

# **UNIVERSITY OF CAPE TOWN**

**Faculty of Law – School for Advanced Legal Studies**

## **Selected Aspects of Asset Deals under South African and Swiss Law**

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I hereby declare that I have read and understood the regulations governing the submission of Master of Laws dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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## Abbreviations

AJP	Aktuelle juristische Praxis, Lachen
art	article (system to number sections in Swiss Acts)
BBI	Schweizerisches Bundesblatt (Swiss Federal Bulletin; available on: <a href="http://www.admin.ch/ch/d/ff/index.html">http://www.admin.ch/ch/d/ff/index.html</a> )
BGE	Bundesgerichtsentscheid (decision of the Swiss Federal Court)
CA	South African Companies Act (Act 61 of 1973)
cit	cited
ed(s)	editor(s)
et al	et alii (and others)
f	following
fn	footnote
JBL	Juta's Business Law
Memorandum SMA	Botschaft zum Bundesgesetz über Fusion, Spaltung, Umwandlung und Vermögensübertragung vom 13. Juni 2000, BBI 2000 4337f. (Memorandum of the Swiss Merger Act) available on: <a href="http://www.admin.ch/ch/d/ff/2000/4337.pdf">http://www.admin.ch/ch/d/ff/2000/4337.pdf</a>
n	note
s(s)	section(s)
p	page
SALJ	The South African Law Journal
SCO	SCO (Bundesgesetz vom 30. März 1911 betreffend die Ergänzung des Schweizerischen

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	Zivilgesetzbuches (Fünfter Teil: Obligationenrecht); SR 220)
SJZ	Schweizerische Juristenzeitung, Zurich
SMA	Swiss Merger Act (Bundesgesetz vom 3. Oktober 2003 über Fusion, Spaltung, Umwandlung und Vermögensübertragung; SR 221.301)
SR	Systematische Sammlung des Bundesrechts (systematic collection of the Swiss Federal Law)
SRP-Code	Securities Regulation Code on Takeovers and Mergers
ST	Der Schweizer Treuhänder, Zurich
SZW	Scheizerische Zeitschrift für Wirtschaftsrecht, Zurich
THRHR	Tydskrif vir hedendaagse Romeins Reg / journal of contemporary Roman-Dutch law
TSAR	Journal of South African Law
US	United States of America
Vol	volume
ziff	cipher (system to number Acts in Switzerland)

## I. Introduction

Although there are many methods to accomplish reorganisations, and these methods may be used in combination, there are broadly speaking two categories of such transactions. First, two or more companies may merge. At least one of the merging companies is dissolved and both of the undertakings form part either of a newly formed company, or of the merging company, which does not cease to exist. Second, an undertaking may be purchased. There are two methods to achieve this: control over a company can be established by a takeover of its undertaking ('asset deal') or by obtaining enough shares in a company to control it in general meeting ('share deal'). Unlike share deals and mergers, asset deals do not remodel or vary membership rights. When referring to an 'undertaking' my intention is to refer to the company's enterprise as such in all its components.

As of today there are no comprehensive provisions in the South African Companies Act ('CA')<sup>1</sup> that regulate the transfer of assets and liabilities in a pure asset deal. The only provision referring to asset deals is s 228 CA. Said section is mainly concerned with the authority of directors to dispose of assets or part of an undertaking where such transactions are of a certain size. Further, s 197 of the Labour Relations Act<sup>2</sup> and s 34 of the Insolvency Act<sup>3</sup> may apply if a company alienates business assets.

With the coming into effect of the Swiss Merger Act ('SMA')<sup>4</sup> on July 1 2004, a new mechanism for 'the transfer of assets and liabilities' respectively the transfer of a company's undertakings was created. It applies to any entity or person registered in the Commercial Registry.<sup>5</sup> The major advantage of this new instrument is that all assets and liabilities are transferred to the transferee by operation of law upon registration of said transaction with the

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<sup>1</sup> Act 61 of 1973.

<sup>2</sup> Act 66 of 1995.

<sup>3</sup> Act 24 of 1936.

<sup>4</sup> Bundesgesetz vom 3. Oktober 2003 über Fusion, Spaltung, Umwandlung und Vermögensübertragung; SR 221.301.

<sup>5</sup> art 69 SMA.

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Commercial Registry.<sup>6</sup> Thus the main disadvantage of asset deals generally – the transfer of title to individual assets – was abolished. The transfer of assets and liabilities by operation of law was possible under Swiss law before the coming into effect of the SMA, but only where two or more companies merged.

This thesis will focus on the capacity of companies in terms of s 1 CA, and limited liability companies in terms of art 620 Swiss Code of Obligations<sup>7</sup> ('SCO'), or their respective organs, to effect the transfer of an undertaking and thus, of assets and liabilities. Attention will also be given to the protection available to shareholders and third parties in relation to such disposals in South Africa and Switzerland. Finally, I will examine the actual transfer of ownership under the 'transfer of assets and liabilities' provisions in terms of the SMA.

I will conclude with a comparison of the transfer of assets and liabilities under the SMA and under s 313 CA. The latter provision deals with reconstructions and amalgamations and involves rearrangement of membership rights – as such it is beyond the scope of pure asset deals. Nevertheless, the comparison is an interesting one, especially as the prospective Companies Bill, 2007<sup>8</sup> seems to adopt a similar model to implement pure asset deals.

## **II. Capacity to dispose of assets or an undertaking in South Africa**

This subsection contains an analysis of whether a company in South Africa is empowered to dispose of assets, or its undertaking or part thereof; if so, which organ within the company has the capacity to do so; and what the consequences of that are for third parties and shareholders.

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<sup>6</sup> art 73 II SMA.

<sup>7</sup> Bundesgesetz vom 30. März 1911 betreffend die Ergänzung des Schweizerischen Zivilgesetzbuches (Fünfter Teil: Obligationenrecht); SR 220.

<sup>8</sup> Available on: <http://www.thedti.gov.za/ccrdlawreview/COMPANIESBILL07.htm>.

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## 1 Capacity and powers of a company

To determine whether a company has the capacity to dispose of assets or its undertaking, one needs to consult the memorandum to establish the company's *main object* as set out therein.

Generally, a company's capacity and powers are limited by its main objects.<sup>9</sup> Sections 33 and 34 read with s 52 CA state which contents the memorandum must contain in relation to the intended activities of the company. Thus, the *main object* as set out in the memorandum determines the capacity and powers of the company.<sup>10</sup> The main object is usually broadly defined. It includes unlimited objects ancillary to the said main object, except such specific ancillary objects as are expressly excluded in its memorandum.<sup>11</sup> Thus, if the disposal of assets or of the undertaking can be said to fall under the main object or any ancillary objects, the company will have the capacity and power to do so.

## 2 Capacity and powers of the company's directors

As a corporate body a company cannot itself perform juristic acts. It can only act through its agents.<sup>12</sup> In South Africa directors do not have inherent powers - they have only such powers as are conferred on them by the CA or the articles of association.<sup>13</sup> Thus, the division of powers between the directors and the general meeting is determined by the articles of association.<sup>14</sup> Most articles of association empower the directors with the 'management' of the business.<sup>15</sup> To determine what 'management' of the business encompasses, the object clause in the memorandum of association has to be considered.

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<sup>9</sup> Cilliers et al at 180.

<sup>10</sup> Cilliers et al at 183 and ss 33 and 34 CA.

<sup>11</sup> Cilliers et al at 184 and s 33 (1) CA.

<sup>12</sup> Cilliers et al at 84.

<sup>13</sup> *Re Emmadart LTd* (1979) 1 All ER 540 (Ch) at 599; Blackman Vol 2 at 8-293.

<sup>14</sup> Colin Jack Cohen 'The Distribution of Powers in a Company as a matter of Law' (1973) 90 SALJ 262 at 286.

<sup>15</sup> Blackman Vol 2 at 8-294.

The directors are empowered to do whatever is reasonably necessary to accomplish the objects of the company as set out in the memorandum of association.<sup>16</sup> So, if the furtherance of the company's objects requires the disposal of assets or parts of the undertaking, the directors have the power to do so.<sup>17</sup> If this is not the case, the disposal is *ultra vires* the company.<sup>18</sup> However, s 228 CA restricts the directors' powers to dispose of a company's assets or the undertaking if such disposal is of a certain size, even if such act would further the company's objects and consequently would be *intra vires* the company.<sup>19</sup>

### **3 Restriction of the directors' power to dispose of the whole or the greater part of assets**

Sections 228 (1) (a) and (b) CA state that the directors of a company do not have the power, save with the approval of the general meeting of the company, to dispose of the whole of the undertaking or the whole of the assets of the company. The section establishes the same requirement for the disposal of 'the greater part of the assets' and for 'substantially the whole of the undertaking' of the company. The required resolution in terms of s 228 (1) CA is an ordinary resolution. The resolution must ratify a 'specific transaction'.<sup>20</sup> Section 228 (2) CA seeks to prevent directors from obtaining general authority to effect any disposal they might deem advisable in the future.<sup>21</sup> 'Specific' accordingly means 'capable of being exactly named or indicated'.<sup>22</sup> By unanimous consent the shareholders may waive compliance with the requirement for the holding of a formal general meeting.<sup>23</sup>

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<sup>16</sup> Blackman Vol 2 at 8- 295.

<sup>17</sup> *Ridge Securities Ltd. v Inland Revenue Commissioners* (1964) 1 All ER 275 (Ch) at 287 -288.

<sup>18</sup> Henschel Vol 1 at 441.

<sup>19</sup> *Levy and others v Zalrut Investments (Pty) Ltd* 1986 (4) SA 479 (WLD) at 486.

<sup>20</sup> Section 228 (2) CA.

<sup>21</sup> *Lindner v National Bakery (Pty) Ltd* 1961 (1) SA 372 (O) at 379 with reference to s 70dec (2) of the repealed Companies Act 46 of 1926.

<sup>22</sup> *Ally and others NNO v courtesy wholesalers (Pty) Ltd* 1996 (3) SA 134 (N) at 146.

<sup>23</sup> *Levy and others v Zalrut Investments (Pty) Ltd* 1986 (4) SA 479 (WLD) at 485.

Furthermore, retrospective approval may be given as s 228 (2) CA explicitly contemplates the approval of a contract already entered into.<sup>24</sup>

The terms 'dispose of', 'substantially the whole' 'undertaking' and 'greater part of the assets' are not defined in the CA. As they can be variously interpreted, it may be difficult for directors and those contracting with a company to decide whether a transaction falls within the ambit of the section.<sup>25</sup>

### **3.1 Restriction of directors' powers imposed by s 228 CA**

Section 228 CA restricts the powers of directors in respect of the disposal of the whole or a major portion of the company's undertaking or assets. It does so by requiring shareholder approval of such a disposal in the form of an ordinary resolution. This limitation applies even should such power have been conferred on the directors in terms of the company's memorandum or articles.<sup>26</sup> The consequences for third parties where the transaction was not duly authorised, are discussed under 3.4 below.

Section 228 CA was clearly introduced for the purposes of shareholder protection, presumably because they have placed the management of the company in the hands of directors,<sup>27</sup> and the disposal of such a large part of a company's undertaking or assets may impact the whole future of the company.<sup>28</sup>

#### **a) Meaning of 'the greater part' of the assets**

For a long time it was unclear what was meant by 'the greater part' of the assets in terms of s 228 (1) (b) CA and how such assets should be valued. In *Norvick and another v Comair Holdings Ltd and others* (1979) (2) SA 116 (WLD) at 147 (A) Colman J seems to assume that the scale is

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<sup>24</sup> DS Ribbens 'Disposal of the undertaking of the whole or greater part of the assets of a company' (1976) 39 *THRHR* 162 at 163.

<sup>25</sup> Lionel Hodes 'Disposal of assets – s 228' (1978) 3 *The South African Company Law Journal* F6 at F6.

<sup>26</sup> *Levy and others v Zalrut Investments (Pty) Ltd* 1986 (4) SA 479 (WLD) at 484 H.

<sup>27</sup> *Farren v Service SA Photo Trip Management (Pty)* 2003 (2) All SA 406 (C) at 411.

<sup>28</sup> JS McLennan 'Section 228 of the Companies Act and the *turquand* rule / *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* 2004 2 SA 146 (C)' (2005) 68 *THRHR* at 304.

tipped where more than 50 per cent of the assets are concerned. Colman J further held that the assets of a company are to be valued according to their market value.<sup>29</sup> The market value is the price which the assets would fetch in a *bona fide* sale between a buyer and a seller, both of whom are reasonably well informed about the transaction, and neither of whom is under extraordinary pressure to buy or sell.<sup>30</sup>

If more than one disposal of assets takes place between a company and different buyers, the value of these individual disposals are not to be summed up to determine whether a disposal triggers s 228 CA.<sup>31</sup>

**b) Meaning of ‘substantially the whole of the undertaking’**

The legislator distinguishes between a disposal of an undertaking and the disposal of assets. This makes sense insofar as the value of an undertaking as a business unit or part thereof does not necessarily equal the total sum of the value of its assets. The value of a company in respect of its undertaking ought to be assessed with a prediction of the future profits which it will produce.<sup>32</sup> This is quite complicated, because the general business conditions of that specific enterprise need to be taken into account,<sup>33</sup> and because an undertaking consists of numerous components.

The valuation of part of an undertaking is not the only problem that arises with regard to this term. The meaning of ‘substantially the whole’ is also obscure. Clearly it is more than ‘the greater part’, but what degree is required to qualify as ‘substantially the whole’ of an undertaking? It seems to be established that what is relevant for determining whether ‘substantially the whole’ of an undertaking has been disposed of is not the value per se of the part in question, but whether the nature of the undertaking retained by the

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<sup>29</sup> *Norvick and another v Comair Holdings Ltd and others* 1979 (2) SA 116 (WLD) at 145 (F).

<sup>30</sup> *Norvick and another v Comair Holdings Ltd and others* 1979 (2) SA 116 (WLD) at 145 (F).

<sup>31</sup> *Norvick and another v Comair Holdings Ltd and others* 1979 (2) SA 116 (WLD) at 147 (D).

<sup>32</sup> *Norvick and another v Comair Holdings Ltd and others* 1979 (2) SA 116 (WLD) at 146 (C and D).

<sup>33</sup> *Norvick and another v Comair Holdings Ltd and others* 1979 (2) SA 116 (WLD) at 146 (F).

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company after the disposal is materially different from the one it owned at the date thereof,<sup>34</sup> and in which the shareholders invested.

When a company disposes of 50 per cent of its total assets, this would normally amount to a disposal of at least part of its undertaking, unless the company disposes only of assets that are not necessary for the operation of the business. This could be the case if a company operating a business additionally holds securities in other companies and disposes of them only, or if a company does not operate any undertaking at all, such as a holding company that merely holds stakes in other companies. According to what has been outlined above the test of whether 'substantially the whole of the undertaking' is disposed of is a *qualitative* one. It seems that this test need only be applied where the value of the assets involved in the transfer is less than 50 per cent of the total assets; otherwise the disposal would in any case fall under s 228 (1) (b) CA.

**c) *Changes in terms of the Corporate Laws Amendment Act, 2006*<sup>35</sup>**

Under the Corporate Laws Amendment Act, 2006 - which is expected to come into effect shortly - the term 'substantially the whole of the undertaking' will be changed to 'the greater part'<sup>36</sup> of the undertaking. As for a disposal of 'assets' the section will – as today – be applicable, if the greater part of them is disposed of.<sup>37</sup> Additionally a new subsection, subsection (4), will be implemented, stipulating that

'the greater part of an undertaking or assets for the purposes of subsection (1) shall be calculated according to the fair value of the undertaking or assets as described in the relevant financial reporting standards'.<sup>38</sup>

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<sup>34</sup> Henochsberg Vol 1 at 443.

<sup>35</sup> Act 24 of 2006.

<sup>36</sup> s 19 Corporate Laws Amendment Act, 2006 amending s 228 (1) (a) CA.

<sup>37</sup> s 19 Corporate Laws Amendment Act, 2006 amending s 228 (1) (b) CA.

<sup>38</sup> s 19 Corporate Laws Amendment Act, 2006 amending s 228 CA with a new subsection (4).

However, these standards apply only in the case of a public interest company.<sup>39</sup> The amendments mentioned are aimed at making the standard for the application of s 228 CA clearer and more objective.<sup>40</sup> While the insertion of this subsection brings a welcome end to the uncertainty surrounding the valuation of assets or an undertaking being disposed of, it seems to indicate that a strict quantitative test applies to both, ie: the sale of the 'greater part of the assets' and the sale of the 'greater part of the undertaking'. This interpretation is in line with the purpose of the amendment - to make the application of the section clearer and more *objective*. Thus, whether the disposal falls within the ambit of the amended s 228 in terms of the Corporate Laws Amendment Act, 2006 will be determined by the value according to the relevant financial reporting standards of the undertaking or assets in question.<sup>41</sup> Assuming that the 'greater part' means more than 50 per cent, the section will be applicable whenever the disposal of either the assets or the undertaking exceeds this threshold.

**d) *Changes in terms of the Companies Bill, 2007***<sup>42</sup>

The Companies Bill, 2007 will provide for yet another modification regarding disposal of major parts of a company's assets or of its undertaking. In terms of s 116 of the Companies Bill, 2007 shareholder approval will be required if a company disposes of 'substantially all of the assets or undertaking' of that company. According to s 116 (5) of the Companies Bill, 2007 'any part of the undertaking or assets of a company to be disposed of in terms of a proposed transaction must be assigned its fair market value as at the date of the proposal'. As was the case under the Corporate Laws Amendment Act, 2006, the legislator determines how the assets or the undertaking are to be valued, without any reference to the application of a qualitative approach. This would seem to exclude the application of the latter. 'Substantially' is not defined in the Companies Bill, 2007. What degree of the

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<sup>39</sup> s 33 Corporate Laws Amendment Act, 2006 introducing a new s 285A CA.

<sup>40</sup> Memorandum on the objects of the Corporate Laws Amendment Bill, 2006 8.6 at 35; available on: <http://www.info.gov.za/gazette/bills/2006/b6-06.pdf>.

<sup>41</sup> Henochsberg *Vol 1* at 444.

