



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

IZAK CRONJE
21294195
MND 802
CAPITAL AND CAPITAL MAINTENANCE
RULES UNDER THE COMPANIES ACT, ACT 61
OF 1973 AND THE COMPANIES ACT, ACT 71
OF 2008

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1. INTRODUCTION

The Companies Act 61 of 1973 applies to every company incorporated under the Act¹, as well as to every external company with a place of business in South Africa and to every company that was a company in terms of any Act repealed on the commencement of the Companies Act. The Act however is not a complete codification of the law applicable to the companies regulated by it and common-law principles form the wider backdrop. It is fair to say however that this Act is outdated. The current Act contains very little on corporate governance, transparency, accountability, modern merger methods and minority shareholders protection.

The first Companies Act in South Africa was modeled very closely on existing English law. The Companies Act 61 of 1973, which came into operation following the report of the Van Wyk de Vries Commission, marked a clear divergence from the English law. However, some of the old English doctrines are still to be found in our law despite having since been abolished or watered down in the English law, where they originated².

Some of the above however, will change when the new Companies Act 71 of 2008 will be incorporated into our law. This Act was signed on 9 April 2009 and will be incorporated into the South African law upon proclamation³. Some of these interesting changes for example is that the Turquand rule is now incorporated into our legislation⁴, the doctrine of constructive notice has “mysteriously” disappeared and the company will only be protected in this regard if it was ring fenced in its memorandum of incorporation.

South Africa’s new Companies Act, 71 of 2008, which is expected to come into operation on 1 July 2010, brings changes which will affect every existing company, its directors,

¹ That is until the new Act, Act 71 of 2008, is incorporated

² For example, the doctrine of constructive notice and the Turquand rule

³ Section 225 of the Companies Act 71 of 2008

⁴ Section 20(7) of the Companies Act 71 of 2008

and shareholders. The new Act is the most important company law development since 1973. It will replace the current Companies Act 61 of 1973, and amends the Close Corporation Act No 69 of 1984. Amongst the most significant changes is that close corporations will cease to exist as a new form of enterprise.

New types of Companies under the Act include the Non Profit Company(NPC), the Ring fenced(RF) and the State Owned Company(SOC). The duties of directors are extensively regulated under the New Act. The Act gives more extensive rights to shareholders in respect of meetings and governance of companies. These rights will not only enhance the control of shareholders over management but will also place management under the spotlight in the execution of their duties. These principles are, therefore, of great importance not only for shareholders but also for management.

The problems with the present section 38⁵ have been rectified in the new Act, but the ambit of the new section 44, and also the other corporate capital provisions, such as in respect of distributions(dividends) and loans to companies in a group, are much wider. It is also now possible to issue shares if full consideration has not been received by the company⁶. These rules are also subject to amendment by the company and a proper analysis of these rules will help to make the financing of the company less complicated. Instead of the Memorandum and Articles of Association, a company's constitutional documents have been consolidated into one document, the Memorandum of Incorporation. This document sets out the rights, duties and responsibilities of shareholders, directors and others in relation to the company.

The compulsory reservation of company names falls away. If the name in the Notice of Incorporation is the same as that of a registered company, or reserved name, the Commissioner may use the registration number as the company name in the interim. Reservation of a name prior to registration is allowed, but is not compulsory. If the company does not respond, the registration number becomes the company name.

⁵ The financial assistance to people to acquire shares

⁶ And also for work to be performed for the company

One of the main advantages of companies, particularly public companies, is that they make it easier for an enterprise to raise large amounts of capital from investors. The need for large amounts of capital played an important role in the early development of company law⁷. However, the ability to obtain a large capital is not important in every enterprise and many companies operate successfully with very little capital. The capital of a company usually consists of two kinds of capital, namely share capital⁸ and loan capital⁹.

Share capital is the fund which reflects the consideration that the company receives when it issues shares to its shareholders. The issued share capital is thus the company's own funds and is reflected in the balance sheet as owner's interest or equity. Although it is often stated that share capital is the primary source of capital of a company, this does not mean that it is necessarily the largest source of the company's capital. It is regarded as primary because a company must have a share capital¹⁰. In its memorandum of association¹¹ or memorandum of incorporation¹² a company with a share capital has to state its maximum authorised share capital. The authorised share capital is just a figure and a company need not issue all its shares.

The second source of capital is loan capital, reflected in the balance sheet as external interest. The can company obtain this by issuing debentures or by taking up other loans.

The providers of share capital are the members or "owners" of the company while the providers of loan capital are the creditors of a company. Creditors receive interest while shareholders receive dividends. If the company is liquidated and it is insolvent, the creditors are entitled to be paid back first. If a balance remains, it will be distributed among the shareholders. The shareholders thus bear a greater risk of losing their

⁷ During the industrial revolution

⁸ Or equity

⁹ Or debt

¹⁰ Unless of course it is a company limited by guarantee

¹¹ According to the Companies Act 61 of 1973

¹² According to the Companies Act 71 of 2008

investment, than the creditors do. This theoretical distinction explains why shareholders have a say in the company affairs through their voting rights and other membership rights while creditors do not. The same person can be both a shareholder and a creditor of a company.

Various factors, such as interest rates, the availability of security and the tax treatment of interest and dividends can influence a company's decision on the ratio between equity and debt financing. The debt/equity ratio of a company reflects the extent to which it uses each of the two kinds of capital¹³. In our law there are no rules prescribing a maximum debt/equity ratio for companies.

2. CAPITAL AND CAPITAL MAINTENANCE RULES UNDER THE CURRENT COMPANIES ACT, ACT 61 OF 1973

The Companies Act 61 of 1973 requires a company having a share capital to state in its memorandum its authorised share capital¹⁴. Where the company has par value shares¹⁵ it must state the amount of the share capital with which it is proposed to be registered and the division thereof into shares of a fixed amount. The par value or nominal value of a share very rarely reflects its actual or market value and may be regarded as a purely arbitrary figure. Nevertheless, the par value has legal implications¹⁶. The market value of all shares fluctuates depending on different factors such as the financial position of the company and the earning capacity of its shares.

¹³ A debt/equity ratio of 1:1 means that half the company's capital is derived from each source, while a ratio of 2:1 means that for every one rand of share capital the company uses two rand of loan capital

¹⁴ Section 52(2)

¹⁵ It is important to notice under the New Act that par value shares and nominal value should be replaced with a capital maintenance regime based on solvency and liquidity

¹⁶ For example the rule that a par value share may generally not be issued for less than its nominal value.

