

# MAGGIE ZEELIE

## Company Secretarial Specialist

084 514 6354

zeelie59@gmail.com

## ROBUST OR A PITFALL?

### Memorandum of Incorporation

#### INTRODUCTION

Implementation of the Companies Act 2008 brought with it a lot of changes and took away a lot of previously regarded rigorous laws, e.g. compulsory audits for all companies.

In the two year grace period granted for **pre-existing companies**<sup>1</sup> from 1 May 2011 to 30 April 2013 to lodge their new Memorandum of Incorporation ("Mol") free from CIPC costs, there was a scramble to replace the old Memorandum and Articles of Association with a new Mol. The other reason was to remove the restriction of compulsory audits. In a lot of instances the short form template issued by CIPC under form CoR15.1A was used as either the actual Mol for the company or applied as a base from which a similarly worded document was drafted.

**Are you aware that your interest as a shareholder in your company could be seriously compromised? Are you under the impression that you, as a shareholder of the company, have a pre-emptive right to be offered any shares already in issue that another shareholder wishes to dispose of?**

**Registered your company after 1 May 2011? Please note that, if your Memorandum of Incorporation is the short form CoR15.1A or a version based on the CIPC issued forms, YOU ARE ALSO AFFECTED.**

#### LEGISLATION

Section 39 of the Companies Act, Act 71 of 2008 ("the Act") addresses the pre-emptive rights of shareholders as it relates to the subscription of unissued shares. *Distinction needs to be drawn between issued and authorised shares (unissued shares). Issued shares are already registered in the name of a specific shareholder and authorised shares (unissued shares) refers to shares still available to be issued.* Provision is made in Section 39(2) for existing shareholders to have the right, before any non-shareholders, to be offered and to subscribe for additional shares in the company.

Only shares that are issued for consideration, which is also due immediately on issue, will trigger the right of pre-emption and only if the shares are not issued in terms of a pre-vested option or conversion right.

It is important to understand that, should an existing shareholder opt not to subscribe for more shares in the company when a pre-emptive offer is made in terms of Section 39, the shares so offered are not required to be offered to the remaining shareholders and the company may therefore offer these shares to any other person.

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<sup>1</sup> A company incorporated prior to 1 May 2011

Another very important aspect to take note of is that the Act only addresses pre-emptive rights as it relates to shares **to be issued** and does not address any rights relating to the transfer of shares from an existing shareholder to another person or entity. The only reference made by the Act to the restriction of transferability is in the definition of a private company<sup>2</sup> where a private company is required to restrict the transferability of its shares in its Memorandum of Incorporation. The Act however does not state to what extent such a restriction should be applied or addressed.

## **CONCLUSION**

If a company's Memorandum of Incorporation does not specifically address pre-emptive rights of existing shareholders on transfer of shares, your investment may be compromised.

It is advisable that you take the time to review your Memorandum of Incorporation, especially if a standard CIPC template was used, and that the pre-emptive rights and rights of first refusal as it relates to new shares to be issued, and already in issue shares transferred, be comprehensively addressed in your Memorandum of Incorporation.

The Memorandum of Incorporation is in essence a binding agreement and governs the interaction and relationship between the Company, directors and its shareholders. In reviewing your Memorandum of Incorporation the extent to which equity investments in a company is protected can be addressed as well as the extent to which the directors should be allowed to introduce new shareholders by way of shares issue. A detailed pre-emptive rights article can be built into the Memorandum of Incorporation setting out the pre-emptive rights as it relates to new share issues, transfers and also considering possible future events they wish to provide for, e.g. "Deemed Offer" or "Forced Sale" or what happens in the event of death or insolvency of a shareholder.

If a shareholders agreement is in place, it is important to note that the Act requires the company's Memorandum of Incorporation to amend, restrict or negate such right, which by interpretation means that any such limitation contained in a shareholders agreement and **NOT** in the Mol, will not suffice unless specifically addressed in the Mol.

If the Memorandum of Incorporation does not address this at all, the default provisions of the Companies Act 2008 will apply and this is another motivation to review and adopt a new Memorandum of Incorporation to ensure that all default provisions are properly addressed.

**Please do not hesitate to contact Maggie Zeelie for assistance**

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<sup>2</sup> Section 8(2)(b)(ii)(bb) of the Companies Act, Act 71 of 2008