<sup>42</sup> Available on: <http://www.thedti.gov.za/ccrdlawreview/COMPANIESBILL07.htm>. The bill is expected to come into force in 2008.

whole does 'substantially' involve? Under a purely quantitative approach, it might be presumed that a percentage closer to 100 per cent than to 50 per cent would fall within the ambit of the section, especially as the legislator's intention is to regulate transactions that *fundamentally alter the structure of the company*.<sup>43</sup> However, a fundamental change in the company's structure does not necessarily involve the transfer of substantially all of its assets or undertaking. In order to achieve the legislator's object, a qualitative test will be indispensable. As will be discussed in the next paragraph, Canadian and US courts apply both a quantitative and a qualitative test.

**e) Comparable provisions in Canada and the US**

Canada<sup>44</sup> and every State in the US<sup>45</sup> have enacted provisions that are similar to South Africa's s 228 CA. However, most of these statutes differ from the latter in two areas. First, they do not distinguish between the sale of 'assets' and the sale of an 'undertaking'. Shareholder approval is simply required when 'all or substantially all of the company's assets' are alienated. Second, they state that such a disposal of corporate assets requires shareholder approval *unless the disposal is in the ordinary course of business*.<sup>46</sup>

The rationale for the enactment of these provisions is to protect shareholders from fundamental changes that would destroy a company's business.<sup>47</sup> Like the current s 228 CA, the Canadian and US provisions do not stipulate how the assets need to be valued.

Canadian jurisprudence applies both a *qualitative* and a *quantitative* approach to determine whether a sale of corporate assets amounts to a sale

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<sup>43</sup> Companies Bill, 2007 Department of Trade and Industry in South Africa, Explanatory memorandum at 13; available on: <http://www.thedti.gov.za/ccrdlawreview/COMPANIESBILL07.htm>.

<sup>44</sup> s 189 (3) of the Canada Business Corporations Act (R.S., 1985, c. C-44) available on: <http://laws.justice.gc.ca/en/C-44/index.html>.

<sup>45</sup> Fletcher cyclopedia at § 2949.20.

<sup>46</sup> Fletcher cyclopedia at § 2949.20.

<sup>47</sup> Mark Gannage 'Sale of substantially all the assets of a corporation' (2000) 33 *Canadian Business Law Journal* 264 at 266 with reference to the relevant Canadian case law and Fletcher cyclopedia at § 2949.20.10.

of substantially all of a company's assets.<sup>48</sup> Under the *qualitative* approach the character of the assets being sold, and the result thereof, need to be analysed. If the sale's effect is to destroy or fundamentally change the nature of the company's business, the sale will qualify as a disposal of 'substantially all assets'. The *quantitative* approach on the other hand is based on strict asset calculation. According to the cases, what is relevant is the transaction size in relation to the company. In particular, the proportion of assets (valued at market and at book value), or the sales and profits represented by the assets or business being sold, are relevant.<sup>49</sup> Thus, more than one factor is relevant, and the applicable parameters may differ depending on the facts of each case. Canadian jurisprudence seems first to apply the quantitative test, and only where the assets involved in the sale do not amount to 75 per cent of the company's assets will the qualitative test be applied.<sup>50</sup>

US courts have a similar approach to Canadian courts. Where the fundamental purpose for which the corporation was formed is eliminated as a result of the disposal, the transfer will be considered a transfer of 'substantially all of the corporate assets', even if a substantial value in assets is retained.<sup>51</sup>

The exclusion of disposals that are *in the ordinary course of business* is aimed at avoiding a situation in which companies that are organized for, and engage regularly in, the sale of real estate or the liquidation of assets, are required to obtain shareholder approval for every single transaction.<sup>52</sup> Whether the transaction is in the ordinary course of business is a question of fact. The transaction must fall within the ordinary day-to-day business activities, with no special features, and must be such that a manager might reasonably be expected to be permitted to carry out on his own initiative,

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<sup>48</sup> Mark Gannage 'Sale of substantially all the assets of a corporation' (2000) 33 *Canadian Business Law Journal* 264 at 269.

<sup>49</sup> Mark Gannage 'Sale of substantially all the assets of a corporation' (2000) 33 *Canadian Business Law Journal* 264 at 269.

<sup>50</sup> Mark Gannage 'Sale of substantially all the assets of a corporation' (2000) 33 *Canadian Business Law Journal* 264 at 273 with reference to the relevant case law.

<sup>51</sup> Fletcher cyclopedia at § 2949.40.

<sup>52</sup> D S Ribbens 'Disposal of the undertaking of the whole or greater part of the assets of a company' (1976) 39 *THRHR* 162 at 167.

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without the need for prior authorisation from his superiors, or the need to report to them subsequently.<sup>53</sup>

**f) *Analysis of the prospective South African provisions in view of the provisions in Canada and the US***

The above comments show that despite the fact that neither the provisions in Canada nor those in the US explicitly subject the disposal of ‘substantially the whole of the *undertaking*’ to shareholder approval, such disposal is covered by the term ‘substantially all assets’. This is achieved by applying both a qualitative and a quantitative approach. If assets essential for the operation of the company’s business are alienated, the relevant provisions apply.

Thus, it is unclear why the South African legislator incorporated the disposal of ‘substantially the whole undertaking’ in s 228 CA. As the law stands today, one could argue that by introducing this term, the legislator sought to introduce a qualitative approach as opposed to a purely quantitative one when determining whether the ‘greater part of the assets’ is disposed of.

Both the Corporate Laws Amendment Act, 2006 and the Companies Bill, 2007 stipulate the valuation of both the assets and the undertaking, which is a sensible approach. However, should these provisions, as mentioned above under section II.3.1c) and II.3.1d), in fact preclude the application of a qualitative approach, the purpose of the provision – shareholder protection from fundamental changes – would not be achieved. Further, it is not defined what degree of the whole is required to qualify as ‘*substantially* the whole’.

**3.2 *Desirable criteria for the assumption of an essential part of the assets***

Although it is difficult to establish a general quantitative threshold that would cover all situations intended by the legislator (as this would depend heavily on the concrete situation) it is desirable that such a threshold be

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<sup>53</sup> Mark Gannage ‘Sale of substantially all the assets of a corporation’ (2000) 33 *Canadian Business Law Journal* 264 at 266 fn 7.

established to provide a greater measure of certainty. As has been shown, a purely quantitative approach does not cover all situations intended by the legislator. Thus, an unambiguous qualitative element needs to be introduced. This would particularly improve the directors' and shareholders' situation.<sup>54</sup> The problem was recognised by the American Bar Association and since 1999, the Model Business Corporation Act<sup>55</sup> has ceased to rely on the 'substantially all assets' rule. In terms of § 12.2 Model Business Corporation Act shareholder approval is required if the disposal '*would leave the corporation without a significant continuing business activity*'. This qualitative element is more concrete than the 'substantially all assets' rule. However, the real improvement is the introduction of a threshold and the definition of a parameter. § 12.2 Model Business Corporation Act defines when the company is deemed to have retained a significant continuing business activity: shareholder approval is not necessary if the company retains a business activity that represents 25 per cent of the total assets at the end of the most recently completed fiscal year, and 25 per cent either of income from continuing operations before taxes, or revenues from continuing operations for that fiscal year.<sup>56</sup> Put another way, the company may be deemed to retain a significant continuing business activity even where it disposes of 75 per cent of the assets as defined in the section.

**a) *Determination of a parameter***

The transaction's financial effect on the company can be objectively measured by analysing the total assets of the company as against the ratio of the assets being disposed of. The ratio will vary depending on the parameter that is applied to calculate this percentage. As mentioned, Canadian case law utilises several parameters<sup>57</sup> and selects the most appropriate based on the facts of each concrete situation. For the purposes of legal certainty, however, statutes should stipulate which one of these parameters ought to apply. The American Model Business Corporation Act provides a good

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<sup>54</sup> Fischer at 210.

<sup>55</sup> Available on: <http://www.abanet.org/buslaw/library/onlinepublications/mbca2002.pdf>.

<sup>56</sup> § 12.2 Model Business Corporation Act.

<sup>57</sup> Like assets valued at market and at book value, the sales or earnings represented by the assets.

solution in this respect. The wording for the valuation of the assets in the Corporate Laws Amendment Act, 2006 and in the Companies Bill, 2007 are also good models for determining the relevant parameter.

**b) Determination of a threshold**

What threshold would be adequate? As has been noted above,<sup>58</sup> most articles of association empower the directors with the 'management' of the business. Thus it could be argued that shareholder approval is required as soon as the decision to proceed with a transaction no longer qualifies as a 'management decision', but is more properly regarded as an 'investment decision'.<sup>59</sup> From this perspective, only a fairly high threshold is justifiable, so that values of between 10 and 25 per cent might reasonably drop out.<sup>60</sup> On the other hand it is not the case that only transactions amounting to 75 per cent qualify as disposal of the essential part of the assets.<sup>61</sup> It is quite possible that a transaction involving less than 75 per cent will have a considerable impact on the company's business. The threshold therefore should be something less than 75 per cent. On this view, the threshold in the Model Business Corporation Act is too high, although it applies only if the transaction '*leaves the corporation without a significant continuing business activity*'. The very reason for the introduction of a quantitative threshold is to prevent the qualitative element from being the key factor in determining whether shareholder approval is required or not. The qualitative element should only apply as an exception. If the threshold is set at 75 per cent, discussions as to whether the company has retained a significant continuing business activity will arise too often.

Thus, the relevant threshold should be fixed between 25 and 75 per cent. Based on this and as a compromise, a threshold of 50 per cent should be established.

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<sup>58</sup> See II.2.

<sup>59</sup> Fischer at 214.

<sup>60</sup> Assenting Fischer at 214.

<sup>61</sup> Fischer at 214.

**c) *Exclusion of transactions in the ordinary day-to-day business***

There might be circumstances where more than 50 per cent of the assets are alienated but the transaction still does not qualify as an investment but as a management decision. To prevent directors from having to obtain shareholder approval in such situations, it would be desirable that the statutes require shareholder approval only where the transaction amounts to more than 50 per cent of the assets, and does not qualify as an ordinary day-to-day business decision.

**d) *Qualitative element***

It is clear that a purely quantitative approach, standing alone, does not achieve the purpose of protecting shareholders from a disposal that impacts heavily on a company's business. Thus, there is a need for the introduction of a qualitative element. Following the qualitative approach in Canada and in the US, particularly in the Model Business Corporation Act, statutes should explicitly state that shareholder approval is required should the transaction *'leave the corporation without a significant continuing business activity'* even where the quantitative threshold of 50 per cent, as is recommended here, is not triggered.

**3.3 *Meaning of 'dispose' in s 228 CA***

'Dispose' refers to acts which would have the effect of permanently depriving the company of its ownership rights of the assets involved.<sup>62</sup> This occurs not only where the assets are sold or donated, but also where the company grants an option, exercise of which by the grantee would result in the company losing ownership of the assets.<sup>63</sup> Furthermore, a sale subject to a suspensive condition is a disposal within the meaning of the section, notwithstanding that until the condition is fulfilled the sale has no effect as such.<sup>64</sup> It is submitted that neither a pledge nor a cession on security nor the granting of a pre-emption right are dispositions as contemplated in s 228

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<sup>62</sup> Henochsberg *Vol 1* at 442.

<sup>63</sup> Lionel Hodes 'Disposal of assets – s 228' (1978) 3 *The South African Company Law Journal* F6 at F9.

<sup>64</sup> Henochsberg *Vol 1* at 442 (1).

CA.<sup>65</sup> As the focus of this thesis is asset deals where ownership is transferred, and as there is no doubt that such transactions fall under the term 'dispose', nothing further need be said on this point.

### **3.4 Protection of the third party contracting for the disposal of assets or liabilities**

What protection is available to third parties contracting with a company for a disposal in terms of s 228 CA, where they are bona fide unaware that no approval from the general meeting has been obtained? In terms of s 228 (2) CA 'no *resolution* of the company approving any such disposal shall *have effect* unless it authorises or ratifies in terms of the specific transaction'. Thus, retrospective approval may be given as s 228 (2) CA explicitly contemplates the approval of a contract already entered into<sup>66</sup> and thus, an agreement regarding a purchase in terms of s 228 CA which has not been authorised by the shareholders of the company prior to its conclusion is not per se invalid or void.<sup>67</sup> As the *having effect* refers to the *resolution* and not to the *agreement*, the question arises whether a third party is entitled to enforce such an agreement by application of the *Turquand* rule. This question has a long history of controversy.

#### **a) The application of the Turquand rule in general**

Where directors act on behalf of the company, the ordinary rules of agency apply.<sup>68</sup> Generally an agent can bind his principal only in accordance with his mandate and if the agent exceeds his authority, the principal will not be bound. Persons dealing with a company are deemed to be fully acquainted with the company's *public documents* ('doctrine of constructive notice'); they therefore cannot successfully claim that they were unaware of limits imposed by such documents.<sup>69</sup> It has long been accepted that a

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<sup>65</sup> For further details see: Lionel Hodes 'Disposal of assets – s 228' (1978) 3 *The South African Company Law Journal* F6 at F7 - F9.

<sup>66</sup> DS Ribbens 'Disposal of the undertaking of the whole or greater part of the assets of a company' (1976) 39 *THRHR* 162 at 163.

<sup>67</sup> *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* [2003] 2 All SA 406 (C) at 411.

<sup>68</sup> Cilliers et al at 188.

<sup>69</sup> Cilliers et al at 181.

company's articles and memorandum qualify as *public documents*.<sup>70</sup>

However, often the memorandum or the articles state that certain internal prerequisites (for example approval in terms of an ordinary resolution by the general meeting) must be fulfilled in order to authorise a director to perform a specific act. Where such internal requirements need not be registered with the Registrar of Companies, a third party may be unaware that certain necessary prerequisites have not been met. With the introduction of the *Turquand*<sup>71</sup> rule by the English courts, the third party's duty to inquire into the authority of the company's agents was restricted to matters which were granted publicly. In terms of the rule a third party contracting in good faith with the company is entitled to assume that the internal requirements and procedures have been complied with and subsequently the company will be held bound. The rule is a form of ostensible authority or *estoppel*<sup>72</sup> and is accepted as part of South African law.<sup>73</sup> There is however debate as to whether a third party who entered into an agreement regarding a disposal of assets in terms of s 228 CA is entitled to enforce that agreement by application of the *Turquand* rule, where the required approval in a general meeting as stipulated in s 228 CA has not been obtained, either in advance or retrospectively.<sup>74</sup>

**b) Application of the *Turquand* rule with regard to s 228 CA**

The solution to this conflict will depend on whether shareholder protection or third party protection shall prevail. In *Farren*<sup>75</sup> at 413 the court held:

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<sup>70</sup> Cilliers et al at 181.

<sup>71</sup> *Royal British Bank v Turquand* (1856) E&B 248 (119 ER 474), affirmed in *Royal British Bank v Turquand* (1856) 6 E&B 327 (119 ER 886) (Ex Ch).

<sup>72</sup> JS McLennan 'Section 228 of the Companies Act and the *turquand* rule / *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* 2004 2 SA 146 (C)' (2005) 68 *THRHR* at 306.

<sup>73</sup> *The Mine Workers' Union v JJ Prinsloo; The Mine Workers' Union v JP Prinsloo; The Mine Workers' Union v Greyling* 1948 (3) SA 831 (A).

<sup>74</sup> For the different positions see *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* 2003 (2) All SA 406 (C) and *Levy and others v Zalrut Investments (Pty) Ltd* 1986 (4) SA 479 (WLD).

<sup>75</sup> *Farren v Sun Service SA Photo Trip Management (Pty) Ltd* 2003 (2) All SA 406 (C) at 413.

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*‘.. [ ] 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”..’.*

From this statement it must be concluded that the court gives internal management rules more weight if they are incorporated in statutes instead of merely the memorandum or the articles of association.<sup>76</sup> For third parties it is however irrelevant where an internal rule has its source.

At present, the resolution required for a disposal in terms of s 228 CA is an ordinary resolution. An ordinary resolution is passed by a simple majority, is not registered by the Registrar of Companies, and consequently is not a *public document*. Thus, a third party may be uncertain as to whether approval of the general meeting was actually obtained. A third party is an outsider to the company and has no right to access the company’s minutes.<sup>77</sup> It could be argued that the non-applicability of the *Turquand* rule results in unfairness, even though the efficacy of s 228 CA would indeed be nullified were the rule to be applied. First, if a third party does not have access to the company’s financial statements, it is difficult for him to ascertain if s 228 CA is applicable at all.<sup>78</sup> Second, the third party has no means to verify whether the required approval was actually obtained. Third, shareholders have certain rights in terms of the CA and the articles of association which third parties do not enjoy. The combined effect of s 228 CA and the non-applicability of the *Turquand* rule, is a reduced incentive to shareholders to monitor and control their directors. It permits shareholders to take a lackadaisical approach, secure in the knowledge that the third party, and not the company, will bear

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<sup>76</sup> Charles Makola ‘Disposing of the undertaking or the greater part of the assets of a company /The Turquand rule versus section 228 – an old conflict resurfaces’ (2003) 2/4 *JBL* 194 at 197.

<sup>77</sup> Lionel Hodes ‘Disposal of assets – s 228’ (1978) 3 *The South African Company Law Journal* F6 at F13.

<sup>78</sup> Lionel Hodes ‘Disposal of assets – s 228’ (1978) 3 *The South African Company Law Journal* F6 at F13.

the consequences of directors acting beyond their authority.<sup>79</sup> Effective corporate governance would be one way of preventing a director from behaving in contravention of s 228 CA.<sup>80</sup>

**c) *Resolution of the dispute with the coming into effect of the Corporate Laws Amendment Act, 2006***

With the coming into effect of the Corporate Laws Amendment Act, 2006<sup>81</sup> a special resolution requirement for the approval of a disposal in terms of s 228 CA will be implemented.<sup>82</sup> Special resolutions must be passed by a two thirds majority and must be registered by the Registrar of Companies.<sup>83</sup> The registration makes the special resolution a public document.<sup>84</sup> The wording of subsection 2 of s 228 CA will be changed to read as follows: 'A special resolution of a company shall not be effective unless it authorizes or ratifies in terms the specific transaction'.<sup>85</sup> Thus, shareholder approval must be given in relation to the specific transaction in order for that approval to be valid. This is required already today (current s 228 CA). A special resolution referring to the specific transaction will provide the third party with certainty as to whether the required shareholder approval was obtained or not. Thus, there will no longer be a need for the application of the *Turquand* rule. The problem of determining whether the disposal is one in terms of s 228 CA will, however, remain, especially if the company's financial information is not accessible to the public. The third parties should therefore include in the contract of sale a condition precedent requiring that a s 228 CA resolution be passed by the transferor; they should insist on being provided with the relevant financial information; and they

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<sup>79</sup> Dimitra Kouvelakis 's 228 and the Turquand rule' (2005) 5/6 *Without Prejudice* 31 at 32.