Although the current Act does not define the term “share”¹⁷ it is clear that a share is a form of property that denotes a financial stake in the company and it entitles its holder to membership rights. Shares in accompany need not all be of equal value. Nor is it necessary that equal rights and privileges should be attached to all shares¹⁸. They may even have peculiar privileges in the matter of voting or in other respects¹⁹. Thus, the division of shares into various classes is based on the nature of the rights afforded by them in regards to dividends and participation in a distribution on liquidation. The differing degrees of risk assumed by the various classes of shareholders are often reflected in their voting rights.

The preferential dividend position enjoyed by the holders of preference shares is offset by the fact that their voting rights are usually curtailed by the articles of the company. The general rule of the current Act is that every member must have the right to vote at meetings of that company in respect of each share held by him or her²⁰. In *Utopia Vakansie-Oorde Bpk v Du Plessis*²¹ the question arose whether the dividend on preference shares could be said to remain in “arrears and unpaid” if no dividend had been declared by the company. The court found that in the context of section 194, these words were wide enough to include the situation where the fixed dividend on preference shares had not been declared. The court also pointed out that the “interests” of preference shareholders were to be interpreted widely, because the concept of interests was much broader than that of rights.

A company may also convert existing shares into redeemable preference shares²². Such conversion and redemption will alter the balance of the voting rights of the company.

When a company redeems a share, it refunds to the shareholder his or her contribution to the capital of the company and cancels the share. This redemption may be funded only

¹⁷ Nor does the New Act for that matter

¹⁸ Some may have preferential rights either to capital, dividend or both

¹⁹ Subject to the provisions of sections 193-198

²⁰ Section 194 permits the articles of a company to provide that its preference shares will not confer the rights to vote at meetings

²¹ 1974 (3) SA 148 (A)

²² Section 75

out of two possible sources²³. A company may also acquire its own shares in terms of section 85, in which case it does not have to maintain its share capital.

As stated in my introduction, the second source of capital in a company is loan capital. And this is obtained by issuing debentures. A debenture is a security that is an investment in a company that can be transferred like a share. The word debenture refers to the document which is issued by the company as proof of the right to reclaim a loan²⁴. Debentures are often not paid back during the existence of the company. A debenture holder who wants to get his investment back will sell the debenture to someone else who will then become the debenture holder. An ordinary loan however, usually has to be paid back within a fixed period²⁵.

A company can have different classes of debentures²⁶ but the main distinction is between secured and unsecured debentures. In the case of default by the company, the holders of secured debentures have a right to the proceeds of the specific property used as security. Although debenture holders are creditors of a company and are therefore not entitled to attend meetings and to vote, shares and debentures are treated as similar for certain purposes²⁷.

Other loans to the company can, just as in the case of debentures, be either secured or unsecured. We can also distinguish between long term loans²⁸ and short term loans²⁹, although their legal nature is the same. A specific kind of loan often encountered in company finance is the “loan account”. Very often the major shareholders, especially of small private companies, will lend money to the company rather than contribute everything in the form of a share capital. Such loans are usually repayable on demand and the idea is that the company will use as capital for as long as required. Again, there is no legal distinction between such loans and loans in general.

²³ Section 98

²⁴ It is an acknowledgement of debt

²⁵ Although a loan can be ceded to someone else, it is not as easily transferable as a debenture

²⁶ Issued for different periods and at different rates

²⁷ For example, the same rules apply when shares and debentures are offered to the public

²⁸ Regarded as fixed capital

²⁹ Regarded as operating capital

2.1 MEMBERSHIP OF A COMPANY AND THE TRANSFER OF SHARES

Although the term “member” and “shareholder” often refers to the same person, it is important to distinguish between these two terms in certain circumstances. For example, some companies, such as companies limited by guarantee, do not issue shares and therefore have members but not shareholders³⁰. Also, the (registered) member of a company with a share capital could be holding the shares on behalf of another person. In this case the member is known as the nominee or the registered nominal owner, while the shareholder is called the beneficial owner.

Shares are freely transferable in the manner provided for by the current Act and the company’s articles. However, shares in private companies are not as easily transferable as shares in public companies, because private companies must impose some form of restriction on the free transferability of their shares³¹. Although shares in public companies are generally freely transferable, the ease with which they can be transferred depends on whether they are evidenced by share certificates, share warrants and, most important, whether they are listed on the stock exchange.

2.2 THE OFFER OF SHARES TO THE PUBLIC

The doctrine of disclosure plays an important role with regards to offering of shares in a company, whether for subscription by the company or for sale by its shareholders. The principle entails that every potential investor should have sufficient material information at his or her disposal on which he or she can rely to make an objective assessment of the merits of the investment he or she wants to make. The doctrine of disclosure underlies the

³⁰ Note however, that in the case of a company with a share capital, the same person will usually be both a shareholder and a member of a company

³¹ Section 20(1)(a)

provisions of the current Act which require that information relating to the issue of shares be given to investors in certain instances. There are a number of issues which play a role in raising the share capital a company needs to conduct its business. Of particular importance is whether it is a private or a public company and, if public, whether it is listed or not. It is also important whether the attempt to raise capital is the company's initial effort or a subsequent attempt to procure additional capital.

It is necessary to distinguish between an offer for subscription and an offer for sale, and the primary and secondary market for shares, in order for us to understand the different kinds of public offers.

An offer for subscription is a method of raising finances for the company as the company receives the issue price of the shares which it offers for subscription³². In a public offer for subscription, a prospectus is usually required. However, if a company makes an offer to its existing shareholders to subscribe for further share which will be listed on the JSE Securities Exchange South Africa, this is known as a rights offer. Rights offers are regulated differently from other offers for the subscription in that a prospectus is not required³³.

An offer for sale is an offer in respect of existing³⁴ shares. An offer for sale in the general sense is not a method of raising money for the company, as it is merely a sale of shares by a shareholder, who receives the entire proceeds of that sale³⁵. The company is not involved in their sales and the seller, if they are on offer to the public, has to issue a written statement containing the information required by the current Act³⁶. We refer to these kinds of offers in which the company is not involved, as offers for sale in the general sense³⁷. However when new shares are issued by a company to an intermediary so that the intermediary can offer them to the public for sale, or when shares are being

³² In other words, the public subscribes for previously unissued shares

³³ Section 146A

³⁴ Previously issued

³⁵ In other words, a sale of shares relates to shares which have been previously issued to, and are held by, a shareholder

³⁶ Section 141

³⁷ Or offers regulated by section 141

offered to the public for sale but it has been announced that those shares will be listed on an exchange, the situation is similar to an offer for subscription and therefore a prospectus will usually be required³⁸.

