdom Companies Act for any loss, damage, costs or expenses which the person has sustained as a result of such contravention.149 Section 568(4) and subsection 5 of the United Kingdom Companies Act, in turn, imposes "civil liability on the company and on every officer in default for breach of such a provision."

147 Mayson et al (n 139) 173 explains that: "The provisions on shareholders' pre-emption rights were introduced by CA 1980 to implement what is now Directive 2012/30/EU, art 33, which makes pre-emption rights mandatory for public companies. Before then, shareholders did not have pre-emption rights under the general law... though a company's constitution might give such rights."

148 Alcock et al (n 137) 175.

149 Mayson et al (n 139) 173, Ferran (n 139) 138.

150 Alcock et al (n 137) 175, Davies et al (n 137) 885–886 "A civil but not a criminal sanction is provided by the Act. Where there has been a contravention of the pre-emption right (either by not providing it all or by not providing it in the way required by the Act), the company and every officer of it who knowingly authorised or permitted the contravention are jointly and severally liable to compensate any person to
The United Kingdom makes the application of pre-emptive rights mandatory for public companies and takes an “opt-out” approach for private companies.

4.2.4 Consideration

Section 582 of the United Kingdom Companies Act states that consideration for shares allotted may take the form of money or money’s worth, ie non-cash consideration. In the case of private companies, directors are required to act in good faith and to be satisfied that the value of the consideration received is worth the value placed thereon for the purpose of issuing the shares.\textsuperscript{151} Public companies are subject to extensive additional requirements, including section 593 of the United Kingdom Companies Act, which requires an independent valuation report to determine the value of non-cash consideration under certain circumstances.\textsuperscript{152} Section 596 of the United Kingdom Companies Act in turn sets out the requirements for the valuation and report as contemplated in section 593 of the United Kingdom Companies Act.

Mayson \textit{et al} submit that in general, the courts will accept the valuation made at the time of the allotment, except where it is shown that it is made dishonestly or falsely, or the contract of allotment itself is set aside for fraud.\textsuperscript{153} In the event shares in a public company has been allotted to a person for non-cash consideration, and the allottee has not received any valuation report, whom an offer should have been made for any loss, damage, costs or expenses. ... The Act does not invalidate an allotment of shares made in breach of the pre-emption provisions, no doubt in order to protect the legitimate interests of third parties.”

\textsuperscript{151} Davies \textit{et al} (n 137) 287 state that “But, except in relation to public companies, it seems that the parties’ valuation of the non-cash consideration will be accepted as conclusive unless its inadequacy appears on the face of the transaction or there is evidence of bad faith. Hence on an issue for a non-cash consideration it is possible to some degree to “water” the shares by agreeing to accept payment in property which is worth less than the value of the shares.”

\textsuperscript{152} There are certain exceptions to the application of s 593. A detailed discussion of same falls outside the scope of this dissertation. Ferran (n 139) 107 states that “Where shares of a public company are allotted for a non-cash consideration, the traditional reluctance to interfere has been replaced by stringent statutory rules ...”, Van der Linde (n 10) 64.

\textsuperscript{153} (n 139) 182 “Where, however, there is an express agreement to credit shares as paid up with more than the value of the contributed assets then the shares are issued at a discount.” And continues to state with \textit{reference to Hong Kong and China Gas Co Ltd v Glen} [2014] 1 Ch 527 “It was held that although the allotment of 400 shares at the time of acquiring the concession was valid, the promise to treat shares allotted in the future as fully paid up was void and unenforceable”, Ferran (n 139) 106.
or knows or reasonably ought to know, that some other provision of section 593 or section 596 has not been complied with, she will be liable to pay the amount treated as paid up, including interest to the company. The company and any officer of the company, who contravened the relevant provisions, will have committed an offence. Similarly, a public company may not accept a promise to do work, or perform services for the company or for any other person, in exchange for consideration for the issue of shares. The allottee is liable to pay in cash the amount unlawfully credited as paid on the share, plus interest, whilst the company and any officer of the company in breach of the provision, will have committed an offence.

4.2.5 Fiduciary duties

Section 171 of the United Kingdom Companies Act provides that –

“A director of a company must - (a) act in accordance with the company’s constitution, and (b) only exercise powers for the purposes for which they are conferred.”