<sup>80</sup> Dimitra Kouvelakis 's 228 and the Turquand rule' (2005) 5/6 *Without Prejudice* 31 at 32.

<sup>81</sup> Act 24 of 2006.

<sup>82</sup> s 21 of the Corporate Laws Amendment Act, 2006 amending s 228 (1) CA.

<sup>83</sup> s 199, s 200, 202 and 203 CA.

<sup>84</sup> Charles Makola 'Disposing of the undertaking or the greater part of the assets of a company /The Turquand rule versus section 228 – an old conflict resurfaces' (2003) 2/4 *JBL* 194 at 196.

<sup>85</sup> s 21 of the Corporate Laws Amendment Act, 2006 amending s 228 (2) CA.

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should ask for shareholder approval when there is any uncertainty as to whether a disposal falls within the ambit of said section or not.<sup>86</sup>

**d) Companies Bill, 2007**

In terms of s 15 (4) of the Companies Bill, 2007 a person is not deemed to have notice or knowledge of the contents of any document relating to the company. Thus, the doctrine of constructive notice will presumably be abolished.

On the other hand section 119 (1) (a) of the Companies Act states, that the company

[...] may not take any steps to *give effect* to an agreement or series of agreements to dispose of substantially all of the assets or undertaking of the company [...] unless it has been approved in terms of this section’.

Today’s s 228 CA and the Corporate Laws Amendment Act, 2006 contain a clause about ‘effectiveness’ too. But both provisions state that the required *resolution* ‘shall not have effect’<sup>87</sup> or ‘shall not be effective’<sup>88</sup> unless the required shareholder approval has been obtained. This leaves open the impact such ‘non-effectiveness’ has on third parties and is the reason the discussion about the applicability of the *Turquand* rule arose at all. It would seem that the Companies Bill, 2007 brings clarity in this respect. It precludes a third party from relying on the *Turquand* rule to enforce a contract for the purchase of substantially all assets or the undertaking of a company, where the transaction was not approved in terms of s 119 of the Companies Bill, 2007, because the company *may not give effect* to such *agreement*. Third parties’ only hope will be that the required approval can be obtained retrospectively as is explicitly provided for in s 116 (2) of the Companies Bill, 2007.

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<sup>86</sup> Lionel Hodes ‘Disposal of assets – s 228’ (1978) 3 *The South African Company Law Journal* F6 at F13.

<sup>87</sup> So the wording in s 228 (2) CA.

<sup>88</sup> So the wording in s 19 Corporate Laws Amendment Act, 2006 amending s 228 (2) CA.

### 3.5 *Validity of acts ultra vires*

As will be shown below (III.2), in Switzerland acts *ultra vires* the company are void. In South Africa the situation is different. Section 36 CA states that '*no act of a company shall be void by reason only of the fact that the company was without capacity or power so to act or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact ...*'. In other words an *ultra vires* act is not void merely because it is an *ultra vires* act. Nor is it void where the director's lack of authority results solely from the fact that the act is beyond the company's capacity or power. Section 36 CA is, however, not applicable if the agent lacked the necessary authority for reasons other than the fact that the act is an *ultra vires* one. Thus, if there is a specific restriction on the directors' authority in the articles of association, and a director performs an act which is both *ultra vires* and in conflict with the specific restriction on his authority, the company will not be bound by that act. For example, a company's articles provide that directors A and B must sign together on behalf of the company (a specific restriction on directors' authority). Director A then performs an act which the company has no capacity to perform (an *ultra vires* act), and in the process signs a contract without director B's signature. That contract will not bind the company, because the fact that the director acted *ultra vires* is not the only basis on which he lacked authority – he also lacked authority in acting beyond the specific restriction in the articles.<sup>89</sup> Since s 228 (2) CA subjects the disposal of major parts of the company's assets or undertaking to approval in a general meeting, it clearly aims at disposals *intra vires* the company.<sup>90</sup> However, the limitation on the directors' capacity in terms of s 228 CA arguably provides for an additional ground for the restriction of the director's authority, beyond any lack of capacity resulting from the fact that the act might be *ultra vires* the company. Accordingly, although s 36 CA is applicable, its consequences do not apply where the disposal is *ultra vires*. Thus, the disposal would in fact be void.

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<sup>89</sup> Cilliers et al at 185.

<sup>90</sup> *Levy and others v Zalrut Investments (Pty) Ltd* 1986 (4) SA 479 (WLD) at 486 C.

It would not make any sense and could not have been the legislator's intention to protect shareholders from *intra vires* disposals and then simply accept that *ultra vires* disposals can be made. Although the general meeting cannot validly approve disposals that are *ultra vires* the company, it seems that if the general meeting were to do so, that disposal would only lack authority insofar as such a disposal is *ultra vires* the company. In these circumstances, the company would be bound in terms of s 36 CA.

This shows that although s 228 CA is aimed at *intra vires* disposals, it protects shareholders from disposals that are not in furtherance of the company's object, as it establishes an additional restriction of director's authority in terms of s 36 CA. If s 228 CA did not exist, this protection would not be afforded to shareholders in companies that did not have a similar restriction of authority in their articles of association.

### **3.6 Application of the rules of the Securities Regulation Code on Takeovers and Mergers ('the SRP-Code')**

#### **a) Application of the SRP-Code in general**

If a transaction falls within the ambit of an 'affected transaction' in terms of s 440A (1) CA, the SRP-Code applies. The SRP-Code was established by the Securities Regulation Panel ('the Panel'), which is empowered and required by the CA to regulate 'affected transactions' and to make rules for this purpose.<sup>91</sup> Generally a change or consolidation of 'control' is a *sine qua non* of an 'affected transaction'<sup>92</sup> and 'control' is obtained through the acquisition or manipulation of shares in a company.<sup>93</sup> This holds true for 'affected transactions' as defined in ss 440A (1) (a) (i), (ii) and (b) CA. 'The first covers a change of control of the company, the second covers either an acquisition of total control of the company or at least control of the securities of a particular class, and the third covers a consolidation of control'<sup>94</sup>. The

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<sup>91</sup> s 440C CA.

<sup>92</sup> *Sefalana Employee Benefits Organisation v Haslam and others* 2000 (2) SA 415 (SAC) at 422 F.

<sup>93</sup> See definition of 'control' in s 440A (1) CA.

<sup>94</sup> SM Luiz 'Some Comments on the Definition of an 'Affected Transaction' in the Companies Act' (2004) 16/1 *SA Mercantile Law Journal* 1 at 12.

purpose of said sections and of the SRP-Code is to protect shareholders in case the composition of the shareholder body, and thus control within the company, changes. If the thresholds set out in the CA and the SRP-Code are triggered, it is assumed that the change in composition of the shareholder body will impact shareholders' rights so heavily that they should be given the option to exit the company. The SRP-Code sets out that persons acquiring or consolidating such control of shares in a company are obliged to make an offer to shareholders - other than those involved in the acquisition or consolidation of control - to purchase their shares upon terms and conditions equal to those upon which the controlling shares were obtained.<sup>95</sup> The Panel is required to make sure that such mandatory offers are fair, that is, that all concerned shareholders obtain equal and adequate information in order for them to be in a position to make a properly informed decision whether to accept the offer and exit the company, or to refuse it.

**b) *The problem with s 228 CA***

A disposal in terms of s 228 CA constitutes an affected transaction in terms of s 440A (1) (c) CA.<sup>96</sup> As has been outlined above, a disposal in terms of s 228 CA requires merely the approval of the general meeting by ordinary resolution. The purpose of the introduction of s 440A (1) (c) CA was to prevent controlling shareholders from abusing their voting power in order to approve a sale of all the assets of the company at a price determined by them, to themselves or to another company in which they are directors and sole shareholders.<sup>97</sup> Before the introduction of said section, minority shareholders were not in a position to prevent such a disposal, and were unprotected.<sup>98</sup>

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<sup>95</sup> SRP-Rules section C general principles 10 and rule 8.

<sup>96</sup> s 440A(1) (c) CA which was introduced by s 14 (a) of the Companies Amendment Act 35 of 1998. For the SRP-Code to apply the requirements of section A 3 need to be fulfilled.

<sup>97</sup> Memorandum on the objects of the Companies Amendment Bill, 1998, clauses 10 and 14 (a) at. 22; available on: <http://www.info.gov.za/gazette/bills/1998/b32-98.pdf>.

<sup>98</sup> Memorandum on the Objects of the Companies Amendment Bill, 1998, clauses 10 and 14 (a) at. 22. available on <http://www.info.gov.za/gazette/bills/1998/b32-98.pdf>.

As mentioned above, a change or consolidation of 'control' is generally a *sine qua non* of an 'affected transaction'<sup>99</sup> and 'control' is obtained through the acquisition or manipulation of shares in a company. However, a disposal in terms of s 228 CA does not affect the shareholders' rights *inter se*.<sup>100</sup> Such a disposal leaves the company with the same shareholders and directors as before, as the disposal itself does not involve the transfer of securities.<sup>101</sup> Although the control over the undertaking will change<sup>102</sup> with regard to the company that effects the disposal, there is no change or consolidation of control. Thus, an 'affected transaction' in terms of s 440A (c) CA differs fundamentally from the other 'affected transactions'. This has given rise to some controversy regarding the applicability of the SRP-Code when a disposal in terms of s 228 CA takes place.

The first question that arises is whether the Panel is should require the purchaser of a company's assets to extend that offer to an offer to purchase shares in the selling company from those shareholders who do not have control as defined in the CA.<sup>103</sup> However, an equivalent offer to buy shares is not possible in the case of an 'affected transaction' in terms of s 440A (1) (c) CA, as no transfer of shares is involved at all - thus there is no offer that could serve as a reference for an 'equal offer' in terms of the SRP-Code. The lack of such a reference offer would require the Panel to judge the commercial advantages and disadvantages of an 'affected transaction', which judgment the Panel is explicitly prohibited to make.<sup>104</sup> Consequently there can be no obligation on the purchaser to make such an offer.

Presumably the application of the SRP-Code in the case of an affected transaction in terms of s 440A (1) (c) CA, respectively of s 228 CA, is limited

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<sup>99</sup> *Sefalana Employee Benefits Organisation v Haslam and others* 2000 (2) SA 415 (SAC) at 422 F.

<sup>100</sup> SM Luiz 'Some Comments on the Definition of an 'Affected Transaction' in the Companies Act' (2004) 16/1 *SA Mercantile Law Journal* 1 at 11.

<sup>101</sup> SM Luiz 'Some Comments on the Definition of an 'Affected Transaction' in the Companies Act' (2004) 16/1 *SA Mercantile Law Journal* 1 at 11 and 12.

<sup>102</sup> SM Luiz 'Some Comments on the Definition of an 'Affected Transaction' in the Companies Act' (2004) 16/1 *SA Mercantile Law Journal* 1 at 12.

<sup>103</sup> John Jarvis 'The protection of minority shareholders' (1993) 1/2 *JBL* 92 at 93.

<sup>104</sup> s 440C (2) CA.

to the information duties which aim to enable shareholders to make an informed decision before voting in a general meeting. In addition to such disclosure requirements, in terms of rule 29 (d) of the SRP-Code, the Panel may

'direct that any shareholder whose vote may as a result of any direct or indirect conflict of interest result in an inequity to any other shareholder, shall not vote or cause its vote to be exercised in whole or in part at the said general meeting or any adjournment thereof'.

This rule ensures that protection of minority shareholders is achieved.<sup>105</sup>

Usually conflicting interests in the context of s 228 CA would be interests in the purchasing company. Where a majority of shareholders in the selling company has an interest in the purchasing company, this may well impact the offer price of the assets. The Panel is not permitted to judge the fairness of the offer price, as it is prohibited from evaluating its commercial acceptability.<sup>106</sup> However, the capacity of the Panel to direct that certain shareholders may not vote, in combination with the information requirements, means minority shareholders have the opportunity to vote against the transaction, thereby preventing its implementation.

Since an affected transaction in terms of s 228 CA has no common ground with other types of 'affected transactions' as defined, it is questionable whether the SRP-Code should regulate them at all. Presumably the insertion was made because s 228 CA was often used as a method of takeover because of its simplicity - approval of a general meeting by ordinary resolution is all that is required. Compared with a takeover or a merger using a scheme of arrangement in terms of s 311 CA, which requires approval of a 75 per cent majority, or an offer in terms of s 440K CA which is even more onerous,<sup>107,108</sup> the s 228 CA method of takeover is appealingly simple. Added

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<sup>105</sup> Lucky Phakeng 'Protecting the minority shareholders' (2004) 10 *De Rebus* 24.

<sup>106</sup> s 440C (2) CA.

<sup>107</sup> Lucky Phakeng 'Protecting the minority shareholders' (2004) 10 *De Rebus* 24 at 25.

<sup>108</sup> Section 440K CA requires that the offer to acquire shares under an affected transaction be accepted by not less than 90 per cent of the holders of the shares

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to this was the advantage of the previous non-applicability of the SRP-Code in case of disposals in terms of s 228 CA. Thus, the legislator simply amended the definition of 'affected transaction' to include s 228-disposals, resulting in the applicability of the SRP-Code. The goal of minority shareholder protection could, however, be achieved in other ways; for example by introducing a special resolution requirement instead of an ordinary resolution requirement. This will in fact be required once the Corporate Laws Amendment Act, 2006 comes into effect. The introduction of the special resolution requirement will not alter the applicability of the SRP-Code, however.

A company can change its memorandum as well as its object clause by special resolution.<sup>109</sup> A change of the object clause may have an impact on shareholders similar to that of a disposal of the company's assets. With the coming into effect of the Corporate Laws Amendment Act, 2006, s 228 disposals will require the approval of the members by special resolution. Given that a company's memorandum can be changed by special resolution without any further restrictions, it is not clear why disposals in terms of s 228 CA should in addition be ruled by the SRP-Code.

Blackman criticizes the provisions in terms of rule 29 (d) of the SRP-Code as an inroad on property rights and on the common law rule entitling shareholders to vote on matters in which they have an interest which conflicts with the interests of the company or other shareholders.<sup>110</sup>

Despite this criticism the Companies Bill, 2007 will provide an even more sophisticated solution for minority shareholder protection. A proposal to dispose of substantially all assets or undertaking will require approval in terms of s 119 Companies Bill, 2007.<sup>111</sup> Holders of at least 25 per cent of voting shares must be present at the relevant shareholder meeting and the resolution must be supported by the holders of at least a majority of the

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involved, excluding those held by the acquiring company in order for the acquiring company to be entitled to compulsorily acquire the shares of those who did not accept the offer.

<sup>109</sup> s 55 CA.

<sup>110</sup> Blackman *Vol 2* at 8-326.

<sup>111</sup> s 119 (1) (a) Companies Bill, 2007.

voting shares present.<sup>112</sup> Shares controlled by the acquirer or persons acting in concert are to be disregarded for the purpose of calculating the majority.<sup>113</sup> Thus, votes of shareholders that have conflicting interests will not be counted and if the vote was tainted with inadequate disclosure, a court application is possible.<sup>114</sup> If at least 15 per cent of the shares voted against the resolution and the respective shareholders unanimously require the company to seek court approval, the company may not implement the resolution.<sup>115</sup> Court approval is also needed if the court, on application of shareholders voting against the resolution, grants shareholders leave to apply for a review of the transaction.<sup>116</sup> Finally, if a resolution is adopted by less than 75 per cent of shares entitled to vote, dissenting shareholders may seek relief into s 165 of the Companies Bill, 2007 ('dissenting shareholders' appraisal rights').<sup>117</sup>

Minority shareholders will thus be provided with quite extensive measures in terms of s 119 of the Companies Bill, 2007. Further protection therefore seems unnecessary. However, in terms of s 109 (2) (a) (iii) Companies Bill, 2007, a disposal of substantially all assets or undertaking by a *widely held* company is still 'an affected transaction'. Thus a disposal of substantially all assets or undertaking is not only subject to shareholder approval but also to approval by the *Takeover Regulation Panel*.<sup>118</sup>

**c) *Lack of definition of offeree company in the SRP-Code***

'In the determination of whether or not the SRP-Code applies, it is the nature of the company which is the offeree or potential offeree company, or in which control (as defined) may change that is relevant.'<sup>119</sup> The term 'offeree company' is defined in s 440A (1) CA and reads as follows: "offeree company" means any company the securities or part of the securities of

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<sup>112</sup> s 119 (2) (a) Companies Bill, 2007.

<sup>113</sup> s 119 (8) Companies Bill, 2007.

<sup>114</sup> s 119 (6) (b) Companies Bill, 2007.

<sup>115</sup> s 119 (3) (a) Companies Bill, 2007.

<sup>116</sup> s 119 (3) (b) Companies Bill, 2007.

<sup>117</sup> s 119 (7) (a) Companies Bill, 2007.

<sup>118</sup> s 119 (2) (d) Companies Bill, 2007.

<sup>119</sup> Section A (3) of the SRP-Code.

which is or is to be the subject of any affected transaction or proposed affected transaction'. Thus, it seems to be established that in order for the SRP-Code to apply, a transfer of securities must be involved, which is not the case in a simple disposal of assets or an undertaking. Accordingly, the SRP-Code as it stands today is not applicable in pure asset deals. However if a disposal in terms of s 228 CA is combined with another transaction that falls within the definition of 'affected transaction' in s 440A (1) (a) (i) (ii) or (b) CA, the SRP-Code is applicable.<sup>120</sup>

### **III. Capacity to dispose of assets or an undertaking in Switzerland**

#### **1 Capacity and powers of a company**

What has been outlined under section II.1 is essentially also true for Swiss limited liability companies in terms of art 620 SCO.