Offers for sale or subscription are regulated by chapter VI of the current Act³⁹. The concepts “offer” and “offer to the public” are defined in section 142. “Share” is defined in section 1 of the current Act. The wide general meaning of an offer for sale is limited for purposes of chapter VI to offers for the sale of shares within the categories described in section 46(1). Certain offers for subscription or sale are specifically excluded from being regarded as offers to the public⁴⁰.

The term distribution is not clearly defined in the current Act which resulted that its regulation of distributions was fragmented. The term distribution is used to refer to payments to shareholders either as a return on share capital or as a return of share capital. Distributions include payments to shareholders for the acquisition of their shares by the company⁴¹, payments to shareholders on the redemption of their shares⁴², payment to shareholders as interest on their shares⁴³ and payments to shareholders by reason of their shareholding⁴⁴.

2.3 SHARE CAPITAL RULES AND PAYMENTS TO SHAREHOLDERS

The concept of the maintenance of share capital entails that the issued share capital of a company may not be directly or indirectly returned to the shareholders except through some statutory procedure providing for proper safeguards for creditors and others who might be prejudiced by the diminution of the company’s assets. The fact that the liability

³⁸ This situation is regulated by section 146 of the current Act. The offer is made on the primary market and is referred to as an offer for sale in terms of section 146

³⁹ Sections 142-169

⁴⁰ They are listed in section 144

⁴¹ Section 85

⁴² Section 98

⁴³ Section 79

⁴⁴ Section 90

of shareholders is limited to their contributions to the company, which is reflected in the capital fund, has led to the idea that creditors have the right to insist that the capital fund must not be reduced, except through normal business risks.

When the doctrine was initially developed in England in the nineteenth century, the *ultra vires* rule played an important role, as is clearly the case in *Trevor v Whitworth*⁴⁵. Even though companies are often formed with a share capital of R100 or less, it is clear that maintaining share capital as such does not necessarily protect creditors. The Companies Amendment Act of 1999 has thus relaxed the traditional capital maintenance rule and allows certain returns of capital to shareholders subject to the company's solvency and liquidity.

Three fundamental capital maintenance rules through the common law was that a company may not purchase its own shares, shares may not be issued at a discount and dividends may not be paid out of share capital. To these rules, statute law added a fourth fundamental rule⁴⁶ namely, a company may not give financial assistance for the purchase of or subscription for its own shares. The present state of our law through the current Act is that the second and fourth rule still applies. The first and third rules have been changed so that distributions to shareholders may, in fact, be made out of share capital, subject to certain safeguards of which the solvency and liquidity requirements are the most important.

When a company buys back its own shares, it in effect returns the purchase price for the shares concerned to the shareholder and thus reduces its share capital. It was for this reason that the common law prohibited a company from acquiring its own shares.

There are a number of advantages in allowing a company to purchase its own shares. Firstly, if a company has the power to buy back its own shares, it can protect itself from manipulative speculation in its shares on the financial markets and stabilise the price of

⁴⁵ (1887) 12 App Cas 409

⁴⁶ Contained in section 38 of the current Act

its shares. Secondly, it can facilitate the transfer of shares in companies when a shareholder who wants to withdraw from the company is unable to find a willing purchaser for his shares, as is often the case in small private companies. A third advantage is in relation to employee shareholder schemes where the company can acquire the shares of an employee leaving its service.

With these advantages in mind, the Companies Act was amended in 1999 to allow companies to acquire their own shares subject to certain safeguards such as the solvency and liquidity requirements and the personal liability of directors and shareholders⁴⁷. It is necessary to take note in section 85 that if the articles do not allow the company to acquire its own shares, they may be altered by special resolution⁴⁸. Also note that in terms of section 201 the special resolution for alteration of the articles and the special resolution allowing the company to proceed with the purchase of its own shares may be passed at the same general meeting.

The redemption of redeemable preference shares was originally designed as an exception to the rule prohibiting a company from purchasing its own shares. Contributed capital is maintained in this case by the requirement⁴⁹ that the shares may be redeemed only out of the proceeds of shares which have been issued for the purpose of the redemption or out of divisible profits. If divisible profits are used, a capital redemption reserve fund must be created to substitute the redeemed shares. Thus the underlying principle, that the company's capital should be maintained, is upheld.

The requirements for the redemption of redeemable preference shares are stricter than those for the acquisition of shares in terms of section 85.

When a company is ordered by a court to purchase the shares of a member in terms of section 252, this also constitutes an exception to the common law rule. Such purchases are also expressly excluded from the ambit of section 85, so that solvency and liquidity

⁴⁷ Section 85-88

⁴⁸ Through section 62

⁴⁹ Section 98

are not required. Section 252 provides a remedy for a shareholder who is being oppressed or prejudiced by the conduct of the company.

The common law rule prohibiting the issue of shares at a discount is aimed at ensuring the initial integrity of the issued share capital. If the company does not receive the full consideration for the shares issued by it, the guarantee fund to which the creditors may look for payment has a value lower than that of the shares it presents⁵⁰. Apart from protecting the creditors, the discount rule also has the effect of protecting the shareholders by ensuring that they all give the same consideration for the same rights.

Because the nominal value of a share does not necessarily correspond with its real or market value, it can happen that the shares of a financial troubled company are faded at a price lower than their nominal value. If the company then tries to obtain further share capital by issuing more of those shares, it will encounter problems in getting investors to subscribe to the overpriced new shares because prospective investors can purchase shares from existing shareholders at a lower price. Practical consideration such as these thus necessitated relaxation of the rule prohibiting issue at a discount. Section 81 provides that in certain circumstances shares may be issued at discount⁵¹.

You will note that the ambit of section 38 is very broad, extending to both direct and indirect assistance and including any type of assistance for the purpose of or in connection with either the purchase of or subscription of shares. Financial assistance is not confined to assistance to the purchaser but to financial assistance to whomsoever given⁵².

⁵⁰ For example, a company issue 100 000 shares with a nominal value of R1 each at 80 cents (at a discount of 20 cents per share)

⁵¹ You will note that the requirements are designed to protect both creditors and shareholders

⁵² It is important to notice that the prohibition is only for financial assistance. Other assistance, for example assistance which involves the restructuring of the board of directors, making information available or entering into bona fide service agreements, is not prohibited by section 38

Certain transactions are expressly exempted from the prohibition against financial assistance. An important exception⁵³ which was added in 1999 has been described as a curious one. However if one bears in mind that the prohibition in section 38(1) also extends to financial assistance given by a subsidiary for the purpose of the acquisition of shares in its holding company, this exception, correctly interpreted, indeed makes sense. We can break this exception up into two alternatives. Section 38(2) (d), together with its introductory sentence, reads: “The provisions of section 38(1) shall not be construed as prohibiting the provision of financial assistance for the acquisition of shares in a company by the company or its subsidiary in accordance with the provisions of section 85 for the acquisition of shares”.