Section 239 of the United Kingdom Companies Act provides that the shareholders of a company by way of resolution, may ratify the conduct of a director that amounts to breach of a duty or trust towards the company.

In the event that the shareholders do not ratify the issue of shares made in breach of a director’s fiduciary duty, Nolan explains that since the power to allot and issue shares is a “statutory, legal power granted to the company and vested in the board”, such issuance can be held to be voidable, not void.

154 Mayson et al (n 139) 183 “... any promise by the allottee to the company is nevertheless enforceable by the company,” despite the fact that the company and any officer of the company will have committed an offence. Davies et al (n 137) 289, Van der Linde (n 10) 65 -66.

155 Mayson et al (n 139) 183 – 184, Davies et al (n 137) 288, Van der Linde (n 10) 65 -66.

156 Mayson et al (n 139) 183, In this regard “... any promise by the allottee to the company is nevertheless enforceable by the company,” despite the fact that the company and any officer of the company will have committed an offence.

157 Makowski “How loyal do I have to be? – Fiduciary duties of companies’ directors in English Law” 2008 Common L. Review 17 19.

The principles in relation to a director’s duty to exercise her powers for the purposes for which they are conferred are very similar to those applied in South African company law in relation to section 76(3)(a) of the act to exercise their powers for a ‘proper purpose.’\textsuperscript{159}

A director will be liable to compensate a company for any loss suffered by the company as a result of her breaching any of her obligations in terms of section 171 of the United Kingdom Companies Act. An exercise of power by a director which falls outside a proper purpose is voidable.\textsuperscript{160}

4.2.6 Liability and validity of actions

Section 39 of the United Kingdom Companies Act provides that no act shall be invalid solely due to the lack of capacity of such act being in contravention of the company’s constitution. Section 41 of the United Kingdom Companies Act in turn deals with the validity of transactions involving directors or their associates acting beyond their authority and affords protection to a person dealing in good faith with the company by stating with reference to section 40 of the United Kingdom Companies Act, that one can regard the power of directors to bind the company and/or, their authority to authorise others to do so, to be free of restrictions in terms of the company’s constitution. Section 41(3)(b) of the United Kingdom Companies Act states that a director will indemnify the company for any loss or damage resulting from a transaction which is non-compliant with section 40 of the United Kingdom Companies Act, regardless of whether such transaction is avoided. Mayson \textit{et al} in respect of section 39(1) “The effect of this provision is that a company, other than a charitable company, cannot refuse to honour a contract simply because it is incapable of being within the company’s objects, as it could have done under the old \textit{ultra vires} rule.”\textsuperscript{161}

5. \textit{Conclusion}

As identified in the introduction, various mechanisms exist to protect the three distinctive interests of shareholders potentially impacted by the further issuance of shares, namely a shareholder’s residual right to ultimately share in the net assets of the company, a shareholder’s right to participate in the management of a company and lastly the value of a shareholder’s

\begin{flushleft}
\textsuperscript{159} See par 2.1.5 above for evidence of the South African court’s reliance on English case law to interpret and apply the principles regarding a director’s duty to exercise her powers for a ‘proper purpose.’

\textsuperscript{160} Mayson \textit{et al} (n 139) 481 - 482.

\textsuperscript{161} (n 139) 617.
\end{flushleft}
interest not being diluted. The shareholder protection mechanisms identified, can be grouped into preventative, ex ante measures, and remedial, ex post measures.\textsuperscript{162}

5.1 \textit{Ex ante} protection mechanisms

5.1.1 Authorised share capital

The act requires a statement of authorised capital in the memorandum of a company, which could be considered an ex ante measure to protect existing shareholders’ interests, in that it potentially limits the amount of shares that may be issued by the company which could result in the dilution of existing shareholders’ interests. The potential shareholder protection afforded is negated by the board’s authority in terms of section 36(2) and (3) of the act, to increase or decrease the number of authorised shares of any class of shares, such authority will only be restricted if explicitly provided for in the memorandum of incorporation.\textsuperscript{163} In addition, and as discussed earlier, if the disparity between issued and authorised share capital is large, like it often is in practice, little or no protection will be provided to shareholders to prevent dilution. Van der Linde rightly questions this requirement in light of other protections afforded to shareholders.\textsuperscript{164} Abolishing such a requirement will align South African company law with the laws of New Zealand and the United Kingdom,\textsuperscript{165} and will not erode shareholder protection due to other important protective measures provided for in the act.

