

# Corporate & Commercial

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## When and how to use a 'ring fenced' company in B-BBEE transactions and contract mining arrangements to protect your investment

Why would an investor, shareholder or mining right holder insist on using a 'ring fenced' company? In this alert we unpack what a ring-fenced company is under the Companies Act 71 of 2008 (Companies Act) and why the use of a ring-fenced company can be an additional mechanism to protect funding and investments.

Why would an investor, shareholder or mining right holder insist on using a 'ring fenced' company? In this alert we unpack what a ring-fenced company is under the Companies Act 71 of 2008 (Companies Act) and why the use of a ring-fenced company can be an additional mechanism to protect funding and investments.

Ensuring that a company and its shareholders comply with the Broad-Based Black Economic Empowerment Act 53 of 2003 (B-BBEE Act) in a B-BBEE transaction is always a concern.

Additionally, a mining right holder may question whether the contractor appointed in terms of the Mineral and Petroleum Resources Development Act 28 of 2002 will fail to meet its obligations and adversely affect its production targets.

In addition to using other forms of security (such as guarantees, cession and pledges and/or special or general notarial bonds), an added layer of protection to consider as a condition to a transaction, is for the counter party to amend its memorandum of incorporation (MOI) to include restrictive conditions (examples of which are below).

### **B-BBEE transactions**

In B-BBEE transactions, a shareholder or investor may want to ensure that the counter party:

- remains 100% Black (as contemplated in terms of the B-BBEE Act) for so long as it is a shareholder within the group of companies;
- does not pass any resolutions to dispose of any of its shares without written consent; and/or
- only disposes of its shares to another B-BBEE company.

### **Contract mining arrangements**

In contract mining arrangements, a mining right holder may want to ensure that the contract mining company it appoints does not:

- change its main business (of contract mining) without consent;
- sell any key or critical equipment or machinery required to perform its obligations; or
- distribute all or a portion of its capital, by means of dividends and/or loans (which could prevent it from performing its obligations, being solvent and/or paying its employees etc.).

By adding a condition to a transaction that the counter party's MOI must be amended to restrict any of the above example activities (in that the shareholder/investor's or right holder's written consent would be required to do so), it can add another means to protect the relevant investment and ensure that any third party who deals with the relevant company is aware of these restrictions.

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# When and how to use a 'ring fenced' company in B-BBEE transactions and contract mining arrangements to protect your investment

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## What is a 'ring fenced' company?

Should any of the above restrictions be incorporated into the MOI of any company, the company's name would need to include the elements "RF" in terms of the Companies Act.

If a company's name includes the elements "RF", it would mean that the company's MOI either (i) contains a restrictive condition(s) applicable to the company (which cannot be amended without adhering to certain additional conditions) or (ii) prohibits the amendment of the MOI as contemplated in terms of sections 15(2)(b) and/or 15(2)(c) of the Companies Act.

The abovementioned restrictive conditions or prohibitions (restrictive conditions) in a company's MOI are referred to as "ring fencing" provisions in explanatory notes published by the Companies and Intellectual Property Commission.

Practically, instead of the company being referred to as "ABC Proprietary Limited", the company's name would be referred to with the additional elements "RF", so "ABC (RF) Proprietary Limited".

## Why use a 'ring fenced' company?

In terms of section 19(5)(a) of the Companies Act, if a company's name includes the element "RF", any person (including, a juristic person, foreign company and/or trust) must be regarded as having notice and knowledge of the restrictive conditions in the company's MOI.

Accordingly, by insisting that these restrictive conditions are incorporated in a counter-party's MOI, it will, *inter alia*:

- alert any third party to the restrictive conditions, should the company attempt to enter into a transaction in contravention of these conditions (for example, should the company attempt to dispose of its shares in the B-BBEE transaction example above, or sell its equipment or machinery in the contract mining example above, without the required consent); and
- allow directors, shareholders or prescribed officers to apply to the High Court to restrain the company or directors from doing anything inconsistent with the restrictive conditions.