The alternative phrases “by the company” and “or its subsidiary” belong to “the acquisition of shares in a company” and not to “the provisions of financial assistance”. Split up into two alternatives this section would read as follows: The provisions of section 38(1) shall not be construed as prohibiting the provision of financial assistance for the acquisition of shares in a company by the company in accordance with the provisions of section 85 for the acquisition of such shares; and, The provisions of section 38(1) shall not be construed as prohibiting the provisions of financial assistance for the acquisition of shares in a company by its subsidiary in accordance with the provisions of section 85 for the acquisition of such shares.

According to our reading of section 38(2)(d), it thus contains two exceptions relating to two different situations. The first exception applies to “the acquisition of shares in a company by a company”, that is, where a company acquires its own shares. Section 38(1) contains two prohibitions which could possibly apply to this situation, namely: the company whose shares are being acquired may not give financial assistance to anyone in connection with the acquisition; and, a subsidiary of the company whose shares are being acquired may not give assistance to anyone in connection with the acquisition.

Applied to the situation where a company is acquiring its own shares, it is obviously not possible for the company to give assistance to itself. But the function of this first

⁵³ S38(2)(d)

exception is to allow a subsidiary to give financial assistance to its holding company when the holding company is acquiring its own shares in terms of section 85⁵⁴.

The second exception applies where a subsidiary is acquiring shares in its holding company⁵⁵. The power of a subsidiary to acquire shares in its holding company is conferred by section 89. However, section 89 expressly states that the subsidiary may acquire the shares “mutatis mutandis in accordance with section 85”⁵⁶.

Returning to the effect of section 38(1) on the situation where a subsidiary is acquiring shares in its holding company, two prohibitions apply to this situation: the holding company⁵⁷ may not give assistance because a company may not give assistance to anyone in connection with the purchase of or subscription for its shares; and, a subsidiary may not give assistance to anyone in connection with the acquisition of shares in its holding company.

The first function of the second exception is thus to allow a holding company to give assistance for the purpose of or in connection with an acquisition of its own shares by its subsidiary. The assistance may be given either to the subsidiary itself, or to any other person, as long as it is given for the purpose of or in connection with the acquisition by the subsidiary of shares in its holding company. The second function of this second exception is to enable the co-subsidiaries of the subsidiary that is acquiring shares in the holding company, to render assistance to the acquiring subsidiary or to anyone else in connection with the acquisition by the subsidiary⁵⁸.

In summary then the exceptions to section 38(2)(d) allows to the giving of financial assistance by a subsidiary in connection with the acquisition by the holding of its⁵⁹ own

⁵⁴ It is important to note that the provisions of section 37 regarding loans made or security given by a subsidiary to its holding company would apply to this situation

⁵⁵ Note that section 38(2)(d) refers to the acquisition by a subsidiary of shares in its holding company in accordance with section 85

⁵⁶ Perhaps section 38(2)(d) should have referred to the acquisition by a subsidiary of shares in its holding company in accordance with section 89

⁵⁷ Being the company whose shares are being acquired

⁵⁸ The subsidiary acquiring the shares can obviously not render assistance to itself

⁵⁹ The holding company

shares; it allows the giving of financial assistance by a holding company in connection with the acquisition by its subsidiary of shares in the holding company; and lastly this section allows the giving of financial assistance by a co-subsiary in connection with the acquisition of shares by a subsidiary in the holding company.

Following the case of *Gradwell (Pty) Ltd v Rostra Printers Ltd*⁶⁰ the courts tended to use the impoverishment test to determine whether financial assistance has been given. This test involved asking if the company had become poorer as a result of what was done for the purpose of, or in connection with, the purchase of or subscription for the company's shares. However, while serving as a useful tool, this is not the only or necessarily the decisive test, as was clearly stated by the Appellate Division in *Lipschitz v UDC Bank Ltd*⁶¹. Here it was clear that where the company gives security or otherwise exposes its funds to risk, the impoverishment test is not useful. The section aimed at not only preventing actual loss of company funds, but also at the exposure of company funds to possible risk.

As was stated in the *Lipschitz* case section 38 comprises two elements, namely the giving of financial assistance and the purpose for which the assistance was given. As regards the requirements that the assistance must be for the purpose of or in connection with the purchase of shares, the *Lipschitz* decision makes it clear that section 38 is only contravened if assistance was at least contemplated at the time of the transaction. The phrase "in connection with" is intended to close loopholes and not to substantially extend the meaning of "for the purpose of". In deciding whether financial assistance was for the "purpose of" the purchase of or subscription for the company's shares, a distinction must be drawn between the ultimate goal and the direct object of the transaction. If the direct object is to perform a perfectly normal business transaction⁶², there can be no objection against the assistance, even though the ultimate goal of the transaction was to facilitate the purchase of shares in the company.

⁶⁰ 1959 (4) SA 419 (A)

⁶¹ 1979 (1) SA 789 (A)

⁶² For example, to pay of an existing debt

For a contravention to have taken place, financial assistance must have been given for the purpose of or in connection with the purchase of the company's shares. If financial assistance is given for some other purpose, section 38 is not contravened. The Appellate division in the Lipschitz case thus found that where a company passed a mortgage bond over its fixed property in favor of a bank in order to secure payment of a loan account, the financial assistance related to the loan account and not to the purchase of shares.⁶³ Although securing the loan account facilitated a transaction which included the purchase of the same company's shares, it did not constitute a contravention of section 38.

As regards the purpose of transaction, the court in *Fidelity Bank Ltd v Three Women (Pty) Ltd* used the fact that a particular transaction which facilitated the purchase of shares did not serve any legitimate commercial interest of the company as a basis for concluding that its purpose was indeed to give assistance for the purchase of shares.

In practice the prohibition against financial assistance is sometimes avoided by converting a company into a close corporation⁶⁴. The close corporation then gives financial assistance in connection with the acquisition of the member's interest. This can only be done if the requirements for a conversion can be satisfied⁶⁵ as well as the requirements for financial assistance⁶⁶. Provided the transaction is structured correctly, this practice is unobjectionable, as was confirmed by the Supreme Court of Appeal in *Peters NO and Others v Schoeman and Others*⁶⁷.

Because the capital maintenance doctrine entails that share capital may not be returned to shareholders, it also means that dividends may not be paid out of share capital. The positive rule that evolved out of this prohibition is that dividends may only be paid out of profits.