5.1.2 Authority to issue shares

The limitation of the board’s authority to issue shares can be considered an ex ante measure to protect shareholders’ interests. The United Kingdom Companies Act requires shareholder approval for all issuances, other than in the case of private companies with one class of shares, or as explicitly provided for in the articles, resulting in less flexibility. New Zealand on the

\textsuperscript{162} Van der Linde “Share repurchases and the protection of shareholders” 2010 2 \textit{TSAR} 288 307.

\textsuperscript{163} The board’s ability to increase the authorised share capital could result in diluting existing shareholders’ interests significantly.

\textsuperscript{164} Van der Linde (n 2) 478. Although both \textit{ex ante} and \textit{ex post} protective measures are important and useful, \textit{ex ante} measures are preferred, as they are preventative in nature, whilst \textit{ex post} measures do provide relief, such relief is typically costly and time consuming.

\textsuperscript{165} Van der Linde (n 2) 478 correctly states that other measures included in the act provides enhanced protection compared to the requirement to retain the statement of authorised capital.
other hand, provides more flexibility, almost allowing the board authority to issue shares in any instance, unless explicitly prohibited in the constitution of the company.

It is submitted that the South African approach adequately identifies particularly risky instances and appropriately limits the board’s authority to issue shares in these instances. The board’s authority is restricted in terms of qualitative criteria when issuing shares to “insiders” when a potential conflict of interest exists, and does not, like many other jurisdictions, solely rely on the directors’ fiduciary duties to ensure shares are issued for a ‘proper purpose’. This is considered an appropriate safeguard to provide ex ante protection to existing shareholders, taking into account the important exceptions provided for. However, it is submitted that the provisions as currently drafted to restrict the board’s power based on certain quantitative criteria, are less effective in respect of shareholder protection. Requiring shareholder approval based on the impact of the issuance of shares on the total voting rights, rather than the impact within a specific class as currently stated, will enhance shareholders’ protection against dilution, as significant changes can be affected to the overall voting rights of shareholders without triggering shareholder approval, given that the impact on the specific class is less significant. Similarly, the current act does not address the impact on distribution rights where voting rights are not necessarily affected by a further issue of shares. The 30% threshold may be considered too high, in relation to international trends of 20%.166

5.1.3 Pre-emptive rights

The New Zealand Companies Act follows an ‘opt-out’ approach and does not exclude the application of pre-emptive rights in the case of non-cash consideration. The United Kingdom Companies Act in turn, allows private companies to follow an ‘opt-out’ approach, whilst making the application of pre-emptive rights mandatory for public companies.

The act follows an ‘opt-out’ approach for private and personal liability companies, and an ‘opt-in’ for public and state owned companies. Accordingly, and based on the analysis performed, a great deal of flexibility is afforded to companies in general, in terms of South African law, to elect not to apply pre-emptives, or alternatively, to apply pre-emptives with the ability to customise such application to a lesser or greater extent.167 When designing pre-

166 Van der Linde (n 10) 559.
167 Van der Linde (n 14) 514 has identified the main issues to consider when designing pre-emptive rights, which include: “[1] Which companies should be subject to pre-emptive rights? [2] To which offers should pre-emptive rights apply? [2.1] Should the type of consideration matter? [2.2] Should it matter who the
emptive rights, it is critical to strike a balance between the protection of shareholders’ interests and the ability of a company to raise further capital and achieve other legitimate objectives.\textsuperscript{168} The pre-emptive provision contained in the act, is adequate to implement as is, with the exception of the application thereof in the case of non-cash consideration, and the approach followed in the United Kingdom Companies Act is accordingly preferred. It is therefore submitted that the act provides sufficient flexibility to companies to “design pre-emptive rights appropriate to their particular mix of share classes, and the type of proportionality relevant to their shareholders.”\textsuperscript{169}

5.1.4 Consideration

Van der Linde explains that through the imposition of fiduciary duties on directors,\textsuperscript{170} directors are obliged to secure the maximum reasonable consideration on behalf of the company for share issuances, which has the effect of aligning the interests of the company to that of the existing shareholders who are not taking up further shares. In New Zealand directors are required to confirm by resolution that the consideration received for the issuance of shares are ‘fair and reasonable’, failure to comply with this provision will result in the issue of shares being void. The United Kingdom in turn distinguishes between private and public companies, in the case of private companies, the board is required to be satisfied that the value of the consideration aligns with the value of the issuance, whilst for public companies more stringent regulations apply, including obtaining an independent valuation. In terms of South African legislation, there is no requirement to value the consideration, the board of directors are required to confirm that the consideration is ‘adequate’, nor is there a requirement to disclose remuneration. Disclosure is considered a useful measure against abuse as it will result in fear of censure.\textsuperscript{171} A director

---


\textsuperscript{168} Van der Linde (n 14) 521; Myners (n 11) 12.