#### **2 Capacity and powers of the company's organs**

In terms of art 698 I SCO the general meeting is the supreme corporate body of a company. *Prima facie* this suggests that the general meeting can influence any issue, provided there is an empowering clause in the articles of association. A deeper analysis of the law shows, however, that the possibility of providing the general meeting with capacities by including empowering clauses in the articles is restricted to certain circumstances.<sup>121</sup> Unlike in South Africa, directors of limited liability companies in Switzerland do have certain inherent powers.<sup>122</sup> Both the general meeting and the directors have their exclusive areas of duty. Thus, directors have not only inherent powers, but certain additional inalienable powers.<sup>123</sup> Powers which inalienably lie with

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<sup>120</sup> SM Luiz 'Some Comments on the Definition of an 'Affected Transaction' in the Companies Act' (2004) 16/1 *SA Mercantile Law Journal* 1 at 13.

<sup>121</sup> Fischer at 73.

<sup>122</sup> art 716a SCO.

<sup>123</sup> art 716a SCO.

the directors can not be assigned to the general meeting. Any provision in the articles of association purporting to do so would be *void*.<sup>124</sup>

The directors are assigned the ultimate management of the company.<sup>125</sup> The assignment of this task is inalienable.<sup>126</sup> Directors are statutorily authorised to perform any act that may be necessary in order to further the company's object as defined in the articles of association.<sup>127</sup> A restriction of such authorisation in the articles of association is not valid against a *bona fide* third party,<sup>128</sup> but an act *ultra vires* the company will be void.<sup>129</sup>

## 2.1 The SMA

The SMA came into force on July 1<sup>st</sup>, 2004. By means of a codification of recent practice, supplemented by somewhat detailed procedural provisions, this law makes available certain important new transactional tools for facilitating reorganisations. Its main focus is on provisions relating to the reorganisation of limited liability companies. The law, however, applies to all other types of companies, including general and limited partnerships, as well as to associations and foundations; areas in which up to now, there was no codified law. Besides mergers, de-mergers, and transformations, the SMA introduces a new legal institution: the 'transfer of assets and liabilities'. With this new institution, assets and liabilities listed in an inventory are transferred by operation of law upon registration of the transfer with the Commercial Registry. A transfer of title of each and every individual asset or liability is not needed. The authority to effect a 'transfer of assets and liabilities' lies with the directors. The shareholders are informed about the transaction only once it has occurred. Any creditors under transferred liabilities are protected by the joint and several liability of the transferor and the transferee, for a period of three years. For aspects that are not regulated in the SMA, the SCO applies.

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<sup>124</sup> Bockli at § 13 N 449.

<sup>125</sup> art 716a I ziff 1 SCO.

<sup>126</sup> art 716a ziff 1 SCO.

<sup>127</sup> art 718a I SCO.

<sup>128</sup> art 718a II SCO.

<sup>129</sup> Bockli at § 13 n 497.

## **2.2 Capacity to dispose of ‘assets and liabilities’ under the SMA**

In terms of art 70 I SMA the authority for the conclusion of a contract to ‘transfer assets and liabilities’ lies with the supreme administrative or managing bodies of the corporate persons involved. To identify this organ in a limited liability company, one must consult the SCO. The supreme administrative or managing organ in a limited liability company consists of the directors.<sup>130</sup> What is required is a resolution of the directors in terms of art 713 SCO. Article 713 SCO does not prescribe any attendance quorum. So, a resolution is valid even where just one director was present, unless otherwise provided for in the articles. If more than one director is present, the resolution is adopted by the majority of the votes present.<sup>131</sup> Minutes must be kept of all resolutions and all minutes must be signed by the meeting chairperson and the secretary.<sup>132</sup> There is no provision comparable to South Africa’s s 228 CA, limiting the directors’ authority for disposals that reach a certain size. Thus generally speaking, the value of the assets or the undertaking disposed of is irrelevant in the context of directors’ authority. The power to conclude a contract to transfer a company’s assets and liabilities constitutes an inalienable power of the directors.<sup>133</sup> Thus, the authority to ‘transfer assets and liabilities’ cannot be assigned to the general meeting. The directors are, however, not authorised to dispose of assets and liabilities if the transaction is *ultra vires* the company.<sup>134</sup>

## **2.3 Reasons for the Swiss legislator’s decision not to introduce a shareholder approval requirement**

Generally any transaction under the SMA may impact on the existing legal status of the shareholders. As a consequence, the principles of continuity of membership and the prohibition on additionally burdening the members apply. The SMA contains specific provisions protecting these principles in the case of a merger, a de-merger or a transformation. For

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<sup>130</sup> Art 716a I ziff 1 SCO.

<sup>131</sup> art 713 I SCO.

<sup>132</sup> art 713 III SCO.

<sup>133</sup> Von Salis-Lütolf at 409 and art 70 I SMA read with art 716a I ziff 1 SCO.

<sup>134</sup> Loser-Krogh at 1099.

instance, membership rights have to be allocated proportionally to the previous rights;<sup>135</sup> further extensive minimum requirements of the transaction contract are stipulated;<sup>136</sup> a report verified by an auditor is required;<sup>137</sup> and the approval of the shareholder meeting by special resolution is also required.<sup>138</sup>

However, such safeguards are absent from the section about ‘transfer of assets and liabilities’. The rationale behind this absence is that the ‘transfer of assets and liabilities’ does not impact membership rights.<sup>139</sup> A consideration – if paid at all – is always paid to the transferor company but not to the members. From these circumstances the legislator concluded that there is very little potential for the oppression of shareholders in this context. Should the transfer be *ultra vires* the company the transfer is void, unless the approval of the general meeting is obtained.<sup>140</sup> As to the practical consequences in such circumstances, however, see the comments under 2.6.

## **2.4 Restrictions by the object of the company**

Although most object clauses are worded so as to include a comprehensive purview of capacities, the disposal of all the assets, the whole of the undertaking or substantially all of the equipment necessary for operating the business, would usually be contrary to the company’s object and thus void.<sup>141</sup> Such acts infringe the object of the company because, instead of furthering that object, they have the effect of terminating the company’s business activity. In practice, however, it is often difficult to determine whether a disposal of assets results in termination of the company’s core business, or whether it in fact results in a concentration on core business, the latter being clearly within the directors’ authority.

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<sup>135</sup> See articles 7, 31 and 56 SMA.

<sup>136</sup> See articles 12 f, 36f and 59f SMA.

<sup>137</sup> See articles 14, 39 and 61 SMA.

<sup>138</sup> See articles 18, 43 and 64 SMA.

<sup>139</sup> Von Salis-Lütolf at 389 and 400; Memorandum SMA at 4462.

<sup>140</sup> Loser-Krogh at 1099.

<sup>141</sup> Böckli at § 13 n 497.

A 'transfer of assets and liabilities' could result in the factual winding-up of the transferor company. This might occur where directors transfer essential parts of the assets necessary for the operation of the company's business without having made new investments in its line of business.<sup>142</sup> Such transactions would not be covered by the company's object clause. Furthermore, directors do not have the authority to transform a company that actively operates a business into a holding company.<sup>143</sup> Finally, the directors do not have the authority to make gifts that exceed the economic power of the company.<sup>144</sup>

A 'transfer of assets and liabilities' that, in an economic sense, would result in a merger, de-merger or transformation would not be covered by the company's object clause either. Thus, directors will lack the authority to perform such transfers, despite the fact that art 70 I SMA explicitly empowers the directors to perform 'transfers of assets and liabilities' and does not set out any restrictions as to the size of such transaction.<sup>145</sup>

In order to effect transactions which are not covered by the company's object clause, the authorisation of the general meeting is required. The general meeting can approve such transactions either in terms of art 704 I ziff 1 SCO, which allows for an alteration of the company's object clause, or by a resolution to dissolve the company in terms of art 736 Ziff 2 SCO. The former resolution is subject to acceptance by two thirds of the votes present and the absolute majority of the present par value shares.<sup>146</sup> A resolution for the dissolution of the company requires just the approval by ordinary resolution.<sup>147</sup>

## **2.5 Other restrictions**

There are other circumstances that are unrelated to acts *ultra vires* the company in which shareholder approval might be required.

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<sup>142</sup> Schumacher at 64 fn 247.

<sup>143</sup> BGE 110 II 384 (390f. E. 2b).

<sup>144</sup> Loser-Krogh at 1099.

<sup>145</sup> Schumacher at 64 with reference to Loser-Krogh at 1099.

<sup>146</sup> art 704 I Ziff. 1 OR.

<sup>147</sup> art 703 OR.

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**a) *Self-dealing and double representation***

A director acts as an agent for the company. If his own interests, or the interests of a third party for whom he also acts as agent, are contrary to those of the company, he has conflicting interests. Conflicts of interest are apparent in self-dealing and double representation situations, where a director purports to represent his company while at the same time acts for himself or a second principal. According to Swiss agency law an agent is not empowered to represent the principal in a self-dealing or double representation situation.<sup>148</sup> Thus, self-dealing or double representation transactions are forbidden.<sup>149</sup> According to the Swiss Federal Court, self-dealing or double representation transactions will be upheld only in exceptional circumstances, if the interests of the company are not at risk.<sup>150</sup> This will be the case if directors can prove that the self-dealing transaction was concluded according to the 'arm's length principle', or if they can present a fairness opinion from an independent external expert.<sup>151</sup> Further, the company itself can approve the self-dealing or double representative transaction. If there are other directors that do not have conflicting interests, they can approve the deal.<sup>152</sup> Otherwise shareholder approval in a general meeting is required.<sup>153</sup>

**b) *Conflicting interests outside self-dealing or double representation***

Directors may have conflicting interests outside self-dealing or double representation situations. For example, a director may transfer part of an undertaking to the majority shareholder in the hope of being re-elected. Unlike self-dealing or double representation, such acts are not forbidden and as a general rule the director's authority includes such acts.<sup>154</sup> However, a director acting with conflicting interests lacks the power to represent his

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<sup>148</sup> Von der Crone *Conflict of interest* at 5.

<sup>149</sup> BGE 126 III 363.

<sup>150</sup> BGE 126 III 363.

<sup>151</sup> Forstmoser at 18.

<sup>152</sup> BGE 127 III 333.

<sup>153</sup> BGE 127 III 335.

<sup>154</sup> BGE 126 III 363f.

company where the third party is aware of the director's conflict.<sup>155</sup> This will frequently be the case where directors conclude a contract to transfer assets and liabilities to a majority shareholder. Such a transaction may be approved by other directors not having conflicting interests, or by the general meeting.<sup>156</sup> Approval by the general meeting requires an ordinary resolution in terms of art 703 SCO. As shareholders can vote in a general meeting despite their self interest,<sup>157</sup> majority shareholders could authorise such a resolution in a general meeting. Minority shareholders would, however, have the right to challenge such a resolution if it would discriminate against them, or would disadvantage them in a manner not justified by the company's purpose.<sup>158</sup>

**c) Contribution of the general meeting in terms of art 29 II of the Swiss Securities Trading Act<sup>159</sup>**

In terms of art 29 II of the Swiss Securities Trading Act, directors of a target company do not have the authority to take any action to frustrate a takeover. Thus, directors may not for instance sell the prize assets of the company once a takeover offer is immanent.

This section has similarities with rule 29 (d) of the South African SRP-Code. The reason for the introduction of art 29 II of the Swiss Securities Trading Act is the same as for the introduction of rule 29 of the SRP-Code: directors may have conflicting interests in a takeover situation.

The general meeting's authority is, however, not restricted in a takeover situation. Thus, its resolutions will be valid.<sup>160</sup> It is under dispute whether article 29 II of the Swiss Securities Act departs from the legislator's allocation of authority between the general meeting and the directors. One doctrine

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<sup>155</sup> BGE 126 III 362f.

<sup>156</sup> However, if the conflict of interest is based on a transaction with the majority shareholder it must be assumed that all directors have conflicting interests, because they all might approve such an agreement to be re-elected. Thus in this case, the transaction can only be validly approved by the general meeting.

<sup>157</sup> Böckli § 12 n 454f.

<sup>158</sup> art 706 II ziff 3 SCO.

<sup>159</sup> Bundesgesetz vom 24. März 1995 über die Börsen und den Effektenhandel; SR 954.1.

<sup>160</sup> art 29 II Swiss Securities Trading Act.

denies such adjustment of authority. According to this doctrine art 29 II of the Swiss Securities Act simply states that the directors' capacities are restricted in a takeover but the general meeting retains all its usual capacities.<sup>161</sup> In terms of this doctrine, the general meeting does not acquire any capacities that usually lie with the directors.<sup>162</sup> The prevailing view, however, is that the general meeting is authorised to take any action after the publication of an offer, even where such action would normally be the directors' responsibility in terms of the SCO.<sup>163</sup> This view is to be preferred, as the first one would leave the company with a capacity vacuum.<sup>164</sup>

So, the general meeting can pass a resolution to frustrate a takeover – for example by selling a major part of the undertaking - with an ordinary resolution in terms of art 703 SCO.<sup>165</sup> Should the resolution involve a change of the company's object, the more severe quorum requirements of art 704 I ziff 1 SCO must be fulfilled. As has been mentioned already, shareholders can vote even if they have conflicting interests.

## ***2.6 Legal consequence of a 'transfer of assets and liabilities' by the directors although shareholder approval was required***

Under Swiss company law resolutions of the directors are not subject to an appeal or other remedies by the shareholders. As an exception to this general principle, shareholders can appeal against resolutions of the directors which do not comply with the *provisions of the SMA*.<sup>166</sup> However, as the SMA does not require approval of the general meeting in case of a 'transfer of assets and liabilities', such approval only being required by the SCO or the Swiss Securities Trading Act, shareholders do not have a right to appeal against a resolution of the directors in this case.<sup>167</sup> Neither the SMA

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<sup>161</sup> Von Büren/Bähler at 400; Böckli at § 7 n 190 f.

<sup>162</sup> Böckli at § 7 N 191; Büren/Bähler 400.

<sup>163</sup> Zobl at 67; Nobel at 466; Meier-Schatz at 273; Von der Crone *Conflict of interest* at 11.

<sup>164</sup> Fischer at 100.

<sup>165</sup> Fischer at 100.

<sup>166</sup> Art 106 SMA.

<sup>167</sup> Fischer at 107; Büchi at 151 fn 993; dissenting: Schumacher at 69f.

nor the SCO contain any provisions regarding the nullity of resolutions of directors. It is however generally accepted in Swiss company law that serious deficiencies render such resolutions void.<sup>168</sup> Section 706b SCO enumerates circumstances that render a shareholder resolution void. Although the provision refers to resolutions of the general meeting, it is accepted that it applies also to resolutions which were adopted by the directors.<sup>169</sup> In terms of art 706b ziff 3 SCO read with art 714 SCO, decisions which disregard the fundamental structures of the company or violate the provisions for the protection of company capital are void. Swiss legal doctrine accepts that a resolution adopted by the directors despite the fact that they were incompetent to adopt it is void, because it contravenes the fundamental structure of the company.<sup>170</sup> Accordingly, the disposal of 'assets and liabilities' by directors under circumstances where shareholder approval would be required, is void. It is however under dispute whether nullity can be claimed once the 'transfer of assets and liabilities' is registered with the Commercial Registry, as ownership of the assets and liabilities is transferred to the transferee upon registration, and the principle of public disclosure applies to the Commercial Registry.<sup>171</sup> The Commercial Registry may not examine whether the directors exceeded their authority in passing the resolution for a 'transfer of assets and liabilities', as this is a *material* requirement and in this respect the Commercial Registry has only restricted cognition. Thus, the registration will be completed even where directors exceeded their authority.<sup>172</sup>

Some scholars argue that upon registration, any deficiencies of the 'transfer of assets and liabilities' are cured. It is argued that this is necessary for reasons of legal certainty, as the registration with the Commercial Registry is made public and any party that is affected by the transaction

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<sup>168</sup> Beretta *Strukturanpassungen* at 229.

<sup>169</sup> Böckli § 13 n 263f.

<sup>170</sup> Böckli § 13 n 270a; Beretta *Strukturanpassungen* at 230.

<sup>171</sup> For the effects of the registration with the Commercial Registry see IV.3.

<sup>172</sup> Beretta *Commentary SMA* at art 70 n 11f.

should be able to rely on the facts that are contained in the Commercial Registry.<sup>173</sup>

Other authors stand for the nullity of a 'transfer of assets and liabilities' although it has been registered with the Commercial Registry.<sup>174</sup> After a successful claim to declare a registered transaction void, restoration of the previous status would be required. Such a procedure would involve extraordinary expenditure.

In this context, the interests of third parties and legal certainty should prevail. Shareholders would have recourse to other remedies, such as the right to file an action in terms of art 108 SMA. In terms of that section, directors are liable for any damages resulting from a breach of duty.

## **2.7 Plea for the introduction of a shareholder approval requirement**

### **a) In major transactions**

As has been outlined, the requirement of approval by the general meeting for the transfer of 'assets and liabilities' is limited to the scenarios discussed. In South Africa, Canada and the US transactions require the approval of the general meeting should the assets to be transferred amount to a certain size. Thus, the question arises whether it is appropriate that in Switzerland directors are authorised to decide on such transactions on their own.

As has been noted, the management of a company lies with its directors.<sup>175</sup> Members have neither a right nor a duty to manage the company's business. Economically, however, the members are the owners of the company, which is why they can, in general, decide essential matters of the company. The shareholder meeting must, for instance, approve essential modifications in the company's legal structure.<sup>176</sup> Further, the

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<sup>173</sup> Schumacher at 124f with further explanations and references; Loser-Krogh at 1102; Beretta *Commentary SMA* art 70 n 12.

<sup>174</sup> Fischer at 108f.

<sup>175</sup> See notes under III.2.

<sup>176</sup> articles 650, 736 SCO.

members decide on mergers, de-mergers and transformations<sup>177</sup>. They have to approve matters that may have a huge economic impact on the company, such as decisions on measures to frustrate a takeover, which directors are prohibited from making.<sup>178</sup> The members have the capacity to change the articles of association and to change the object of the company.<sup>179</sup>

From the principle that the ordinary management lies with the directors while essential matters need shareholder approval, one could deduce that this division of competence will also apply in the case of a 'transfer of assets and liabilities'. Thus, directors would be authorised to effect ordinary 'transfers of assets and liabilities' whereas considerable 'transfers of assets and liabilities' would require the approval of the shareholders. Unlike in a merger, de-merger or transformation, in the case of a 'transfer of assets and liabilities', the legal structure as regards membership rights remains the same. But the transfer may well have a huge economic impact. The transfer of an essential part of assets and liabilities may alter the company's field of activity. Thus, the income and risk structure of the company may change.<sup>180</sup> Even if such transfer is formally covered by the company's object it may – at least materially – bear comparison with an alteration of the object clause.<sup>181</sup> Consequently such transfer would not fall within the ordinary management of the company, and the question arises whether it is appropriate that the directors have the exclusive authority to effect transfers of assets and liabilities. Arguably, a provision which fulfils the requirements as set out in section II.3.2 would be desirable.