⁶³ A loan account reflects the amount of money owed to a creditor which is often also a shareholder of the company

⁶⁴ With the new Act that will come into corporation 1 July 2010, this will however not be possible as close corporations will cease to exist under the new Act

⁶⁵ Section 27 of The Close Corporations Act of 1984

⁶⁶ Section 40 of The Close Corporations Act of 1984

⁶⁷ 2001 (1) SA 872 (SCA)

Payment is defined as including any direct or indirect payment or transfer of money or other property to a shareholder by virtue of the shareholder's shareholding in the company. This clearly includes dividends. Certain payments are specifically excluded from the ambit of section 90 because they are provided for under other sections of the Act⁶⁸.

Shareholders will be liable to the company for any payments received contrary to the solvency and liquidity requirements.

It can be assumed that the articles of many companies still provide that dividends may be paid out of profits. Companies wishing to make payments in terms of section 90 may thus have to amend their articles.

The consistent application of the common law rule means that interest on shares may also not be paid out of share capital. This is not always desirable for the company as it could discourage investment. Section 79 of the current Act thus makes another statutory exception to the common law rule. It allows the payment of interest out of capital subject to the approval of the Minister of Trade and Industry. Although the minister may theoretically approve of such payment even if the solvency and liquidity requirements are not met, it is unlikely that such approval will be given unless the financial health of the company is above suspicion.

The payment of interest on shares is a payment by virtue of a shareholder's shareholding and is thus also a payment for purposes of section 90. Unlike other payments specifically regulated by other sections of the current Act, payment of interest on shares has not been excluded from the definition of payment for purposes of section 90.

⁶⁸ For example, payments to shareholders in their capacity as creditors or employees are not regulated by section 90

I feel it is necessary however to point out some of the main shortcomings of the current Act⁶⁹. The critical deficiencies in it relate to capital maintenance rules, corporate governance and shareholder protection.

The concept of par value shares is economically insignificant, especially since shares of low par value and shares of no par value exist. Many jurisdictions have scrapped the par value concept altogether. The concept also forms part of the capital maintenance rule, which in many jurisdictions has been replaced with more sophisticated forms of protection for creditors and has also been substantially eroded in South Africa through amendments to the current Act in recent years. The rule prohibits, among other things, companies making distributions to its shareholders out of its capital and companies giving financial assistance for the acquisition of its shares.

Corporate governance has largely been regulated by common law and codes of corporate practice rather than by statute. This has created uncertainty and imprecision, especially with regard to directors' fiduciary duties.

The current Act also lacks effective enforcement mechanisms, resulting in directors and senior management becoming largely immune to their wrongdoing and negligence. Litigation by the aggrieved is costly and protracted, and class actions and attorneys' contingency fees are still relatively novel and immature. Furthermore, the public institutions tasked with investigating wrongdoing and negligence and enforcing the current Act lack adequate power and resources.

⁶⁹ Thus the reason for the new Act, 71 of 2008

3. CAPITAL AND CAPITAL MAINTENANCE RULES UNDER THE NEW COMPANIES ACT, ACT 71 OF 2008

The new Act⁷⁰ is the most important company law development in South Africa since 1973. This Act was signed on 9 April 2009 and is expected to become operative on 1 July 2010. There is a desire to ensure that company law is more easily understandable and that it is simplified by containing as few mandatory rules and prohibitions as possible. At the same time and in the context of increased globalization, there is a desire to harmonise South African company law with the company law of other countries. It is believed that this will give rise to increased certainty in conducting business, increased foreign investment⁷¹, and will enjoy the use of a wide range of judicial precedent, opinion and practice, thus reducing the uncertainty and costs of litigation.

King III will come into effect from 1 March 2010, until which time King II will apply. King III is aligned to the new Act and should be read within that context. King III deviates from King I and King II in that an “apply or explain” basis of corporate governance is mooted in place of the current “comply or explain” basis. The philosophy of the report revolves around leadership, sustainability and corporate citizenship.

3.1 PUBLIC OFFERINGS OF COMPANY SECURITIES

Chapter 4 introduces certain new concepts like the initial public offering, primary offerings and secondary offerings⁷². Securities defined by reference to section 1 of the Security Services Act include shares, stocks and depository receipts in a public company.

Offers to the public includes the offer⁷³ of securities to be issued by a company to any section of the public, whether selected as holders of company securities⁷⁴, clients of a

⁷⁰ Act 71 of 2008

⁷¹ Both inbound and outbound

⁷² In many respects it is similar to the corresponding provisions in the Current Act

person issuing the prospectus and holders of any class of property. It however excludes offers under section 96, secondary offer through exchange. Section 95(2) states that persons to be regarded as being a member of public, despite being a shareholder of, or purchaser of goods from a company. This reverses the *Golfields v Harmony*⁷⁵ case.

3.2 CLASSES OF SHARES

Instead of Memorandum and Articles of Association, a company's constitutional documents have been consolidated into one document, the memorandum of Incorporation. This document sets out the rights, duties and responsibilities of shareholders, directors and others in relation to the company.

The Memorandum of Incorporation (MOI) must set out the classes of shares and the number of shares of each class that the company is authorised to issue. The Memorandum of Incorporation must set out, with regards to each class of shares a distinguishing designation for the class as well as the preferences, rights, limitations and other terms associated with that class. The MOI may authorise a number of unclassified shares which are subject to classification by the board⁷⁶. The concept of authorised capital is thus retained by the New Act⁷⁷ in the sense that the classes of shares and the number of each class of shares that the company is authorised to issue must be set out in its MOI. The MOI may set out a class of shares without specifying the preferences, rights, limitations and other terms associated with that class⁷⁸.

⁷³ Section 95(1)(h)

⁷⁴ See also section 95(2)

⁷⁵ 2005 (3) ALL SA 142(W)

⁷⁶ Except to the extent that the MOI provides otherwise, the board may classify any unclassified shares that have been authorised, but have not been issued.

⁷⁷ Act 71 of 2008

⁷⁸ The board may determine the preferences, rights, limitations or other terms of shares in a class (section 36(1))

3.3 ALTERATION

Authorisation and classification of shares of each class and preferences, rights, limitations and other terms associated with each class of shares may be changed by an amendment of the MOI by way of special resolution of the shareholders. Also by the board as contemplated in section 36(3), unless the MOI provides otherwise⁷⁹. Thus, the authorised capital can be increased or decreased by a special resolution of the shareholders amending the MOI.

