MONEY MARKETING
30 Nov 2012, p.2

Fiduciary Matters

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How the new Companies Act affects buy and sell arrangements

Buy and sell agreements

Two objectives of the new Companies Act that came into force on 1 May 2011 were to simplify company law and to bring it in line with international best practice. The new company law is less prescriptive and protects freedom of association between prospective shareholders.

For instance, fewer statutory forms are required to incorporate a company now. Instead of a memorandum and articles of association, a company's constitutional document will comprise one document only, the Memorandum of Incorporation (MOI).

The transitional arrangements of the act recognise that it may take a while for companies that existed prior to 1 May 2011 to align their affairs with the new legislation. They have been afforded two years, until 30 April 2013, to convert their founding statements to new MOIs.

As is the case with any situation where the rights and legal relationships amongst affected persons are influenced by external factors, the individuals concerned retain the burden of having to protect their best interests themselves. Shareholders and co-owners of private companies are specifically advised to review their buy and sell agreements in the light of the new Companies Act as there are implications for their individual estate planning.

> The MOI may render the buy and sell agreement in conflict with it

Typically, shareholders with pre-existing buy and sell agreements are owners of proprietary limited companies that have purchased insurance policies backed by applicable buy and sell arrangements. Historically these agreements took various forms and contained multiple practical arrangements for the transfer of shares.

In essence, the crux was that upon death or permanent disability of a business co-owner his estate was obliged to sell his shares to the remaining shareholders who were obliged to purchase them. Primarily funding came from the policy proceeds.

Under the new act, the typical company for which a buy and sell agreement will be entered into is a "profit company" with restrictions relating to the transfer of its shares. These companies are referred to as "private companies". Their names must contain the abbreviation "(Pty) Ltd" at the end.

Private company shareholders face two distinct responsibilities. First, they need to convert their existing company founding documents to MOIs. Second, they have to compare their existing shareholder agreements with both the act and the MOI to ensure legal compliance.

If private company shareholders entrust the statutory conversion process to auditors or accounting officers, it will be dangerous to assume that the process will also deal with the secondary duty of bringing their legal agreements in line.

The secondary process has nothing to do with statutory compliance and all to do with their own legal governance. It is advisable to entrust this review to capable legal advisers or financial advisers with a proven legal back-up resource.

It follows that if private company shareholders have two years to implement a MOI, their pre-existing shareholders' arrangements must also be revised within that time frame.

If a buy and sell arrangement is not reviewed within the same time frame it is not necessarily null and void. However, the MOI, which must comply with the new legislation, may render the buy and sell agreement in conflict with it. This may bring about contractual difficulties.

If an existing buy and sell agreement does not contain references to the old memorandum and articles of association and is not in conflict with its new MOI, no alterations are necessary and the shareholders can retain it in its present form.

On the other hand, since a MOI may cater specifically for contractual variations specific to the needs of a specific company, a buy and sell or other relevant shareholder arrangement may be included in the MOI itself.

This has the advantage that the existence of specific conditions contained in the MOI is indicated with the letters "RF" behind the company's name. In this way those terms are brought to the attention of third parties who otherwise may have escaped obligations to remaining shareholders by alleging that they did not know of the prohibition and are therefore not bound by it.

The new Companies Act contains a number of measures for the protection of minority shareholders, the appraisal of their ownership rights and the appointment and removal of directors. These matters are all pertinent to the arrangements between company owners and should specifically be contained in either the MOI or a separate buy and sell agreement if they endeavour to depart from the provisions of the act.

The review process required to adhere to the new Companies Act presents an opportunity for shareholders to get their affairs in order. In addition, many buy and sell agreements contain obsolete or outdated valuation provisions or provide for annual valuation certificates that have never been drawn up. A wholesale review of buy and sell or other shareholder agreements is a very good idea while the topic is open for discussion.

This article was written by Kobus Oosthuizen, a FISA member and senior fiduciary practitioner with PSG Konsult Trust (Pty) Ltd.

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