\textsuperscript{169} Van der Linde (n 14) 519.

\textsuperscript{170} Van der Linde (n 2) 485.

\textsuperscript{171} Van der Linde (n 10) 307.
will be personally liable if in breach, however, it is unclear what the consequences for subscribers will be if the adequacy of the consideration is successfully challenged.

5.2  *Ex Post* protection mechanisms

5.2.1 Fiduciary duties

Fiduciary duties of directors to use their power for a ‘proper purpose’, affords shareholders significant protection and the sanctions imposed on directors for a breach of such duties, act as a deterrent and is considered an *ex post* protective measure. The nature of fiduciary duties imposed on the board of directors when issuing further shares are largely the same across the jurisdictions evaluated.

5.2.2 Liability and validity of actions

In terms of the act, directors will incur personal liability to the company, when not complying with the relevant provisions of the act when issuing shares as discussed earlier. It is submitted that to the extent that unauthorised shares are issued and such issue is not ratified, the issue of shares will be null and void, as contemplated in terms of section 38(3) of the act. It is also submitted that, other than as contemplated in section 38 of the act, non-compliance with the requirements of the act when issuing shares, for example the requirement to comply with pre-emptive rights, or obtaining a special resolution approving an issue of shares in certain circumstances, will not render such issues null and void, due to the absence of a specific provision in the act declaring that such issue is void as a result of such non-compliance, as required in terms of section 218(1) of the act. Despite such issues not being considered null and void, section 218(2) of the act, may result in a director being liable for losses incurred and damages suffered by any person as a result of non-compliance with the requirements of the act when issuing shares.

5.3 The JSE Listings Requirements

The JSE Listings Requirements approach, which excludes the application of pre-emptive rights when issuing shares for non-cash consideration is preferred. Consideration should also be given to the JSE Listings Requirements, which allows shareholders by way of ordinary resolutions, to waive their pre-emptive rights in certain instances, affording more flexibility and efficiencies, without compromising the protection afforded to shareholders when issuing further shares.
5.4 Final analysis

Regardless of the recommendations and criticisms mentioned, in addition to providing a great deal of flexibility,\textsuperscript{172} the act overall strikes a good balance between affording the directors discretion in issuing shares of the company, and by so doing, managing the business and affairs of the company,\textsuperscript{173} and when required, limiting such powers to provide sufficient protection to shareholders when issuing further shares.

\textsuperscript{172} Katz (n 25) 249 states with reference to the act “... that there is a great deal of flexibility available to the promoters of a company with regard to the governance of the company.”

\textsuperscript{173} Van der Linde (n 49) 48.
6. Bibliography

6.1 Articles in Journals

Blais P “Shareholder’s protection from share watering caused by the additional issue of shares: pre-emptive rights” 1961 *U.T. Fac. L. Rev.* 43


Delport P “Companies Act 71 of 2008 and the “Turquand” Rule” 2011 *THRHR* 132

Delport P “Share issues and shareholder protection” 2013 *De Jure* 1056

Ganor M “The power to issue stock” 2011 *Wake Forest L Rev* 701

Havenga M “Corporate opportunities: a South African update (part 1)” 1996 *SA Merc LJ* 40

Havenga M “Directors’ exploitation of corporate opportunities and the Companies Act 71 of 2008” 2013 *TSA R* 257

Katz MM “Governance under the Companies Act 71 of 2008: Flexibility is the keyword” (2010) *Acta Juridica* 248

Makowski “How loyal do I have to be? – Fiduciary duties of companies’ directors in English Law” 2008 *Common L. Review* 17