The board may, unless the MOI provides otherwise, increase/decrease the number of authorised shares of any class, reclassify any classified shares that have been authorised, classify unclassified shares that have been authorised, but are not issued, determine the preferences, rights, limitations or other terms of shares in a class⁸⁰.

3.4 GENERAL

Issued shares are movable property, transferable in any manner provided for or recognized in the new Act or other legislation⁸¹. In the New Act shares do not have a nominal or par value, subject that the same does not apply to banks, as defined in the Banks Act until a date declared by the Minister. Any shares of a pre-existing company that have been issued with nominal or par value and are held immediately before the Act's effective date, shall continue to have the nominal or par value assigned to them, subject that the Minister must make regulations providing for the transitional status and conversion of nominal and par value shares and capital accounts of a pre-existing company⁸².

A company may not issue shares to itself⁸³. Authorised shares of a company have no rights until it have been issued⁸⁴ and issued shares acquired by a company in terms of

⁷⁹ Section 36(2)

⁸⁰ Section 36(3)

⁸¹ Section 35(1)

⁸² Such regulation must preserve the rights of shareholders associated with such shares, or provide for the compensation, by the company, for the loss of any such rights (section 35(2))

⁸³ Section 35(3)

section 48 or have been surrendered to the company in terms of section 164, have the same status as authorised unissued shares⁸⁵. Shares issued by pre-existing companies and held immediately before the Act's effective date continues to have all the rights associated with it, subject to the company's MOI being amended; those shares being acquired by the company⁸⁶ or being surrendered to the company under section 164; the Minister making regulations providing therefore that either preserve the right of shareholders associated with such shares or providing for the compensation by the company, for the loss of any such rights.

3.5 CLASS RIGHTS

Each issued share, notwithstanding its class, has associated with it one general voting right, except as provided otherwise in the Act or in the preferences, rights, limitations and other terms of the shares in the MOI⁸⁷. A company's MOI may establish that a class of shares shall have special, conditional or limited voting rights⁸⁸. Every share has a irrevocable right of a shareholder to vote on any proposal to amend preferences, limitations, rights and other terms associated with that share⁸⁹.

If there is only one class of shares, those shares have the right to be voted on every issue to decided by shareholders and the holder of those shares are entitled to receive the net assets of the company upon liquidation⁹⁰. If there are more classes of shares, the MOI must provide that at least one of the classes has voting rights on any particular issue for a decision to the shareholders and, that at least one class⁹¹ has the right to receive the net assets of the company upon liquidation⁹².

⁸⁴ Section 35(4)

⁸⁵ Section 35(2) and item 6 of Schedule 5

⁸⁶ Section 48

⁸⁷ Section 37(2)

⁸⁸ Section 37(5)(a)

⁸⁹ Section 37(3)(a)

⁹⁰ Section 37(3)(b)

⁹¹ Even if not a voting class

⁹² Section 337(4)

Shares of the same class must have the same preferences, rights, limitations and other terms, unless the Act or the MOI provides otherwise. So the MOI can expressly differentiate between shares of the same class.

The MOI may establish that a class of shares is redeemable or convertible⁹³. The company's MOI may determine that the shares of a specific class have preference over any other class of shares with respect to distributions, or rights upon the final liquidation of the company⁹⁴.

Class rights can vary "in response to any objectively ascertainable external fact..." which includes the board decision or determination by any other person or an agreement to which company is a party⁹⁵. If the MOI is altered to materially affect the preferences, rights, limitations or other terms of shares of a specific class, then the holder of shares of a specific class, may invoke the provisions of section 164⁹⁶.

The board of a company may resolve to issue shares of the company at any time, but only within the classes and to the extent, that the shares have been authorised by or in terms of the company's MOI. If company issues shares that have not yet been authorised or in excess of the number of authorised shares the issue may be authorised by the board if not excluded in terms of the Act or the MOI, or by way of a special resolution of shareholders. If such authorisation is not forthcoming, the share issue is a nullity to the extent that it exceeds the authorisation. This, however raise various issues: what about section 218, which states that something shall not be void unless the court declares it void; what about bona fide third parties? The statutory Turquand in 20(7) may become applicable; what about a court order for validation?

⁹³ At the option of the company, the shareholder or another person at any time or upon the occurrence of a specific event; for cash, indebtedness, securities or other property; at prices or in amounts specified or determined in accordance with the formula; subject to any other terms set out in the MOI. Same has to be subjected to clauses 46 and 48 however (section 37(5)(b))

⁹⁴ Section 37(5)(d)

⁹⁵ Section 37(6)

⁹⁶ If the shareholder notified the company before the passing of the special resolution that he will vote against such passing and if he actually did vote against such passing

3.6 CORPORATE CAPITAL

A company may give direct or indirect financial assistance for the purpose of or in connection with the purchase or subscription of any securities or option issued or to be issued by the company or related or inter related company, unless the MOI provides otherwise⁹⁷.

No financial assistance may be provided, unless the financial assistance is pursuant to an employee share scheme that satisfies section 97, or pursuant to a special shareholder resolution, adopted within the previous two years, which approved such assistance. And the board is satisfied that the company would satisfy the solvency and liquidity test after the provision of the assistance and the terms of the financial assistance are fair and reasonable to the company.

Any decision by the board to deliver financial assistance is void to the extent that it is inconsistent with section 44 or a prohibition, condition or requirement of the MOI. If a resolution or agreement is declared void in terms of section 44(5) read with section 218(10) a director is liable⁹⁸ if he was present at the meeting when the board approved the resolution or agreement and failed to vote against the resolution or agreement, despite knowing that provision of financial assistance was inconsistent with section 44 or prohibition, condition or requirement in the company's MOI.

3.6 DISTRIBUTIONS

Distributions are: dividends (in cash or in kind); capitalisation shares (or payment in cash instead of capitalisation); the repurchase of shares by the company; a debt incurred to or for the benefit of a holder of any of the shares; a debt cancellation in respect of a holder of any of the shares⁹⁹.

⁹⁷ Section 44(2)

⁹⁸ To the extent of section 77(3)(e)(iv)

⁹⁹ Section 1

There are certain instances in which distributions may not be made. If the distribution have not been completed within 120 days after the board has acknowledged that the company will satisfy the solvency and liquidity test after the distribution has been completed¹⁰⁰.

A distribution in contravention of section 46 is not void unless a court declares it void¹⁰¹. Director's can be held liable only for any loss, damage or costs sustained by the company¹⁰².

Directors are liable to the extent of section 77(3)(e)(vi) if the director: was present at the meeting where the resolution was passed to allow distribution, and he failed to vote against the distribution, despite knowing that the distribution was contrary to section 46¹⁰³.