#### **b) Quorum**

The next step is to determine an appropriate quorum. Currently, if shareholder approval is required and no change in the company's object is involved, shareholder approval by the absolute majority of the votes allocated

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<sup>177</sup> articles 18, 43 and 64 SMA

<sup>178</sup> art 29 II Swiss Securities Trading Act.

<sup>179</sup> art 698 II SCO.

<sup>180</sup> Fischer at 162.

<sup>181</sup> Fischer at 162.

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to the shares represented is enough.<sup>182</sup> In these circumstances minority shareholders are not provided any protection at all.

A major 'transfer of assets and liabilities' has similarities with a change of the company's object clause. Such a change requires the approval of two thirds of the votes present and the absolute majority of the present par value shares.<sup>183</sup> The SMA provides for the same quorum in the case of a merger, de-merger or transformation. A major 'transfer of assets and liabilities' may be a transaction which, from an economic perspective, is tantamount to a merger, de-merger or transformation. On this basis, it seems reasonable that the respective statutory quorum requirements should also apply for major 'transfers of assets and liabilities'. This quorum would also serve the purpose of protecting minority shareholders.<sup>184</sup>

**c) *Practical consequences***

As will be explained below (IV.3), the Commercial Registry has full cognition with regard to the *formal* requirements of a 'transfer of assets and liabilities'. If shareholder approval were a statutory condition in order to effect such a transaction, the Commercial Registry would have to dismiss the application for registration unless confirmation of shareholder approval was submitted therewith. This requirement would protect shareholders from acts of their directors where directors lacked the authority to act, and would solve the dispute described under III.2.6 above. Precondition would, however, be that the SMA would include a provision which states the requirement for shareholder approval clearly and the Commercial Registry would be provided with the relevant financial information in order to determine whether the transaction to be registered is subject to such approval.

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<sup>182</sup> art 703 I SCO.

<sup>183</sup> art 704 I ziff 1 SCO.

<sup>184</sup> Fischer at 225.

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## **IV. Transfer of ownership of assets and liabilities**

### **1 In South Africa**

As of today there are no provisions in the South African CA that regulate the transfer of assets and liabilities in a pure asset deal. All assets need to be transferred according to title. The transfer of encumbered assets is only possible with the creditor's consent. The transfer of a contract requires the consent of the contracting party. This process is costly, time consuming, complicated and inconvenient.

As an exception to these principles, s 197 of the Labour Relations Act<sup>185</sup> specifies certain circumstances in which employment contracts can be transferred to a new employer without the new employer's consent. Said section entails an automatic transfer of labour contracts in the event of a transfer of the whole or any part of a business, trade or undertaking.<sup>186</sup> Thus, the primary consequence of the section is that a transfer referred to in s 197 (1) of the Labour Relations Act does not interrupt the employee's continuity of employment; that employment continues with the new employer as if with the old employer.<sup>187</sup>

### **2 In Switzerland**

Below follows an analysis of the transfer of assets and liabilities under the provisions of the SMA. Thereafter, South Africa's prospective Companies Bill, 2007 will be scrutinised for any provisions similar to the ones in Switzerland.

#### **2.1 Transfer by operation of law of all assets and liabilities**

The major innovation of a 'transfer of assets and liabilities' in terms of the SMA is the transfer of all inventoried assets and liabilities by operation of law, subject to the observance of the relevant statutory rules. Before the SMA and its provisions regarding the 'transfer of assets and liabilities' came into

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<sup>185</sup> Act 66 of 1995.

<sup>186</sup> For an overview of the related problems see: Nicola Smit 'Automatic transfer of employment contracts and the power to object?' (2003) 3 *TSAR* 465.

<sup>187</sup> s 197 (2) Labour Relations Act.

effect, such a transfer by operation of law was only possible within the framework of a merger.

A merger<sup>188</sup> combines two or more companies in such a way that at least one of the initial companies is dissolved. In some cases, all of the initial companies dissolve. In the case of a ‘transfer of assets and liabilities’, the transferor company continues to exist with the same members. In principle, a merger entails that all of the members of the merging entities become members of the merged entity. Thus, unlike a ‘transfer of assets and liabilities’ a merger affects membership rights. It is possible that in a ‘transfer of assets and liabilities’ the transferee company grants membership rights as a consideration for the transferred assets and liabilities; but the membership rights are granted to the transferor company and not to its members.<sup>189</sup>

## **2.2 The transfer contract**

In order to utilise the ‘transfer of assets and liabilities’ mechanism, the transferor and transferee companies have to conclude a *transfer contract*. All assets and liabilities listed in the transfer contract will be transferred to the transferee by operation of law upon entry into the Commercial Registry.<sup>190</sup> Thus, the main purpose of the transfer contract is to determine exactly which assets and liabilities are to be transferred.

The transfer contract must be in writing.<sup>191</sup> If the transfer involves immovable property the respective part of the transfer contract is subject to public notarisation.<sup>192</sup>

### **a) Statutorily required contents of the transfer contract**

Article 71 I SMA stipulates the necessary contents to be included in the transfer contract: it must clearly identify the parties, the assets and liabilities, as well as the employment contracts to be transferred, and the amount of a

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<sup>188</sup> Note that the prospective Companies Bill, 2007 distinguishes between *mergers* and *amalgamations* as defined in s 1 Companies Bill, 2007.

<sup>189</sup> Schumacher at 14.

<sup>190</sup> art 73 II SMA.

<sup>191</sup> art 70 II SMA.

<sup>192</sup> art 70 II SMA.

possible consideration. It goes without saying that the parties are free to include further matters.

**b) Inventory**

According to the SMA the assets and liabilities to be transferred need to be ‘*unambiguously denominated*’ in the inventory.<sup>193</sup> Despite the wording of the section not every single asset or liability must necessarily be itemized.<sup>194</sup> The degree of specificity required depends on the kind of assets and liabilities to be transferred and on their composition. The denomination must be such as to allow the specific allocation of the assets and liabilities in the concrete situation.<sup>195</sup> The degree of detail depends also on the size of the transaction. If all assets and liabilities are to be transferred, not much detail is required. The same is true for large ‘transfers of asset and liabilities’, especially if parts of an undertaking are transferred. In such situations it is usually already clear from an economic point of view which assets are to be assigned to which party.<sup>196</sup> In small transactions, specifying every single asset and liability is unavoidable, because they do not form an integral whole of an undertaking, and thus cannot readily be assigned to one contracting party from an economic point of view.<sup>197</sup> For reasons of legal certainty immovable property, intangible values, and securities ought always to be enumerated separately.<sup>198</sup> Additionally, a list with all employment contracts to be transferred ought to be included.<sup>199</sup>

Assets, claims and intangibles that cannot be allocated due to a lack of detail in the inventory remain with the transferor company.<sup>200</sup>

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<sup>193</sup> art 71 I b SMA.

<sup>194</sup> Von Salis-Lütolf at 411.

<sup>195</sup> Memorandum SMA at 4463.

<sup>196</sup> Malacrida at art 71 n 6.

<sup>197</sup> Büchi at 158 fn 1049.

<sup>198</sup> See art 71I lit b SMA.

<sup>199</sup> art 71 I lit e SMA.

<sup>200</sup> art 72 SMA.

**c) Composition of the assets and liabilities to be transferred**

The parties may determine the composition of the inventory freely. It may also consist of just one asset.

The parties' freedom is however restricted with regard to employment contracts. According to art 76 I SMA, art 333 SCO is applicable in a 'transfer of assets and liabilities' situation. Thus, if an undertaking or part thereof is transferred, the employment contracts are necessarily transferred to the transferor company.<sup>201</sup> Restrictions may also be applicable if the parties wish to transfer contracts, claims or liabilities.<sup>202</sup> Finally, the freedom to allocate the assets and liabilities to be transferred is constrained by the provisions about *capital protection* and *winding-up*.<sup>203</sup>

**d) Valuation of the assets and liabilities**

The 'transfer of assets and liabilities' is possible only if the inventory shows a surplus of net assets.<sup>204</sup> It is not necessary to specify the value of every single asset or liability, but the total value of the assets and the total value of the liabilities need to be indicated separately.<sup>205</sup>

The SMA does not contain any guidance regarding the valuation of the assets and liabilities. It seems to be established, however, that the relevant value is the market value.<sup>206</sup> Article 71 II SMA, which requires a surplus of net assets, was introduced to protect the transferor company's creditors.<sup>207</sup> Thus, assets and liabilities need to be valued from the point of view of the transferor company. The value of the assets and liabilities may be quite different from the perspective of the transferor, as opposed to that of the transferee. For instance, assets may provide the transferee company with

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<sup>201</sup> art 333 SCO see further comments under IV.2.5.

<sup>202</sup> For more details see IV.2.3d), IV.2.3e) and IV.2.4.

<sup>203</sup> See also the comments under V.2.1.

<sup>204</sup> art 71 II SMA.

<sup>205</sup> Beretta *Commentary SMA* art 71 n 26.

<sup>206</sup> Schumacher at 85.

<sup>207</sup> Von der Crone *MSA* at 325 n 833; see however the comments under V.2.2b) regarding the inefficiency of the intended purpose of art 71 II SMA.

new possibilities of utilization; the transfer may result in synergies; or the transaction may create goodwill in the transferee company.<sup>208</sup>

### **2.3 Transferability of:**

#### **a) Immovable property**

Ownership of immovable property outside a 'transfer of assets and liabilities' in terms of the SMA is only transferred upon registration of the transfer with the Registry of Deeds.<sup>209</sup> The transfer of immovable property in the context of a 'transfer of assets and liabilities' is specifically regulated in the SMA. As has already been mentioned, the respective part of the transfer contract requires public notarization.<sup>210</sup> If this requirement is fulfilled, ownership is transferred upon registration of the 'transfer of assets and liabilities' with the Commercial Registry. Thus, transfer of ownership occurs outside the Registry of Deeds; consequently the records in the Registry of Deeds will be incorrect after a 'transfer of assets and liabilities' is effective.<sup>211</sup> In terms of art 104 II lit c SMA, the Registry of Deeds must therefore be updated accordingly. The transferee company can only sell on the immovable property once the transfer has been registered with the Registry of Deeds. On the other hand, the transferor company may still dispose of the immovable property as long as it remains unregistered in the Registry of Deeds.<sup>212</sup> The update of the entry is thus not only essential for legal certainty and accuracy of the Registry of Deeds, but also to protect the transferee company from bad faith disposals by the transferor company. In terms of art 104 II SMA, the transferee is authorised to file the application to update the Registry of Deeds, so it is their responsibility to prevent bad faith disposals by the transferor by filing the application immediately after registration of the 'transfer of assets and liabilities' with the Commercial Registry.

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<sup>208</sup> Schumacher at 86.

<sup>209</sup> art 656 II Swiss Civil Code (Schweizerisches Zivilgesetzbuch vom 10. Dezember 1907, SR 210).

<sup>210</sup> art 70 II SMA.

<sup>211</sup> Schumacher at 142.

<sup>212</sup> Schumacher at 142.

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**b) Movable property**

Movable property is transferred upon registration of the ‘transfer of assets and liabilities’ with the Commercial Registry. Acquisition of physical possession is not necessary.

**c) Securities and immaterial property rights**

Although securities and immaterial property rights are transferred by operation of law upon registration with the Commercial Registry, a subsequent factual update of the respective registers is advisable.

**d) Claims**

Negotiable claims do not need to be ceded. They are simply transferred by operation of law. It is, however, unclear whether this is also true for claims which the parties contractually declared non transferable (a *pactum de non cedendo*), and where consent of the other party to transfer the claim has not been obtained. Some hold the view that the other party’s consent may not even be relevant in this situation.<sup>213</sup> The very reason for the implementation of the ‘transfer of assets and liabilities’ mechanism was to enable efficient transfers of complex structures of assets and liabilities. The legislator’s goal was to provide companies with the utmost flexibility with regard to such transactions.<sup>214</sup> The transfer by operation of law of claims characterised by a *pactum de non cedendo* is, however, only justified where the whole or part of an undertaking is transferred.<sup>215</sup> In view of the purpose of the ‘transfer of assets and liabilities’ mechanism, claims which are connected with the undertaking or part thereof should be transferred, even where the parties to the contract agreed on a *pactum de non cedendo*.<sup>216</sup> On the other hand, the transfer by operation of law should not be effective if there is no such connection.

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<sup>213</sup> Loser-Krogh at 1101; Büchi at 172; dissenting opinion Von Salis-Lütolf at 204 and 431.

<sup>214</sup> Loser-Krogh at 1101.

<sup>215</sup> Schumacher at 147.

<sup>216</sup> Schumacher at 145.

### e) *Liabilities*

Liabilities are generally negotiable in the context of a 'transfer of assets and liabilities'. Creditors are protected because the old and the new debtor are rendered jointly and severally liable for a period of three years after the transfer.<sup>217</sup> As an exception, liabilities might not be transferable where their fulfilment can only be effected by the old debtor, specifically.

Unlike in the case of assets, claims and intangibles,<sup>218</sup> the SMA contains no provision for determining whether a liability should be transferred or not, where the inventory is unclear. Thus, the question arises whether art 72 SMA should be applied analogously, or whether the fact that liabilities are not mentioned in the section means that the liabilities in question are transferred to the transferee company. To ensure legal certainty in this respect, it would have been useful had the legislator regulated this situation.<sup>219</sup> In terms of art 71 I lit b SMA, the inventory should reveal whether certain assets and liabilities are to be attributed to the transferor or the transferee company. This wording suggests that liabilities which are not clearly allocated remain with the transferor company, although this is not explicitly stated in art 72 SMA.<sup>220</sup>

### **2.4 *Transfer of contracts under the 'transfer of assets and liabilities' provisions***

Generally, the transfer of contracts requires the consent of all parties involved in the transfer, and all parties to the contracts concerned. Before the coming into effect of the SMA, a transfer of contracts by operation of law was only possible in a merger situation. It is under dispute whether this should also be possible under the 'transfer of assets and liabilities' provisions. A merger involves the whole of the undertaking, and all the assets and liabilities, of each merging company, whereas a 'transfer of assets and liabilities' normally concerns only part thereof. Thus, the difference between

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<sup>217</sup> art 75 I SMA see further comments under V.2.3a).

<sup>218</sup> art 72 SMA.

<sup>219</sup> Loser-Krogh at 1106.

<sup>220</sup> Schumacher at 147.

the two mechanisms is merely a quantitative one.<sup>221</sup> From a qualitative point of view the two mechanisms operate in the same way. Accordingly there is no reason why contracts should not be transferable by operation of law under the provisions of ‘transfer of assets and liabilities’.<sup>222</sup> There are, however, some considerations to be borne in mind. Transfer of a contract by operation of law may compel the party who remains in the contractual relationship to accept a new party to the contract, against their will. This affects the remaining party’s freedom of contract. Accordingly, the conflicting interests need to be assessed. The transfer of contracts by operation of law will only be justified if the assets and liabilities or part of an undertaking to be transferred are objectively linked with such contracts.<sup>223</sup> Thus, such transfer should not be permitted where the particular assets or liabilities being transferred are totally unrelated to the contracts being transferred. This differentiation is in line with the approach taken to transfer of employment contracts in terms of s 333 SCO.<sup>224</sup>

**a) *Protection of interest of the party remaining in the contract***

The consequences of the transfer of a contract against the remaining party’s will, will depend on the nature of the contractual obligations of the transferee company under the contract. In the case of a purely monetary obligation, the remaining party is afforded even better protection than before the transfer, as the transferor company is rendered jointly and severally liable for the contractual obligations for a period of three years.<sup>225</sup>

Article 75 SMA states that the transferor company will also be jointly and severally liable where the transferee’s obligation under the contract consists of a service or a benefit in kind. The transferor remains jointly and severally liable for the fulfilment of the contract. If the transferred assets are indispensable to fulfilment of the contractual obligation, the remaining party can either sue the transferee for performance, or the transferor for damages.

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<sup>221</sup> Schumacher at 119f and at 150.

<sup>222</sup> Beretta *Strukturanpassungen* at 238 with reference to further literature.

<sup>223</sup> Schumacher at 151 fn 662.

<sup>224</sup> Schumacher at 151 see further notes under IV.2.5.

<sup>225</sup> art 75 SMA, see further notes under V.2.3a).

The joint and several liability of the transferor and the transferee, in terms of art 75 SMA, may not be enough to protect the interest of the party remaining in the contract, if the contract was concluded with regard to a specific contract partner. Such contracts, known as *ad personam contracts*, contain personal elements or are based on elevated mutual trust. Employment contracts, agency contracts and banking contracts are counted among *ad personam contracts*.<sup>226</sup> In such situations, the joint and several liability provisions of the SMA might not provide creditors with enough protection.<sup>227</sup> Thus, the question arises as to how the situation of the party remaining in the contract can be improved.

The transfer of a contract may mean that the requirements for an adaptation of the contract have been met. Generally a precondition for the adaptation of a contract is an alteration of the circumstances (*'clausula rebus sic stantibus'*).<sup>228</sup> The alteration must not have been foreseeable, and must be such as to fundamentally change the contractual relationship.<sup>229</sup> These preconditions might be fulfilled in the case where a contract is transferred by operation of law, and the change of the contracting party is not acceptable from the perspective of justice and equity. An adaptation might concern not only the contents of the contract, but also its duration. As a result, the party remaining in the contract may have a right of termination.<sup>230</sup>

#### **b) Particular contract clauses**

It is very common to include contract clauses that prohibit the transfer of contracts, or that stipulate that any such transfer requires the consent of the other party. In light of what has been discussed above regarding the transfer of *ad personam contracts*, such clauses shall not prevent the transfer of the contract by operation of law.<sup>231</sup> A transfer despite such a clause would,

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<sup>226</sup> Beretta *Vertragsübertragung* 255.

<sup>227</sup> Schumacher at 153.

<sup>228</sup> Wiegand at art 18 n 95.