Myners P “DTI pre-emption rights: final report – a study by Paul Myners into the impact of shareholders’ pre-emption rights on a public company’s ability to raise new capital” February 2005 URN 05/679
Nolan RC “Controlling fiduciary power” 2009 Cambridge L.J. 293
Van der Linde K “Par-value shares or no-par-value shares – is that the question?” 2007 SA Merc LJ 473
Van der Linde K “Pre-emptive rights in respect of share issues’ 2008 SA Merc LJ 510
Van der Linde K “Share repurchases and the protection of shareholders” 2010 TSAR 288
Van der Linde K “The regulation of conflict situations relating to share capital” 2009 SA Merc LJ 33
Van der Linde K “The regulation of share capital and shareholder contributions in the Companies Bill 2008” 2009 TSAR 39
Van der Linde K “The validity of company actions under section 20 of the Companies Act 71 of 2008” 2015 TSAR 833

6.2 Books


Cassim FHI, Cassim MF, Cassim R, Jooste R and Yeats J Contemporary Company Law Claremont (2013)


Davies PL and Worthington, S Gower and Davies’ Principles of Modern Company Law Croydon (2012)

Ferran E *Principles of Corporate Finance Law* Oxford (2008)

*Listings requirements of the JSE Service Issue 19* Johannesburg LexisNexis Durban (2015)


Pretorius JT, Delport PA, Havenga M, and Vermaas M *Hahlo’s South African Company Law Through the Cases* Cape Town (1999)


Van der Linde KE *Aspects of the Regulation of Share Capital and distributions to Shareholders* 2008 Thesis SA

6.3 Case Law

6.3.1 South African

*Alley and others v Courtesy Wholesalers (Pty) Ltd* 1996 3 SA 134 (N)

*Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others* 2013 2 All SA 190 (GNP)

*Ex Parte New Seasons Auto Holdings (Pty) Ltd* 2008 4 SA 341 (W) 345D
Ex Parte Russlyn Construction (Pty) Ltd 1987 1 SA 33 D

Farren v Sun Service SA Photo Trip Management (Pty) Ltd 2003 2 All SA 406 (C)

Grancy Property Limited v Manala and others 2013 3 All SA 111 (SCA)

Navigator Property Investments (Pty) Ltd v Silver Lakes Crossing Shopping Centre (Pty) Ltd and others 2014 3 All SA 591 (WCC)

Peel and others v Hamon J & C Engineering (Pty) Ltd and others 2013 1 All SA 603 (GSJ)

Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others 1983 (1) SA 276 (A)

Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd and another v Göbel NO and others 2011 3 All SA 549 (SCA)

6.3.2 United Kingdom

Extrasure Travel Insurances Ltd v Scattergood [2013] 1 BCLC 598 (ChD)

Hogg v Cramphorn Ltd and Others 1966 3 All ER 420

Howard Smith Ltd v Ampol Petroleum Ltd and others 1974 1 All ER 1126

Punt v Symons & Co Ltd [1903] 2 Ch 506

6.4 Internet Sources

“South African company law for the 21st century: guidelines for corporate law reform”
Government Gazette Notice 183 of 2004
6.5 Legislation

The Companies Act 61 of 1973

The Companies Act 71 of 2008

New Zealand, Companies Act 105 of 1993

United Kingdom, Companies Act 46 of 2006

7. Abbreviations

act Companies Act 71 of 2008

Cambridge L.J. Cambridge Law Journal

CILSA Comparative and International Law Journal of Southern Africa

Common L. Review Common Law Review

DGCL Delaware General Corporation Law

GG Government Gazette

MBCA Revised Business Model Corporation Act OF 1984

New Zealand Companies Act New Zealand Companies Act of 1993
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>SA Merc LJ</td>
<td>South African Mercantile Law Journal</td>
</tr>
<tr>
<td>THRHR</td>
<td>Tydskrif vir Hedendaagse Romeins-Hollandse Reg</td>
</tr>
<tr>
<td>TSAR</td>
<td>Journal of South African Law</td>
</tr>
<tr>
<td>United Kingdom Companies Act</td>
<td>United Kingdom Companies Act of 2006</td>
</tr>
<tr>
<td>U.T. Fac. L. Rev.</td>
<td>University of Toronto Faculty of Law Review</td>
</tr>
<tr>
<td>Wake Forest L. Rev.</td>
<td>Wake Forest Law Review</td>
</tr>
<tr>
<td>1973 Act</td>
<td>Companies Act 61 of 1973</td>
</tr>
</tbody>
</table>