Directors is hence liable only if immediately after the distribution the company does not satisfy the solvency and liquidity test, and it was unreasonable at the time of decision to conclude that the company would satisfy the solvency and liquidity test after making the relevant distribution. And the maximum liability is the difference between the amount by which the value of the distribution exceeded the amount that could have been distributed without causing the company the company to fail to satisfy the solvency and liquidity test, and the amount, if any, recovered by the company from persons to whom the distribution was made.

3.7 ACQUISITION OF OWN SHARES

The acquisition by a company of its own shares is regulated by section 48¹⁰⁴. A company may acquire its own shares if the decision satisfies the requirements of section 46¹⁰⁵. The

¹⁰⁰ It is interesting to note that no mention is made in section 46 of the interaction with the MOI. It is therefore uncertain whether, in respect of dividends, the MOI can require more stringent conditions that the company can not take losses of the previous years into account

¹⁰¹ Section 218(1)

¹⁰² Section 46(6)

¹⁰³ Section 46(6)

¹⁰⁴ This was regulated in current Act under section 85

¹⁰⁵ Section 48(2)(a)

acquisition by a company of its own shares is a distribution and must comply with section 48(1) and (2).

Any subsidiary(or subsidiaries) of the holding company, can also acquire shares in the holding company, but the aggregate number of shares held by or on behalf of the subsidiary(or subsidiaries) may not exceed ten percent of the number of any class of any class of shares. As long as such subsidiaries remain subsidiaries, no voting rights attached to those shares may be exercised in respect of the shares so held.

A company may not acquire its own shares and a subsidiary may not acquire shares in the holding company if there would no longer be shares in issue other than shares held by one or more subsidiaries of the company or convertible or redeemable shares¹⁰⁶.

A contract with a company providing for the acquisition by the company of shares issued by it, is enforceable against the company¹⁰⁷ except if the company can not execute the contract without being in breach of section 48(2) – (3)¹⁰⁸.

If the company acquires shares contrary to section 46 or section 48, one can apply to court and the court may make an order that the person from whom the shares were acquired to return the amount to the company, and the company to issue that person the equivalent number of shares of the same class as those acquired¹⁰⁹.

3.8 SOLVENCY AND LIQUIDITY TEST

One of the objectives of the New Companies Act was the replacement of par value shares and nominal capital with a capital maintenance regime based on solvency and liquidity.

¹⁰⁶ Section 48(3)

¹⁰⁷ The burden of proof lies on the company

¹⁰⁸ Section 48(4)

¹⁰⁹ Section 46(6)

A company satisfies the solvency and liquidity test if, considering all reasonably foreseeable financial circumstances of the company, the assets of the company or, if the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, the aggregate liabilities of the company, and it appears that the company will be able to pay its debts as they become due in the course of business for a period of 12 months after the date on which the test is considered, or in the case of a distribution, 12 months following the date of that distribution¹¹⁰, based on compliant financial statements and accounting records¹¹¹, fair value of the company's assets and liabilities, including reasonable foreseeable contingent assets and liabilities and all reasonably foreseeable financial circumstances¹¹².

As seen above, the solvency and liquidity test is set out in section 4 of the New Act. The test comprises a solvency¹¹³ element and a liquidity element¹¹⁴, both of which must be satisfied.

As a restriction on distributions, a solvency test entails that the assets of the company should exceed its liabilities after the distribution has been taken into account. Distributions may thus be made out of net assets only.

3.9 PROPOSALS TO DISPOSE OF ALL OR THE GREATER PART OF ASSETS OR UNDERTAKING OF A COMPANY

Section 112 replaced the old section 228. Section 112 regulates the disposal of all or the greater part of the assets of a company and provides that the disposal must be approved as determined in section 115. A company may not dispose of all or the greater part of its assets, unless the disposal has been approved by a special resolution of the

¹¹⁰ Section 4(1)

¹¹¹ See section 28 and 29 for compliance guidelines

¹¹² Section 4(2)(a), 4(2)(b) and 4(1)

¹¹³ Section 4(1)(a)

¹¹⁴ Section 4(1)(b)

shareholders¹¹⁵ in accordance with section 115 and the company has satisfied all other requirements set out in section 115.

Amalgamation means a transaction or series of transactions pursuant to an agreement between two or more companies, resulting in, the formation of one or more new companies which together hold all the assets and liabilities that were held by any of the amalgamated or merging companies, immediately before the implementation of the agreement and the dissolution of each of the amalgamating or merging companies¹¹⁶.

3.10 SCHEME OF ARRANGEMENT

Section 114 replaced the old section 311. The board of a company may propose or implement any arrangement between the company and its shareholders including but not limited to a re-organisation of the share capital of the company, by way of, among other things: a consolidation of shares of different classes; a division of shares into different classes; an expropriation of shares from shareholders; a share exchange; a combination of the above methods¹¹⁷. The company or the offer contemplated in subsection 1¹¹⁸ must retain an independent expert to compile a report as required by section 113(4).

A company may not dispose of or give effect to an agreement or series of agreements to dispose of all or the greater part of its assets or undertaking¹¹⁹, or implement a scheme of arrangements¹²⁰, unless the transaction has been approved in terms of section 115. a proposed transaction in terms of section 112, 113 or 114 must be approved by a special resolution adopted by persons entitled to voting rights on such a matter, and the court in the circumstances and manner contemplated in section 115(3)-(6).

¹¹⁵ Section 112(2)

¹¹⁶ Section 1

¹¹⁷ Section 114

¹¹⁸ Of section 114

¹¹⁹ Section 112

¹²⁰ Section 114

In *Smuts v Booyens*¹²¹ the requirements to transfer shares was set out. The court found that the right to transfer share can be restricted¹²² in its articles. This is absolute. Transfers contrary to such restrictions are void *ab initio*. This is void even against the purchaser who didn't know of such restrictions.

In *Ex Parte Federale Nywerhede*¹²³ the applicant applied for an order in terms of section 311, of the 1973 Act¹²⁴, to convene a meeting to consider the proposed arrangement. This arrangement involved the cancellation of shares of "outside shareholders"¹²⁵, in return for which shares in the holding company would be issued to such shareholders. At the hearing the question arose of whether the provisions of section 314 to 321 of the Current Act in connection with takeover offers applied to this scheme of arrangement. The court found that the proposed arrangement was not a takeover as set out in section 314(1). And thus didn't section 314 to 321 apply. Also that the proposed scheme of arrangement could be seen as an arrangement, although if one is offered shares, it does not constitute a scheme of arrangement.

In *Ex Parte Satbel: Meyer Interviening*¹²⁶ the scheme members was offered money instead of shares, this also didn't constitute a scheme of arrangement.