<sup>229</sup> Wiegand at art 18 n 99f.

<sup>230</sup> Beretta *Vertragsübertragung* at 255.

<sup>231</sup> Schumacher at 157.

however, qualify as a breach of contract.<sup>232</sup> As a result, the contracting party might exercise their right to adapt the contract and consequently may have a right of termination.<sup>233</sup>

In practice, parties often agree on contract clauses stipulating that the contract will terminate automatically in the case of reorganisations which result in a change of contracting party. Such clauses are valid and effective.<sup>234</sup>

## **2.5 The transfer of employment contracts**

According to art 76 SMA, art 333 SCO is applicable for the transfer of employment contracts in the context of a ‘transfer of assets and liabilities’.

Article 333 of the SCO regulates the transfer of employment contracts when an *undertaking or part thereof* is alienated.

### **a) Transfer of employment contracts if an undertaking or part thereof is transferred**

As has been mentioned, parties are generally free to allocate the assets and liabilities they wish to transfer in the context of a ‘transfer of assets and liabilities’. According to this principle the parties could also freely decide on the allocation of employment contracts. Should the parties be provided with such freedom, the possibility of employees being deprived of their workplace could arise. The transaction parties could agree on a transfer of part or the whole of an undertaking and at the same time stipulate that the employees remain with the transferor.<sup>235</sup> The transferor company would then possibly have a right to terminate the employment contract for operational reasons, namely: lack of an actual workplace.<sup>236</sup> The reference in art 76 SMA to art 333 SCO resolves this conflict of interests in favour of the employees. Article 333 SCO limits the legal entities’ freedom to allocate the employment

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<sup>232</sup> Beretta *Vertragsübertragung* at 255.

<sup>233</sup> Beretta *Vertragsübertragung* at 255.

<sup>234</sup> Malacrida at art 73 n 21; assenting Beretta *Vertragsübertragung* at 255.

<sup>235</sup> Schumacher at 194 with reference to Frank Müller-Ehlen Dissertation Bonn 1998 *Der Übergang von Arbeitsverhältnissen im Umwandlungsrecht* at 27.

<sup>236</sup> Schumacher at 194.

contracts freely, when an *undertaking or part thereof* is alienated. If such transaction occurs the employment contracts are automatically transferred to the transferee. The section is very similar to South Africa's s 197 of the Labour Relations Act. In terms of art 333 I SCO, the employees have the choice to refuse the transfer. The employment contract is then terminated with the statutory notice period.

Thus, in terms of art 333 SCO agreements that employment contracts which form part of the undertaking to be transferred should remain with the transferor company, are prohibited. A respective classification in the inventory would be of no effect.<sup>237</sup>

**b) *Transfer of employment contracts if no undertaking or part thereof is transferred***

The question arises as to how employment contracts are allocated outside the scope of art 333 SCO. The following situations are not covered in terms of art 333 SCO:

- (i) Parties to the transfer wish to transfer *additional* employment contracts, besides those being transferred within the context of the transfer of part of an undertaking; or
- (ii) the 'transfer of assets and liabilities' does not amount to the transfer of part of an undertaking in the sense of art 333 SCO at all, but employee contracts should still need to be transferred.<sup>238</sup>

Here, art 333 of the SCO is not applicable because the transfer does not concern an alienation of at least *part of an undertaking*.<sup>239</sup> Whether employment contracts are transferred in these situations depends on whether an objective link exists between the employment contract, and the assets to be transferred. If this can be answered in the affirmative, a transfer by operation of law is possible. As art 333 of the SCO is not applicable, because no transfer of *an undertaking or part thereof* is concerned, the affected

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<sup>237</sup> Schumacher at 195.

<sup>238</sup> See Michael Winkler ‚Arbeitnehmerschutz nach dem Entwurf zum neuen Fusionsgesetz‘ 97 (2001) *SJZ* 477 at 479 fn 11.

<sup>239</sup> Schumacher at 195 and von Salis-Lütolf at 451.

employees do not have a right to decline the transfer in terms of art 333 SCO. The employer-employee relationship is however qualified as an *ad personam contract*,<sup>240</sup> thus the employee has a right to terminate the contract in terms of the application of the principle of *clausula rebus sic stantibus*.

### 3 The registration with the Commercial Registry

As has already been mentioned, the novelty of the mechanism of 'transfer of assets and liabilities' is the transfer of all assets and liabilities by operation of law. Ownership is transferred without meeting the usual requirements as to form. Instead, the transfer must be registered with the Commercial Registry. The registration has a *constitutive effect* for the transfer of ownership. The SMA does not contain any provisions that define the time limits within which the transfer must be registered. Following the respective provisions in a merger<sup>241</sup> or de-merger,<sup>242</sup> it is arguable that registration should take place immediately after the conclusion of the transfer contract.<sup>243</sup> The parties may, however, agree contractually on the point in time at which the 'transfer of assets and liabilities' is to be registered with the Commercial Registry.<sup>244</sup>

The Commercial Registry must examine the application for registration of a 'transfer of assets and liabilities'. The transferor is responsible for providing the Commercial Registry with the *transfer contract*, including the inventory and the *respective resolution of the directors*.<sup>245</sup> With regard to the formal requirements of the application, the Commercial Registry has full cognition and can refuse to effect the registration unless all formal requirements are complied with.<sup>246</sup> The Commercial Registry would, for example, refuse to register a 'transfer of assets and liabilities' where the

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<sup>240</sup> See notes under IV.2.4a) above.

<sup>241</sup> art 21 I SMA.

<sup>242</sup> art 51 I SMA.

<sup>243</sup> Fischer at 43.

<sup>244</sup> Von Salis-Lütolf at 427 and Schumacher at 106.

<sup>245</sup> art 108 ordinance of the Commercial Registry / Handelsregisterverordnung vom 7. Juni 1937; SR 221.411.

<sup>246</sup> See art 940 I SCO; BGE 113 II 280; Böckli § 1 n 350.

respective resolution of the directors was not provided with the application. On the other hand, the Commercial Registry may only refuse to register the 'transfer of assets and liabilities' for *material* reasons if it is obviously contrary to mandatory rules, and those rules were established for the protection of the public or third parties' interests.<sup>247</sup> The Commercial Registry first journalizes the transfer in the Commercial Registry's diary, and must then publish the transfer in the '*Swiss Commercial Gazette*' (Schweizerisches Handelsamtsblatt).<sup>248</sup>

The 'transfer of assets and liabilities' is registered with the transferor company only. In terms of art 108a of the ordinance for the Commercial Registry,<sup>249</sup> the entry in the Commercial Registry contains information regarding the *parties*, the *date of the transfer contract* and the *total value of the assets and liabilities to be transferred* as well as the *amount of the consideration, if any*.

The 'transfer of assets and liabilities' becomes effective immediately after being entered in the Commercial Registry's diary ('Tagebucheintrag').<sup>250</sup> Ownership of all assets and liabilities included in the inventory is transferred to the transferee company at this point. Against third parties, however, the transfer of ownership is only effective after the publication in the '*Swiss Commercial Gazette*'.<sup>251</sup>

#### **4 Information of the members**

In terms of art 74 I SMA, the directors of the transferor company must inform its members about the 'transfer of assets and liabilities'. The members are informed only *after* the 'transfer of assets and liabilities' takes effect, thus only after the registration of the transaction with the Commercial Registry.<sup>252</sup> The directors of the transferee company do not have any information duties.

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<sup>247</sup> Von Salis-Lütolf 435 and 387; BGE 114 II 69; BGE 125 III 21.

<sup>248</sup> See also art 931 I OR.

<sup>249</sup> Handelsregisterverordnung vom 7. Juni 1937; SR 221.411.

<sup>250</sup> art 73 II SMA.

<sup>251</sup> ,Schweizerisches Handelsamtsblatt see' also art 932 II OR.

<sup>252</sup> Von Salis-Lütolf at 439.

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Article 74 II SMA identifies the kind of information with which members must be provided. The following aspects need to be covered and explained from a *commercial* and *legal* perspective:

- the purpose of, reasons for, and consequences of the ‘transfer of assets and liabilities’;
- the details of the transfer contract;
- the amount of the consideration, if any, paid in return for the ‘transfer of the assets and liabilities’;
- the consequences for employees and details of any possible social plan.

These are minimum information duties. The directors are of course free to provide members with further details.

According to the SMA, the members need only be informed if the transaction reaches a certain size. In terms of art 74 III SMA, the information duty is triggered where the assets to be transferred amount to more than five per cent of the transferor company’s balance sheet total.

If the directors fail to comply with their information duty, the members of the transferor company have a right to take action against the resolution of the directors, in terms of art 106 SMA. The period in which an appeal may be lodged is two months from the date of publication of the ‘transfer of assets and liabilities’ in the Swiss Commercial Gazette. However, in terms of the SMA the members are to be informed about the transaction by means of the next annual financial statement, or at the next general meeting. In practice, the period of appeal may already have expired by that time.<sup>253</sup> The members would then have to revert to other remedies. A claim for damages resulting from disregard of the information duties will lie in terms of art 108 SMA. Further, the members of the transferor company can demand that a special audit be initiated in terms of art 697a SCO.

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<sup>253</sup> Loser-Krogh at 1104.

## 5 Transfer of assets and liabilities outside the provisions of the SMA

The SMA does not explicitly state whether a more conventional transfer of assets and liabilities (transfer of each and every asset according to title) is also possible. This kind of transfer would take place without reference to the specific SMA provisions at all.

The entries in the Commercial Registry (particulars regarding the *parties*, the *date of the transfer contract* and the *total value of the assets and liabilities to be transferred* as well as the *amount of the consideration, if any*), including documents submitted with the application for registration, are open to the public.<sup>254</sup> Thus the transfer contract, including the inventory, is accessible to everybody. To prevent such information from becoming public, the parties may wish to effect the ‘transfer of assets and liabilities’ conventionally.

The majority of Swiss legal doctrine is of the view that conventional transfer does remain an option.<sup>255</sup> These authors refer to the wording of art 69 SMA, in terms of which persons or entities registered with the Commercial Registry *may* transfer assets and liabilities. Further, the official guidance of the Commercial Registry of the Canton of Zurich explicitly indicates that a transfer of assets and liabilities in terms of a conventional asset deal remains possible.<sup>256</sup> This view is acceptable in cases of ‘transfers of assets and liabilities’ which concern only individual assets.<sup>257</sup> Here it would not make sense that the supreme administrative or managing body of the corporation, the directors, necessarily have to effect such transaction in accordance with art 70 I SMA. As soon as the ‘transfer of assets and liabilities’ includes the whole, or part of an undertaking, however, this view should no longer

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<sup>254</sup> art 930 SCO.

<sup>255</sup> Beretta *Commentary SMA* preliminary remarks to art 69-77 n 35; von Salis-Lütolf at 392; Malacrida at art 69 n 35.

<sup>256</sup> Handelsregisteramt Zürich ‘Fragen und Antworten zum neuen Fusionsgesetz’ last update 20.02.2007 at 11 available on:  
<http://www.hra.zh.ch/internet/ji/hra/de/downloads.SubContainerList.SubContainer1.ContentContainerList.0001.DownloadFile.pdf>

<sup>257</sup> Fischer at 31.

apply.<sup>258</sup> Shareholders ought to be provided with a right to appeal against a resolution of the directors for a 'transfer of assets and liabilities' in terms of art 106 SMA.<sup>259</sup> They ought also to enjoy their right to information in terms of art 74 SMA. The companies involved in such transfers should not have the option of evading the respective provisions simply by choosing not to apply the instrument of 'transfer of assets and liabilities' in terms of the SMA.<sup>260</sup>

Between the coming into effect of the SMA in July 2004, and February 2006, 1350 mergers, 120 de-mergers, 1200 transformations and 670 'transfers of assets and liabilities' occurred.<sup>261</sup> It is apparent that the number of 'transfers of assets and liabilities' is relatively low. A key reason for this might be the parties' desire not to disclose the transaction. Given this possibility, a requirement that only general, and not specific, facts be registered with the Commercial Registry may improve the situation.

## **6 Section 120 of the South African Companies Bill, 2007<sup>262</sup>**

Chapter Five of the Companies Bill, 2007 is entitled 'Takeovers, Offers and Fundamental Transactions'. Amongst other things, it regulates affected transactions, and contains provisions for (i) *mandatory offers*, (ii) *compulsory acquisitions*, (iii) *squeeze outs*, (iv) *proposals to dispose of substantially all assets or undertaking* and (v) *schemes of arrangements*. The chapter also breaks new ground by introducing provisions for *mergers* or *amalgamations*<sup>263</sup> in the true sense of the word. In terms of s 120 (5) of the Companies Bill, 2007:

*'when a merger or amalgamation takes effect -*

*(a) the property of each amalgamating or merging company becomes property of the newly amalgamated, or surviving merged, company; and*

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<sup>258</sup> Fischer at 31.

<sup>259</sup> As stated above (see III.2.6) the possibility to appeal a resolution as provided for by the SMA constitutes an exception to the general principle under Swiss law that directors' resolutions are not appealable.

<sup>260</sup> Fischer at 31f.

<sup>261</sup> Vischer/Gnos 'Erfahrungen mit dem Fusionsgesetz' (2006) *AJP* 783 at 783.

<sup>262</sup> Available on: <http://www.thedti.gov.za/ccrdlawreview/COMPANIESBILL07.htm>.

<sup>263</sup> The terms 'merger' and 'amalgamation' are defined in s 1 of the Companies Bill 2007.

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*(b) each newly amalgamated, or surviving merged company is liable for all of the obligations of every amalgamating or merged company subject to any agreement to the contrary’.*

Thus the South African legislator introduces provisions according to which all assets and liabilities as well as any obligations of one or more companies, may be transferred by operation of law, provided the parties adhere to the statutory rules. Unlike the SMA, the Companies Bill, 2007 does not contain an equivalent provision for the transfer of ownership of substantially all assets or undertaking outside of a merger or amalgamation. It does introduce, however, a new rule for the transfer of ownership of assets and liabilities, or any part of an undertaking, where the transfer occurs in the context of certain transactions.

### **6.1 Transfer of assets, liabilities or undertaking in terms of s 120 (6)(a) of the Companies Bill, 2007**

Section 120 (6) (a) of the Companies Bill, 2007 reads as follows:

*‘If a transaction contemplated in this Part has been approved, any person to whom assets are or an undertaking is to be transferred, may apply to the Court for an order to effect the transfer of the whole or any part of the undertaking, assets and liabilities of a company contemplated in that transaction’.*

Section 120 (6) (a) of the Companies Bill, 2007 has similarities with the current s 313 (1) (a) CA, which facilitates reconstructions or amalgamations under a scheme of arrangement in terms of s 311 CA. It must be borne in mind, however, that transactions in terms of s 311 CA are not pure asset deals, as are generally the focus of this thesis. Nevertheless, a short comparison of s 313 (a) CA and s 120 (6)(a) Companies Bill, 2007 is useful for two reasons. First, because of the resemblance with regard to the factual transfer of ownership of assets and liabilities. Second, because it is unclear whether s 120 (6)(a) of the Companies Bill, 2007 should also apply where substantially all assets or undertaking in terms of s 116 of the Companies Bill, 2007 are disposed of.

**a) Application of s 120 (6)(a) of the Companies Bill, 2007 to certain transactions**

Section 120 is entitled '*implementation of amalgamation or merger*'. Notwithstanding the wording of the title, it would make little sense to apply s 120 (6) (a) of the Companies Bill, 2007 in '*mergers*' or '*amalgamations*' as defined in s 1 of the Companies Bill, 2007, as s 120 (5) of the Companies Bill, 2007 provides for specific provisions regulating the transfer of ownership and obligations by operation of law in a merger or amalgamation. That aside, the question arises whether s 120 (6)(a) of the Companies Bill, 2007 – applies to other transactions, despite the title of the section referring only to mergers and amalgamations. Section 120 (6) explicitly stipulates that it applies to any '*transaction contemplated in this Part*'. Proposals for scheme of arrangements<sup>264</sup> and proposals to dispose of substantially all assets or undertaking<sup>265</sup> form *part* of the provisions *referred to*. Because s 120 (6) (a) of the Companies Bill, 2007 is very similar to s 313 CA, it can be assumed that the former is applicable to effect the transfer of ownership under a scheme of arrangement in terms of s 118 Companies Bill, 2007. But it is unclear whether it is really the legislator's intention to make said subsection applicable to disposals of substantially all assets or undertaking in terms of s 116 Companies Bill, 2007. Should this in fact be the legislator's intention, it is suggested that the title of s 120 of the Companies Bill, 2007 be changed to, for example, '*implementation of fundamental transactions*'.

**b) Transfer in due form**

In terms of s 313 (1) (a) CA, the court may *make provision* for the transfer of the whole or any part of the undertaking, and of the property or liabilities of any transferor company, to the transferee. Where a court order in terms of s 313 (1)(a) CA provides for the transfer of property or liabilities, the property will vest in the transferee company by virtue of the order but *subject to transfer in due form*; liabilities, however, will become liabilities of the transferee company by virtue only of the order.<sup>266</sup> Thus the transfer of

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<sup>264</sup> s 118 Companies, Bill, 2007.

<sup>265</sup> s 116 Companies Bill, 2007.

<sup>266</sup> s 313 (2) CA.

immovable property requires registration of transfer of ownership in the Deeds Registry. If the property is an incorporeal right, cession thereof will be required to complete the change of ownership; and ownership of movables is transferred by delivery.<sup>267</sup> Section 120 of the Companies Bill, 2007 contains no provision similar to s 313 (2) CA stipulating that the transfer of property will be subject to transfer in *due form*. The wording '[...]' may apply to the court for an order to *effect* the transfer [...] in s 120 (6) (a) of the Companies Bill, 2007 seems to indicate a clear intention on the part of the legislator that ownership of the undertaking, the assets, and the liabilities shall be transferred with the court order alone. It follows that should s 120 (6) (a) of the Companies Bill, 2007 also apply to transactions in terms of s 116 Companies Bill, 2007 the main disadvantage of assets deals - namely, the transfer of every single asset in due form - would disappear. In any case, considerations of legal certainty suggest that a clause requiring the transferee to update property registries once the court order is binding on the parties, be included in s 120 of the Companies Bill, 2007.