As stated earlier, the use of a ring-fenced company is an added layer of protection to consider as a condition to your next transaction.

**Carmen Mckinlay and Chané Stievenart**



## New legislative developments under the Movable Property Security Rights (Amendment) Bill, 2024

The Movable Property Security Rights (Amendment) Bill, 2024 (Bill) proposes to make amendments to various statutes to harmonise laws relating to security over movable property, including the Movable Property Security Rights Act, Cap 499A Laws of Kenya (MPSRA) and the Companies Act, Cap 486 Laws of Kenya (Companies Act). The Bill also proposes to repeal the Hire Purchase Act, Cap 507 Laws of Kenya (HPA). In this alert, we consider some of the proposed amendments under the Bill.

### Expanded scope of hire purchase business

Notably, the Bill defines a hire purchase agreement to include a sale and loan agreement under which the whole or part of the purchase price is financed by the seller or by a third party that is engaged in the business of lending money.

The HPA excludes certain types of agreements and entities from its application, but under the Bill there are no monetary exceptions and, as presently drafted, all persons engaged in hire purchase business must be licensed.

It would be useful if the Bill excluded from registration those financial institutions already licensed by the Central Bank of Kenya (CBK) to mitigate bureaucracy and potential duplication.

### Registration to carry on hire purchase business

The HPA currently requires any person carrying on hire purchase business to obtain a valid licence and the Bill provides for a transition of hire purchase licences issued under the HPA. If the Bill is passed into law, persons intending to carry on hire purchase business will be required to make an application to the registrar under the MPSRA (Registrar) and some of the considerations the Registrar will take into consideration include (i) the applicant's financial condition and history, (ii) the character of the applicant's management and (iii) the professional and moral suitability of the applicant's management.

In contrast, the current considerations under the HPA include the applicant's financial condition and the manner in which the applicant has conducted any hire purchase business (currently or in the past). Under the Bill, the Registrar will need to be satisfied of not only the soundness of the business but also the people in control of the business. The test or standards to be applied by the Registrar in this regard are, however, not specified.

The Registrar may, upon review of the application, grant the licence with or without conditions or refuse to grant the licence. Regrettably, the Bill does not provide for a mechanism for appeal of the Registrar's decision to refuse to grant a licence.

# New legislative developments under the Movable Property Security Rights (Amendment) Bill, 2024

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## Interest rates for hire purchase agreements

The Bill provides that the CBK shall determine the interest rates for the hire purchase of goods under hire purchase agreements. It is not clear whether the CBK will be assessing the interest rates set by hire purchase businesses or will prescribe a particular interest rate, but constrained interest rate change procedures will likely make the business of hire purchase cumbersome and less attractive.

## Repossession of goods sold under hire purchase

Under the HPA, where a buyer has paid more than two thirds of the purchase price, the seller can only repossess the goods after obtaining a court order. With the proposed repeal of the HPA, the Bill does not contain a similar provision and it appears that there will be no prescribed restrictions on repossession upon default.

## Registration of charges created by companies under the Companies Act

Section 878 of the Companies Act requires certain charges created by a company or over a company's property to be registered at the Companies Registry. There has been confusion regarding the necessity to register movable security over assets such as book debts under both the Companies Act and the MPSRA. The Bill proposes to clarify this by specifically, among others, excluding book debts from the charges to which the Companies Act applies.

## Compulsory registration of amendment/cancellation notice by the Registrar

The Bill proposes to amend the MPSRA to allow a borrower that gave security to request the Registrar to intervene and have the security registration notice cancelled, for instance where the security right has been extinguished. It is not uncommon to have secured creditors that have failed to cancel registration notices by failing to prioritise or through loss of credentials to the portal and this proposed change will be a welcome relief to borrowers. The Registrar will give notice to the secured creditor before cancelling the registration.

## Conclusion

If passed into law, the Bill will be a significant milestone in the effective regulation of transactions involving creation of security over movable property as well as hire purchase businesses.

**Sammy Ndolo and Damaris Muia**

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**BBBEE STATUS:** LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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