In *Ex Parte NBSA Centre*¹²⁷ the court found that an expropriation cant be an expropriation for cash only.

In the *Verimark* case the company wanted to "de list" themselves and proposed a scheme of arrangement. Two entities who held eighty percent of the share holding wanted to get rid of the third entity by means of giving them moneys. This arrangement was approved but the court felt the votes were tainted. The court felt that only the third entity should have voted and if seventy five percent of the third entity votes for the arrangement, the

¹²¹ 2001(4) SA 15 (SCA)

¹²² If this case was judged under the New Act, this could be done in the MOI

¹²³ 1975(1) SA 826 (W)

¹²⁴ Section 114 of the New Act, Act 71 of 2008

¹²⁵ That is the shares which did not belong to the applicant's holding company

¹²⁶ 1987(3) SA 440 (W)

¹²⁷ 1987(2) SA 449 (W)

arrangement should be approved or sanctioned. According to the New Act, Act 71 of 2008, in section 114, only the Board can make a proposal for the arrangement, no one else. This differs a lot from the Current Act. The Question arises: Can one use section 114 instead of section 48 when acquiring its own shares? It seems so in the wording of Section 114. When a court is however faced with this crisis, it will have to look at the circumstances of each case individually and determine whether the arrangement was unfair for the whole class and also if the votes were tainted because of a conflict of interest.

4 CONCLUSION

A company's objects should be stated broadly and where it is restricted, a shareholder should be entitled to take action to restrain the company in situations where it acts beyond those restrictions. The fact that there is no more distinction between share premium and par value in the New Act is much welcomed as it was largely artificial, arbitrary and detached from economic value.

In future electronic registers and uncertified shares would be used where appropriate, whereas currently only shares listed on the JSE Securities Exchange System of South Africa uses such systems. The capital maintenance rule is adjusted in such a manner that after making a distribution to its shareholders, a company's assets must exceed its liabilities and it must be able to pay its debts as they become due in the ordinary course.

One of the New Companies Act's¹²⁸ main aims is to reform the capital maintenance rules of the Current Act¹²⁹. The New Act requires a company to state in its Memorandum of Incorporation the different classes of shares and the amount of shares in every different class together with the preferences, rights and limitations of each different class.

Companies are given a lot of freedom when it gets to the establishment of class rights, provided that there is always at least one class of shares that has unlimited voting rights

¹²⁸ Act 71 of 2008

¹²⁹ Act 61 of 1973

and at least one class right that provides for the right to receive the net assets at liquidation of the company.

The New Act requires that there should always be at least one issued share capital that is owned by someone else than the company. This issued share does not have to be one with unlimited voting rights or the right to receive the assets at liquidation.

The New Act requires approval by the shareholders by means of a special resolution when it comes to the issuing of shares to directors, also for substantial further offers to issue shares. The determination of substantiality is based on the influence of existing voting rights, but the sections are badly formulated. Pre-emptive rights in favor of the existing shareholders when private companies issue further shares, unless it is expressly excluded in the Memorandum of Incorporation. A company will however be able to side step this obligation when they accept futuristic payments for shares.

The New Companies Act provides for much more freedom when it gets to the size, nature and time limitations of the compensation for shares. The abolishment of the rule that shares must be fully paid upon their issue, will make it easier for the obtainment of shares transactions. This freedom is however balanced by the fact that more have been put on the directors in this regard.

The requirement of solvency and liquidity has been put into practice since 1999 in the South African Companies by protecting the debt collectors when a company makes certain distributions to its shareholders. The New Act provides for a wider application of the solvency and liquidity test in that all distributions to shareholders, financial assistance when acquiring its own shares, loans and providing of securities to directors and amalgamations and mergers are all bound by it. The solvency element recognises the payment preference of debt collectors instead of shareholders while the liquidity element gives reasoning to the back payment of debt collector when a debt is being made. When and how one must comply with the requirements of the solvency and liquidity test, is stipulated by the type of distribution or transaction.

The term distribution includes payments to shareholders under the New Act.

Distributions are regulated to protect debt collectors as well as shareholders. The New Act provides a wide definition for the term distribution and set the same requirements for all distributions, except for the additional requirements set when a company or its subsidiary (or subsidiaries) acquires its own shares.

Distribution can be made by way of transferring money or property, the compliance to a responsibility of the company by the company, a debt cancellation by the company. There are still a lot of problems regarding the interpretation of a distribution, which includes the regulation of transactions or distribution to a group.

Although the liability of shareholders with regards to unauthorised distributions is not arranged by legislation, they still should be held liable by common law principles.

The objectives of the new company law are to recognise the changes which have occurred in the South African economy since 1973 as well as to update South African company law in accordance with current international standards. The legal frame work in South Africa has changed considerably over the last ten years with the introduction of the Constitution and numerous other statutes which will affect business and how business is conducted, such as the Competition Act. These legislative changes need to be recognised in South African company law.

Furthermore cognisance is to be taken of the need to simplify the creation and administration of companies in order to facilitate the entry of new business people and entrepreneurs into the economy and thereby facilitate black economic empowerment. Although not specifically dealt with in detail in the policy document, it is also to be noted that many provisions of the Current Companies Act do not sit happily with modern business practice in the financial markets.

It is in the area of the regulation of a company's share capital and distributions to shareholders that the inherent conflict between creditors and shareholders and the fragile balance among shareholders internally, intersect. The share capital of a company underlies its corporate structure and represents not only its initial own funds from which creditors can be paid, but also the relative equity interests of the shareholders.

The balance between shareholders can be disturbed by capital reorganisations through increase, reduction or variation of share capital or through disproportionate contributions by, or distributions to, shareholders. Share repurchases are particularly risky in this regard. Creditor interests are affected when their prior right to payment is endangered by distributions to shareholders. Two main approaches to creditor protection are evident. The capital maintenance doctrine, which is followed in England and Delaware, protects creditors by emphasising the notional share capital of a company as a limit on distributions. In contrast the solvency and liquidity approach focuses on the net assets of the company and on its ability to pay its debts.

Whichever way one looks at it, the changes that was made to the Current Act, Act 61 of 1973, by the New Act, Act 71 of 2008, is a remarkable improvement to South African company legislation. There are still a lot of uncertainties with regards to some subjects but I am sure that future court findings and amendments will sort out most of these uncertainties. South African company legislation will be more inline with International company laws and legislation once the New Act comes into operation.

Existing companies and close corporations would however have to identify themselves fully with the regulations of the New Act before it becomes into operation as it will affect every existing company and close corporation under the Current Act.