**c) *Transfer of 'undertaking', 'assets' and 'liabilities'***

In terms of s 120 (6) (a) of the Companies Bill, 2007 the whole or any part of the *undertaking, assets and liabilities* of a company may be transferred by court order. The wording of s 313 (1) (a) CA is slightly different: here, the court may make provision for the transfer of the whole or any part of *the undertaking and of the property or liabilities*. Section 313 (4) CA specifies that the expression 'property' covers *property, rights and powers of every description*, and the expression 'liabilities' covers *duties*.<sup>268</sup>

Under the current CA the court order will operate only to transfer the rights, powers, duties and property which would be capable of being lawfully transferred by the parties if the section did not exist.<sup>269</sup> Thus, the court order in terms of s 313 (1) CA cannot transfer contracts which, by their terms, are non-transferable nor contracts for a personal service which at common law

<sup>267</sup> Blackman *Law of South Africa* at 87 n 6.

<sup>268</sup> s 313 (4) CA.

<sup>269</sup> *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] 3 All ER 549 at 555 with reference to s 154 of the English Companies Act 1929 (c 23).

could not have been transferred without the consent of both parties.<sup>270</sup> In terms of s 313 CA<sup>271</sup> liabilities are, however, transferable by court order. The reasons for the different approach regarding transferability of contracts and liabilities were explained in *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] 3 All ER 549 at 573, where Lord Porter held that, when sanctioning a scheme of arrangement, the court can assure itself that the assets of the transferor company are sufficient to answer liabilities already incurred. To discover whether that company can meet its future liabilities, however, would be a different and more difficult matter. From this, Lord Porter concluded that contracts which would not be transferable outside a scheme of arrangement are not transferable by court order.

As an exception, it would seem that s 197 of the Labour Relations Act is applicable whenever a business or the undertaking of a company is transferred under a scheme of arrangement in terms of s 311 – 313 CA.<sup>272</sup>

It seems to follow that the transfer of employment contracts by operation of law in terms of s 197 of the Labour Relations Act will also apply in the context of a transfer of business or undertaking under the Companies Bill, 2007.

Section 120 (6) (a) of the Companies Bill, 2007 explicitly provides for the transfer of liabilities. However, it is not clear whether contracts for a personal service, or contracts which by their terms are non-transferable, should be transferable by court order in terms of s 120 (6) (a) of the Companies Bill, 2007, as is possible under the SMA. It must be remembered, though, that the SMA does not require a court order, as ownership is transferred by operation of law upon registration of the transaction with the Commercial Registry. If contracts or liabilities are transferred under the SMA, the transferor is jointly and severally liable with the transferee for the liabilities, respectively the obligations under the transferred contract, for three

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<sup>270</sup> *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] 3 All ER 549 at 573 with reference to s 154 of the English Companies Act 1929 (c 23).

<sup>271</sup> see s 313 (2) CA.

<sup>272</sup> Blackman *Law of South Africa* at 87 n 8.

years after the transfer (art 75 SMA).<sup>273</sup> The provisions in the Companies Bill, 2007 regulating the transfer of assets, liabilities and obligations in mergers and amalgamations, provide for certain measures of creditor protection. Creditors of the amalgamating or merging companies must be given notice in writing about the intended merger or amalgamation, and they have a right to object.<sup>274</sup> Further, the merger or amalgamation is subject to the liquidity and solvency test.<sup>275</sup> Finally, the notice of amalgamation or merger to be filed with the Commissioner must include a statement that there are reasonable grounds for believing that no creditor will be prejudiced by the amalgamation or merger.<sup>276</sup> Comparable creditor protection provisions – which, presumably, also apply to contract parties whose contracts are transferred – are not to be found in s 118 of the Companies Bill, 2007 (scheme of arrangement), nor in s 116 of the Companies Bill, 2007 (disposal of substantially all assets or undertaking). Section 116 of the Companies Bill, 2007 does not mention creditors at all. Section 118 (2)(a)(i) of the Companies Bill, 2007, which deals with scheme of arrangements, requires a report by an independent expert who must, among other requirements, be qualified to '*[...] assess [the arrangement's] effect on the rights and interests of a shareholder or creditor of the company*'. Surprisingly, the effect on creditors' rights need not be included in the report, and the report need only be distributed to the shareholders, and not the creditors (see s 118 (3) of the Companies Bill, 2007). From this it is apparent that, in fact, s 118 of the Companies Bill, 2007 does not provide for creditor's protection either – at least, not in an effective way.

In terms of the current s 313 CA read with s 311 CA, the court must always approve a scheme of arrangement as such, as opposed to merely enforcing it. The court will only approve a scheme of arrangement if it is convinced that the transferee will be in a position to fulfil the liabilities to be

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<sup>273</sup> Regarding the joint and several liability under the SMA see V.2.3a).

<sup>274</sup> s 120 (2) Companies Bill, 2007.

<sup>275</sup> s 117 (1) and (4) Companies Bill, 2007.

<sup>276</sup> s 120 (1) (b) Companies Bill, 2007.

transferred. Thus, court approval is obtained before it comes to the enforcement of the scheme of arrangement.

Under the Companies Bill, 2007 a scheme of arrangement, or a proposal to dispose of substantially all assets or undertaking, always requires shareholder approval, while court approval is only required under certain circumstances.<sup>277</sup> Section 120 (6) (a) of the Companies Bill, 2007 seems to introduce a provision for the enforcement of a scheme of arrangements. The section may also provide for the enforcement of disposals of substantially all assets or undertaking which have been approved in terms of s 119 of the Companies Bill, 2007, if the section is found to apply to such transactions. Should such transactions not require court approval in terms of s 119 of the Companies Bill, 2007, a court would, in terms of s 120 (6) of that Bill, presumably have to ensure that the transferee has the financial powers to answer the liabilities to be transferred to it under an application in terms of s 120 (6)(a). It is, however, unsatisfactory that the court can only intervene when the transaction has reached enforcement stage. Although creditors do not seem to be provided any protection until it comes to the enforcement of the transaction (at least if no court approval in terms of s 119 of the Companies Bill, 2007 is required) – it is clear that the wording of s 120 (6) (a) of the Companies Bill, 2007 permits the transfer of liabilities by court order. The lack of creditor protection provisions, and the fact that ‘contracts’ are not explicitly mentioned in s 120 (6) (a) seems, however, to indicate that they are not transferable by court order. The considerations below will confirm this.

The transferability of contracts in a ‘transfer of assets and liabilities’ under the SMA is based on the difference between a transfer ‘of assets and liabilities’, and a merger or de-merger, being merely a quantitative one. Swiss law provides for the transfer of ownership by operation of law for all of these mechanisms, and for all assets and liabilities, including contracts.

First of all, the Companies Bill, 2007 does not allow a transfer of ownership by operation of law in the case of a scheme of arrangement, or a disposal of substantially all assets or liabilities. It reserves this mechanism for

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<sup>277</sup> see s 119 Companies Bill, 2007.

mergers and amalgamations. In the case of schemes of arrangement or disposals of substantially all assets or liabilities, ownership of assets can be transferred by a court order. The question remains, however, as to what will be considered an 'asset' in terms of s 120 (6)(a) of the Companies Bill, 2007. Unlike s 313 (4) CA, which specifies the wording of 'property' to include 'property' and 'rights', and powers and liabilities to include 'duties', s 120 (6) (a) of the Companies Bill, 2007 simply lists 'assets' and 'liabilities' without giving any further definition. This seems to indicate that it was not the legislator's intention to include more than was already transferable under s 313 CA. This view is supported by the fact that, in terms of s 120 (5) (b) of the Companies Bill, 2007 'each newly amalgamated or surviving merged company is liable for all of the *obligations* of every amalgamating or merged company'. On the other hand, s 120 (6) (a) of the Companies Bill, 2007 does not mention the fate of obligations at all.

All these arguments appear to indicate that the transfer of personal contracts, or contracts that are non-transferable by their terms, is not possible by court order in terms of s 120 (6) (a) of the Companies Bill, 2007. However, a clarification of the terms 'assets' and 'liabilities' would be desirable for reasons of legal certainty.

**d) *Detail of specification***

A court order in terms of s 313 (1) CA transfers all property and all liabilities of the transferor company that form part of the arrangement in terms of s 311 CA. It is not legally necessary that all the various properties and liabilities of the company be specified in schedules to the order.<sup>278</sup> In terms of s 313 (1) CA, either the whole of the undertaking or 'any part of the undertaking or the property of any company' may be the subject of the transfer. Where only a part of the undertaking is concerned, some kind of specification will be inevitable. The court order must at least indicate ownership of that part of the undertaking which is to be transferred. With regard to the degree of specification, the points made under IV.2.2b) with regard to the SMA can be applied here equally. Presumably the court

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<sup>278</sup> *Re "L" Hotel Co Ltd & Langham Hotel Co Ltd* (1946) 1 All ER 319 (Ch) at 320.

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application in terms of s 120 (6) of the Companies Bill, 2007 would need to contain the respective details, at least in cases where only a part of the undertaking or assets are to be transferred.

**e) *Transfer of single assets and liabilities***

As has been mentioned, the provisions regarding the ‘transfer of assets and liabilities’ of the SMA may be applied even when only particular assets or liabilities are alienated. On the other hand, s 120 (6) of the Companies Bill, 2007 operates only in the context of a transaction contained in Chapter 5 Part B of the Companies Bill, 2007. The danger of that section being abused for the purposes of transferring specific assets is minimal.

**f) *The possibility of transferring ownership the conventional way***

The wording ‘may apply to the Court’ in s 120 (6) of the Companies Bill, 2007 makes clear that the transfer of all assets and liabilities may be effected conventionally, that is: by transferring every asset according to title, and obtaining creditor consent for the transfer of encumbered assets. It has been mentioned that there is controversy in Switzerland as to whether the application of the provisions regarding the ‘transfer of assets and liabilities’ in the SMA should be mandatory in the case of major transactions.<sup>279</sup> The main concerns are that with a traditional transfer of assets and liabilities, Swiss shareholders do not need to be informed about the transaction at all, and they lose their right to object in terms of s 106 SMA. In South Africa, such disposals are subject to shareholder approval whether they are effected traditionally or in terms of s 120 (6) (a) of the Companies Bill, 2007; thus shareholder interests are not jeopardised either way.

## **6.2 *Implementation in practice***

Practical experience will clarify whether a disposal of substantially all assets and undertaking in terms of s 116 of the Companies Bill, 2007 can be effected under 120 (6) (a) Companies Bill, 2007. It will also show how often parties actually make use of this provision to effect the transfer of ownership of major parts of a company’s assets. The current s 313 (1) (a) CA is only

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<sup>279</sup> See comments under IV.5.

rarely used. A key reason for this might be that parties are unwilling to disclose to the court details of their transaction. Presumably companies might have reservations about applying to court to effect a transaction in terms of s 120 (6)(a) of the Companies Bill, 2007 for the same reasons. Last but not least, the wording of s 120 (6) of the Companies Bill, 2007 allows only the transferee, not the transferor, to apply for a court order. The former obviously has an interest in applying for the transfer of the assets. With regard to any liabilities, however, the situation might be different.

## **V. Creditor protection**

### **1 In South Africa**

#### **1.1 *Accountability for existing liabilities that are not transferred***

Existing creditors of both the transferor and the transferee could be prejudiced by a ‘transfer of assets and liabilities,’ as such transaction may impact on the liquidity and solvency of the transferor or the transferee, if not made at a fair consideration. The law provides for certain generic measures to protect creditors in such situations, irrespective of whether they occur in the context of a ‘transfer of assets and liabilities’.

##### **a) *Impeachable disposition***

In the case of the winding-up of a company unable to pay its debts, s 340 (1) CA brings a series of sections in the Insolvency Act<sup>280</sup> into application. These sections empower the trustee of an insolvent estate, or a creditor in the name of the trustee, to apply to court for an order setting aside certain dispositions. Thus, in addition to the liquidator being vested with the property belonging to the company at the time of winding-up, the liquidator or creditors have the means of recovering certain property alienated by the insolvent company before the winding-up.

The sections in the Insolvency Act in terms of which dispositions may be set aside are s 26 (dispositions without value), s 29 (voidable preference), s 30 (undue preference), s 31 (collusive dealings before sequestration) and s

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<sup>280</sup> Act 24 of 1936.

34, which in certain circumstances renders void the transfer of a business by a trader. The last-mentioned section will be discussed in more detail in the next paragraph. Section 340 (1) CA also makes the common law principle entitling a creditor to attack alienations in fraud of creditors, applicable in a winding-up.<sup>281</sup>

Except for s 34 of the Insolvency Act, these provisions provide creditors only with retroactive defences and only in the case of the winding-up of companies. One needs, however, to bear in mind that as of today in South Africa, there are no specific rules for the transfer of 'assets and liabilities,' or for the whole or part of an undertaking. It follows that there is no need for specific creditor protection provisions in such situations. Thus, the measures outlined are simply those that are generally applicable to any disposition by a company.

**b) *Special protection for creditors of traders in terms of s 34 of the Insolvency Act***

In terms of s 34 (1) of the Insolvency Act read together with s 340 CA, where a company that qualifies as trader, without giving notice contractually transfers a business belonging to it, or its goodwill, or any goods or property forming part of it – except in the ordinary course of that business or for securing the payment of a debt – the transfer is *void* as against its creditors for six month thereafter, and is also void against its liquidator if the company is wound-up at any time within that period.

The notice that is required is the publication of notice of an intended transfer in the *Government Gazette* and two issues of an Afrikaans newspaper and two issues of an English newspaper, circulating in the district in which that business is carried on.<sup>282</sup> The publication must appear not less than 30 days and not more than 60 days before the date of the transfer.<sup>283</sup>

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<sup>281</sup> Sharrock at 129.

<sup>282</sup> s 34 (1) of the Insolvency Act.

<sup>283</sup> s 34 (1) of the Insolvency Act.

If such notice was published, every liquidated liability of the trader in connection with his business, which would fall due at some future date, falls due immediately, if a creditor demands payment.<sup>284</sup>

The section is clearly designed to protect creditors.<sup>285</sup> It aims to prevent traders from seeking to evade their business debts by disposing of the business to a third party who is not liable for their debts, and thereafter dissipating the price paid or using it to pay some creditors, regardless of the claims of others.<sup>286</sup>

Given what is outlined above, s 34 of the Insolvency Act applies only where:

- The party which contractually transfers assets, qualifies as a ‘trader’ as defined in s 2 of the Insolvency Act; and
- The assets can be construed as forming part of the trader’s business; and
- The disposal did not occur in the ordinary course of that business or for securing the payment of a debt.

These three issues will be discussed below.

The definition of ‘trader’ in s 2 of the Insolvency Act is very long and includes, inter alia, any person who carries on any trade, business, industry, or undertaking in which property is sold, or in which property is bought, exchanged, or manufactured for purpose of sale or exchange.<sup>287</sup> In terms of this definition a company does not qualify as a ‘trader’ simply because it carries on any business or undertaking at all.<sup>288</sup> In order to fall within the

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<sup>284</sup> s 34 (2) of the Insolvency Act.

<sup>285</sup> *Harrismith Board of Executors v Odendaal* 1923 SA 530 (AD) at 538 with reference to s 33 (1) of the repealed Companies Act 32 of 1916.

<sup>286</sup> *Harrismith Board of Executors v Odendaal* 1923 SA 530 (AD) at 538 with reference to s 33 (1) of the repealed Companies Act 32 of 1916.

<sup>287</sup> Sharrock at 141.

<sup>288</sup> Alastair Smith ‘Traders and their primary and incidental businesses’ (2006)14/4 *JBL* 180 at 182 with reference to *McCarthy Ltd v Gore NO* [2007] SCA 32 RSA (SCA 28 March 2007 (case no 163/06) unreported).

ambit of the definition, the trade must be such as to fall into one of the specified categories.<sup>289</sup>

The 'trade' activity needs to be the *main* business for the section to apply.<sup>290</sup> Taking into account every incidental business of a trader would result in every company or person maintaining a business or undertaking falling within the definition of 'trader'; at least if that business had to buy or sell goods at some stage. The Supreme Court of Appeal held in *McCarthy Ltd v Gore NO* [2007] SCA 32 RSA (SCA 28 March 2007 (case no 163/06) unreported)<sup>291</sup> that the purpose of the definition of 'trader' was actually to identify those types of trade, business, industry or undertaking which, by reason of the fact that they engage in specified activities, attract the obligations of traders in terms of the Insolvency Act. This statement makes sense in view of the definition of 'trader' in s 2 of the Insolvency Act. However, it is hard to see why creditors of 'traders' as defined should have measures available to them that creditors of other types of businesses do not have. As the purpose of s 34 of the Insolvency Act is to protect creditors from people or companies carrying on a business from disposing of their business assets, it is difficult to see why the distinction was made.<sup>292</sup> Section 2 of the Insolvency Act should be adjusted so as to dissolve this distinction.

The next step is to identify whether the assets transferred form part of the trader's business. This question can be difficult to answer if the 'trader' is a private person.<sup>293</sup> The trustee will bear the onus of proving that the relevant assets belong to the trader's business and not to their private estate.<sup>294</sup> A different question arises if the 'trader' qualifies as a company in terms of s 1 of the CA. Does s 34 of the Insolvency Act apply whenever a

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<sup>289</sup> *Kevin & Lasia Property Investments CC and another v Roos NO and others* (2004) 1 SA 380 (SCA) at 384.

<sup>290</sup> The Cape High Court was mistaken in *Gore NO v McCarthy Ltd* 2006 (3) SA 229 (C) 237 widening the meaning of 'trader' to companies activities incidental to the core business of a company.

<sup>291</sup> Reference from Alastair Smith 'Traders and their primary and incidental businesses' (2006)14/4 *JBL* 180 at 182.

<sup>292</sup> Assenting Smith at 144.

<sup>293</sup> See for example *Paterson v Kelvin Park Properties CC* [1998] 1 All SA 22 (E) at 31.

<sup>294</sup> *Joosab v Ensor NO* 1966 (1) SA 319 (A) 324.

company transfers any assets, no matter in what relation such assets stand to the company's business activity? It is unlikely to have been the legislator's intention that a company qualifying as a 'trader' is required to give notice whenever it disposes of any of its assets. For example, if a company specialises exclusively in the sale of auto parts and owns an immovable property that is not used for the sales activities at all, the immovable property cannot be considered to form part of the business assets in terms of s 34 of the Insolvency Act. This can also be concluded from the fact that s 34 of the Insolvency Act applies even if the disposal was an advantageous one, for instance at a price in excess of the value of the assets.<sup>295</sup> The Appeal Court has held that creditors may be prejudiced even where the business or its assets are advantageously disposed of.<sup>296</sup> Arguably this is only the case if business assets in the narrow sense of the word are disposed of. An advantageous disposition of the immovable property in the example would not prejudice creditors at all.

Section 34 of the Insolvency Act does not apply if the transfer of goods or property is in 'the ordinary course of *that* business'. The question is whether such a transaction would normally have been concluded by a solvent business person conducting a business of the kind carried on by the 'trader'.<sup>297</sup> Thus, regard must be had to what would be done by similar businesses in similar circumstances.

The section may be too rigorous in requiring that notice needs to be given if any property or goods forming part of the business are alienated. Some dispositions will be excluded under the 'ordinary course of that business' rule. As long as the trader's business is not an empty shell and they still can operate it and generate income, such dispositions should be possible without giving notice. An approach similar to that taken in the context of dispositions requiring shareholder approval would be adequate here. Then, s 34 of the Insolvency Act would apply whenever the trader disposes of 50 per cent or more of its assets, unless this occurs in the

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<sup>295</sup> Sharrock at 141 with reference to *Joosab v Ensor* NO 1966 (1) SA 319 (A) 326-327.

<sup>296</sup> *Joosab v Ensor* NO 1966 (1) SA 319 (A) 326 – 327.

<sup>297</sup> *Joosab v Ensor* NO 1966 (1) SA 319 (A) 326 – 327.

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ordinary course of business, or if the disposition *fundamentally changes or destroys the trader's business*.

However, the protection that s 34 of the Insolvency Act affords creditors is not to be overestimated. The section does offer creditors recourse where the company disposing of assets is in fact wound-up within six months of the disposition, and the required notice was never published. But unless it is common knowledge that a company is insolvent, a creditor will most probably not notice a publication made in terms of the section and thus, it may not be of much value to them.

**c) *Winding up under s 344 CA***

An alienation of assets where no appropriate consideration is paid in return may lead to circumstances in which the company is wound up by the court. Section 344 (e) CA provides that a company may be wound up by the court if seventy-five per cent of the issued share capital of the company has been lost or has become useless for the business of the company, and s 344 (f) CA states that a company may be wound up if it is unable to pay its debts as described in s 345 CA.

The danger of being wound-up as a result of a disposal of assets or the whole or part of an undertaking, may have a preventative effect.

**1.2 *Accountability for existing liabilities that are transferred***

Under common law the transfer of liabilities requires the consent of the creditor. Further protection is not required. If the creditor does not want the liability to be transferred he simply refuses his consent.

As has been explained above under IV.6.1c), there are no provisions for creditor protection where a transfer of liabilities is effected in terms of s 120 (6) (a) of the Companies Bill, 2007. If liabilities are to be transferred, however, the court will have a duty to ascertain whether the transferee is in a position to fulfil its obligations under the transferred liabilities.<sup>298</sup> Generally,

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<sup>298</sup> *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] 3 All ER 549 at 573.

the provisions about impeachable dispositions do not apply when the alienation was made in compliance with a court order.<sup>299</sup>

## 2 In Switzerland

### 2.1 *Capital protection, liquidation provisions and impeachable dispositions*

There are three measures to protect creditors of a company in general. They are applicable irrespective of whether a 'transfer of assets and liabilities' takes place.

The SMA explicitly refers to the first two: the 'transfer of assets and liabilities' may only be implemented if the provisions on *protection of a company's capital* and on *liquidation of companies* are adhered to.<sup>300</sup> Unlike in South Africa, in Switzerland the capital maintenance rule remains applicable.

The reservation regarding the capital protection provisions depends on the adequacy of the compensation to be paid for the 'transfer of the assets and liabilities'.<sup>301</sup> The 'transfer of assets and liabilities' for no consideration, or for a consideration that is not appropriate, may be an infringement of the capital protection requirements.<sup>302</sup> If directors effect such a transaction, they risk being held criminally liable for disloyal management ('ungetreue Geschäftsbesorgung') in terms of art 158 of the Swiss Penal Code.<sup>303</sup>

If the 'transfer of assets and liabilities' amounts to a liquidation act, the provisions on liquidation must be observed. Again, this may be the case where the transferee does not pay any consideration, or pays one that does not correspond with the value of the transferred assets and liabilities.<sup>304</sup>

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<sup>299</sup> Sharrock at 128.

<sup>300</sup> art 69 Abs. 2 SMA.

<sup>301</sup> Schumacher at 39.

<sup>302</sup> For example articles 675, 678, 680, 725f and 732f SCO.

<sup>303</sup> Schweizerisches Strafgesetzbuch vom 21. Dezember 1937; SR 311.0.

<sup>304</sup> Schumacher at 41.

Finally, in the event of the company being wound-up, a ‘transfer of assets and liabilities’ may under certain circumstances qualify as an ‘impeachable disposition’ in terms of articles 285 -292 Swiss Insolvency Act,<sup>305</sup> and be set aside by court order. Articles 285 - 292 Swiss Insolvency Act are very similar to the provisions about impeachable dispositions in the South African Insolvency Act.

Below follows an analysis of whether there are specific provisions for creditor protection in the context of a ‘transfer of assets and liabilities’ in terms of the SMA.

## **2.2 Accountability for existing liabilities which are not transferred**

### **a) Accountability of the transferor**

The creditors of the selling company are not affected by a ‘transfer of assets and liabilities’ if the selling company gets an appropriate consideration in return. Thus, it is a neutral process.<sup>306</sup> However, there are cases where the process is not neutral. If the selling company values the assets lower, and the liabilities higher, than the buying company does, a profit results.<sup>307</sup> In the opposite scenario a loss may occur. This scenario needs to be distinguished from circumstances where the consideration for the assets and liabilities is not adequate, or where no consideration is paid at all. A ‘transfer of assets and liabilities’ in which a loss occurs may well impact existing creditors of the selling company.<sup>308</sup> No specific measures to protect creditors under such circumstances are to be found in the SMA.<sup>309</sup> There is no provision equivalent to s 34 of the South African Insolvency Act. Thus, the only protection available to creditors are the provisions about capital protection, liquidation and impeachable dispositions, discussed under V.2.1 above.

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<sup>305</sup> Bundesgesetz vom 11. April 1989 über Schuldbetreibung und Konkurs; SR 281.1

<sup>306</sup> Schumacher at 182.

<sup>307</sup> Büchi at 149 fn 968.

<sup>308</sup> Loser-Krogh at 1105

<sup>309</sup> In terms of articles 46 f of the SMA creditors from de-merging companies have the right to demand that their claims be secured before the de-merger takes effect.

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**b) Accountability of the transferee**

The transferee company's creditors may be prejudiced if the consideration payable by the transferee company is higher than the value of the assets and liabilities transferred. Again, the SMA does not provide provisions to protect these creditors.

According to the legislator's memorandum to the SMA,<sup>310</sup> the transferee company's creditors are protected by art 71 II SMA, which states that the 'transfer of assets and liabilities' is not permitted unless the inventory shows a surplus of net assets. However, as there are no provisions dictating the amount of the consideration to be paid for the assets and liabilities to be transferred, the said prohibition cannot prevent the transferee company from paying an excessive consideration.<sup>311</sup> The prohibition in terms of art 71 II SMA is thus not effective.<sup>312</sup> Again, the provisions about capital protection, liquidation and impeachable dispositions are the only protections with which such creditors are provided.<sup>313</sup>

**2.3 Accountability for existing liabilities that are transferred****a) Accountability of the transferor company**

Upon registration with the Commercial Registry, all inventoried liabilities are transferred to the transferee company by operation of law. In terms of art 75 SMA, the transferor company is jointly and severally liable with the transferee company for such liabilities. With this measure, the interests of creditors are protected. Their situation should not change for the worse because of the transfer of their liabilities. The condition precedent for the joint and several liability is that the liability must have existed before the 'transfer of assets and liabilities' took effect. The 'transfer of assets and liabilities' becomes legally effective upon registration with the Commercial Registry.<sup>314</sup>

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<sup>310</sup> Memorandum SMA at 4363.

<sup>311</sup> Von der Crone *MSA* at 364.

<sup>312</sup> Loser-Krogh at 1105.

<sup>313</sup> Schumacher at 184.

<sup>314</sup> art 73 II SMA.

The due date of the transferred liabilities is irrelevant.<sup>315</sup> It may lie before or after the coming into effect of the ‘transfer of assets and liabilities’.

The joint and several liability of the transferor company endures for three years.<sup>316</sup> For liabilities having a due date before the publication of the transfer of assets and liabilities in the *commercial gazette*, the prescription period of three years starts to run at the date of the publication.<sup>317</sup> For liabilities due only after the ‘transfer of assets and liabilities’ has been published, prescription starts to run with their due date.<sup>318</sup> After this three year prescription period has expired, the transferor company ceases to be liable. Creditors may then demand fulfilment from the transferee company alone.

Under certain preconditions, art 75 III SMA provides for the securing of claims by the parties involved in the ‘transfer of assets and liabilities’. First, a creditor can demand that their claim be secured if the joint and several liability ceases before the expiration of the three year prescription period.<sup>319</sup> This could occur where one of the companies involved in the transfer of assets and liabilities is wound up before the three years have expired.<sup>320</sup>

Second, creditors can demand that their claims be secured if they show *prima facie* evidence that joint and several liability does not provide sufficient protection.<sup>321</sup> Whether the joint and several liability is sufficient in order to protect creditor interests depends mainly on the financial situations of the transferor and transferee companies after the ‘transfer of assets and liabilities’ has taken place. The creditor protection may not be sufficient where no appropriate consideration is paid for the ‘transfer of assets and liabilities’, with the result that the transferor, as the original debtor, is financially weakened. This is exacerbated where the new debtor is less

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<sup>315</sup> See art 75 II SMA second sentence.

<sup>316</sup> art 75 I SMA.

<sup>317</sup> art 75 II SMA.

<sup>318</sup> art 75 II SMA.

<sup>319</sup> art 75 III lit a SMA.

<sup>320</sup> Memorandum SMA at 4467.

<sup>321</sup> art 75 III lit b SMA.

solvent than the old debtor, or is over-indebted from the beginning.<sup>322</sup> It is for the creditors to show that the joint and several liability does not provide them with enough security. However, no strict proof is required; it is enough that they can plausibly explain the necessity of securing their claims.<sup>323</sup>

**b) *Accountability of the transferee company***

Upon registration of the ‘transfer of assets and liabilities’ in the Commercial Registry, the transferee company becomes the new debtor under the transferred liabilities. The transferee company remains liable if the transferor is released from the joint and several liability for any reason.<sup>324</sup>

## **VI. Conclusion**

As a major transfer of assets and liabilities may – at least from an economic point of view – have an impact similar to that of a merger, demerger or transformation, it is clear that shareholders need to approve such transactions. This is consistent with the general principle that directors may make management decisions, while investment decisions lie with the general meeting. Shareholder approval is required under US, Canadian and the current South African Law, and neither the Corporate Laws Amendment Act, 2006 nor the Companies Bill, 2007 will alter the South African position. The Swiss legislator does not differentiate between the transfer of individual assets, and the transfer of the whole of an undertaking or part thereof. Under Swiss law, the power to effect a ‘transfer of assets and liabilities’ always lies with the directors. Shareholder approval may be required only as an exception under certain circumstances. If the ‘transfer of assets and liabilities’ requires a change of the company’s object clause, for instance, or is an act to dissolve the company, shareholder approval may be required. Likewise, if the directors have conflicting interests, or if the directors are prevented from acting in terms of the Swiss Securities Trading Act, shareholder approval is required. The failure to differentiate between the transfer of individual assets, and the transfer of the whole of an undertaking or part thereof is problematic.

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<sup>322</sup> Loser-Krogh at 1105.

<sup>323</sup> Schumacher at 188.

<sup>324</sup> Schumacher at 190.

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With regard to Switzerland, the SMA should be amended to make shareholder approval a requirement for a major 'transfer of assets and liabilities'. With the introduction of a shareholder approval requirement, the Commercial Registry would be in a position to dismiss the application for registration of a 'transfer of assets and liabilities' if the required resolution of the general meeting was not attached thereto. As has been explained, this would put an end to the discussion about the effectiveness of 'disposals of assets and liabilities' that were registered in the Commercial Registry although the directors – as an exception lacked the authority to make such dispositions.

The wording of today's s 228 CA requires improvement. The formulation in the Corporate Laws Amendment Act, 2006 does not, apart from the provisions dealing with valuation of assets, ameliorate the situation. Nor does the prospective Companies Bill, 2007 provide the necessary guidance and parameters. The argument has been made that the provision regarding cases where shareholder approval is required ought to be made clearer and more specific, for the purposes of legal certainty. The latter is imperative for the protection of all involved parties. Statutes should stipulate which parameter ought to apply to value the assets and liabilities, and fix a threshold of 50 per cent. Shareholder approval would then be required whenever the assets disposed of amount to more than 50 per cent of the total business assets, unless the disposal occurs in the ordinary day-to-day business. It is clear that a purely quantitative approach, standing alone, does not achieve the purpose of protecting shareholders from a disposal that impacts heavily on a company's business. Thus, there is a need for the introduction of a qualitative element. Statutes should explicitly state that shareholder approval is required should the transaction '*leave the corporation without a significant continuing business activity*', even where the quantitative threshold of 50 per cent is not triggered.

For reasons of minority shareholders' protection, a quorum of two thirds of the votes would be appropriate. The Corporate Law Amendment Act, 2006 will introduce a special resolution requirement. Minority shareholders will be provided with an even better safeguard with the coming into effect of the Companies Bill, 2007.

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It has been noted that a disposition in terms of s 228 CA falls within the definition of an 'affected transaction' in terms of s 440A CA, and is thus subject to the SRP-Code. This is potentially problematic. A transaction in terms of s 228 CA is extraneous to the other matters regulated in the SRP-Code. However, as the law stands today an application of the SRP-Code is prevented because of the unfortunate definition of 'offeree company' in section A (3) of the SRP-Code. The stated objective - minority shareholder protection - can be achieved otherwise, and the prospective changes in the Corporate Laws Amendment Act, 2006 and the Companies Bill, 2007 will provide this protection. In view of these modifications, the treatment of such disposals as 'affected transactions' is no longer appropriate.

With the coming into effect of the Corporate Laws Amendment Act, 2006 a special resolution requirement with regard to shareholder approval will be introduced. This will put an end to the controversy surrounding the applicability of the Turquand rule to protect third parties contracting for a disposal of major parts of the assets or undertaking. As a special resolution is a public document, the third party will have to assure themselves that the required shareholder approval was obtained. However, unless the third party has access to the financial information of the transferor, it will be difficult for them to evaluate whether the transaction requires shareholder approval or not. Although a clearer shareholder-approval provision with a parameter and a threshold would be a step in the right direction, it would not solve the third party's dilemma. Under the Companies Bill, 2007 the doctrine of public notice will be abolished and a company may not *effect* the transaction unless the required approval was obtained. So, third parties are advised to include a condition precedent in the sales contract providing for the passing of a shareholder resolution by the transferor.

The Swiss mechanism of 'transfers of assets and liabilities' provides an efficient and rather simple instrument to effect asset deals of any size. It provides for the transfer by operation of law of all kinds of assets and liabilities, including contracts. As a general rule, neither the other contracting party nor creditors have a right to object to the transfer. Contracting parties and creditors under existing liabilities which are transferred are, however, protected by the joint and several liability of the transferor and the transferee,

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as well as by the possibility of securing their claims under certain circumstances. Although the SMA provides that the transferred assets must exceed the transferred liabilities, this is inadequate protection for the transferee company, because whether the transferee and its creditors will be prejudiced depends on the amount of the consideration paid. Thus, the introduction of a provision stating that an appropriate consideration is to be paid, is to be desired.

Whether s 120 (6)(a) of the Companies Bill, 2007 applies for the transfer of ownership if substantially all assets or undertaking in terms of s 116 of the Companies Bill, 2007 are disposed of, is unclear. The title of s 120 of the Companies Bill, 2007 ('implementation of amalgamation or merger') is confusing, especially as s 120 (6) explicitly refers to *transactions in this Part* and both 'scheme of arrangements' and 'disposals of substantially all assets or undertaking' are part of the sections referred to. Further uncertainties result from the fact that neither a disposal of substantially all assets or undertaking, nor a scheme of arrangements necessarily requires court approval. Thus, creditors under liabilities to be transferred are only protected when it comes to giving effect to the transaction. Further, only the transferee can apply to the court to effect the transfer of liabilities. The transferee will, however, seldom have an interest in effecting the transfer of liabilities, at least not where they are to be transferred to it.

In practice 'transfers of assets and liabilities' are not effected under the provisions of the SMA too often, because the process makes quite detailed information about the transaction accessible to the public. To remedy this, the SMA should be changed so that the data accessible to the public is less extensive.

Considering that South Africa's section 313 (1) (a) CA is hardly ever applied, it is questionable how often s 120 (6) (a) of the Companies Bill, 2007 will be used to effect a transfer of assets and liabilities, should it be applicable for the transactions in terms of s 116 Companies Bill, 2007 at all. It is to be supposed that parties would be reluctant to disclose their transactions to the court too often.

Except for s 34 of the Insolvency Act, which is only applicable where a debtor qualifies as 'trader' as defined therein, there are no provisions to directly protect existing creditors in the case of a transfer of assets and liabilities. Such a disposition may, however, render applicable the provisions on impeachable disposition and the winding-up of a company.

It is not appropriate that only creditors of 'traders' as defined are provided with the protection of s 34 of the Insolvency Act, as opposed to creditors of other business people.

However, the protection is not to be overestimated, as it is unlikely that a trader's creditors would even notice the publication that is required in terms of said section. It must be borne in mind that s 34 of the Insolvency Act is usually not applicable where the transfer of ownership of assets and liabilities occurs by court order.

Finally, creditors are not endangered as long as the parties to the transaction are still solvent. The provisions on winding-up may prevent transactions that would lead to the insolvency of one of the companies concerned. In addition, the provisions on impeachable dispositions provide for the setting aside of a disposition in the case of a winding-up of a company.

Baden, September 13, 2007

Sarah Kocher

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