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A CRITICAL ANALYSIS OF CAPITAL RULES IN THE COMPANIES ACT 71 **OF 2008**

Dissertation submitted in partial fulfilment of the requirement for the LLM Degree (Corporate Law) by:

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Abbreviations

Companies Act no 71 of 2008 ("**2008 act**")

Companies Act no 61 of 1973 ("**1973 act**")

Memorandum of Association ("**Memo**")

Memorandum of Incorporation ("**MOI**")

Companies Act no 37 of 1999 ("**the 1999 amendment act**")

Black Economic Empowerment ("**BEE**")

Broad Based Black Economic Empowerment Act no 53 of 2003 ("**BEE act**")

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CHAPTER 1
INTRODUCTION

1.1 Background of study

The Department of Trade and Industry endeavoured on a task to develop a companies act that had, as its main objective, being appropriate to the legal, economic and social context of South Africa as a constitutional democracy and an open democracy. On the 8th of April 2004 former President Kgalema Motlanthe gave consent to the promulgation of the new Companies Act 71 of 2008 (“**new act**”). This meant that the corporate world would face a new age and more specifically, this meant major changes for the capital rules in company legislation.

The present Companies Act 61 of 1973(“current Act”), was established in the mid nineteenth century and its principles are those rooted in Britain with the enactment of the Joint Stock Companies Acts of 1844, 1856 and 1863. The present act is therefore still a mould of English law despite many attempts in amending this piece of legislation. This basically means that the Companies Act was not only outdated but, was no longer suited for South Africa’s changing and developing economy and society.

The capital rules provisions in the current act were based on the capital maintenance rule. The main principle of this rule is that creditors should look to the company’s funds/capital for payment and that such creditors stand to be prejudiced if the company pays out its funds. The current companies act was not only renewed, in the form of the new companies act, but the capital maintenance rule was completely removed as the foundation for this piece of legislation.

1.2 Objective of the paper

The general purpose of this paper is to critically analyse the new act that will come into effect in the year 2010 and the effect it will have on South Africa's economy. This paper will:

1. Show how the different acts, the 1973 act and the 2008 act maintained capital.
2. Assess the impact of 1973 and 2008 act on business practices and subsequently the South African society in generally.
3. Articulate whether in fact the new piece of legislation, the 2008 act, is best suited for South Africa's developing economy.

1.3 Research question

Is the change of the South Africa's company legislation one that has resulted in a piece of legislation that is best suited for its economy and society?

1.4 Significance of study

The South African economy has changed and developed significantly since 1994 and since the implementation of the constitution dispensation. This change birthed the need for comprehensive company legislation that would be best suited for this new environment. It is therefore, important to determine if this 2008 act will be able to achieve what was set out by the Department of Trade and Industry in its policy paper (Government Gazette 26493 of 23 June 2004) and whether this new act will fulfil its role adequately.

1.5 Methodology

A comparative critical analysis method will be used. It will be largely based on the usage of library research/work on the relevant literature and some comments on the development of company legislation by industry experts.

1.6 Scope of the paper

This paper will involve a review of capital rules/maintenance provisions in the developing company legislation. In general terms this task will include the critical analysis of the current companies act and the new companies act and their impact on the South African economy and business. This paper will further consider which act is or was best suited as South Africa's companies' legislation.

1.7 Chapterization

This paper will have 6 chapters. The first will discuss the general introduction of the work and has been discussed above. The second will introduce the capital maintenance rule and its development in South Africa's company legislation. The third will discuss the South African social context. Chapter 4 and 5 will discuss the present act and the new act consecutively. The last chapter of the paper will conclude and make observation with regards to the research questions posed.

CHAPTER 2
CAPITAL MAINTENANCE RULE

2.1 Introduction and History

The capital maintenance rule is one that has its origins in English law almost a hundred years ago in the *Trevor v Wothworth case.*[1] It was applied to the South African company law since its inception. The main purpose of this rule was to grant creditors protection in that they looked to the company's funds for payment of their debt. Capital was viewed to be fixed and certain and its purpose was so creditor of the company would be entitled to look to such capital as his security.[2] This meant there had to be funds which were to be maintained and to which creditors would look for satisfaction of their claims. Under this rule creditors were to be prejudiced if the company payed out any funds from its capital. Under this rule the company could not buy back its own shares, not pay out dividence out of its capital or issue shares at a discount.

2.2 Development in South African legislation

The capital maintenance rule was removed in South African company law and more particularly the Companies Act no 61 of 1973 ("**1973 act**") by the Companies Amendment Act no 37 of 1999 ("**the 1999**"). This amendment adopted a middle path which had elements of the two primary international models of maintenance of capital, namley the English model of the capital maintenance rule and the American solvency and liquidity test. The amendment however did not completely remove the capital maintenance rule which had and has become outdated for the modern and fast developing business world of South Africa. There is however still some residual of the capital maintenance rule still remaining in the act.

1 1887 12 App CAS 409 (HL)
2 *The Capital Maintenance Concept and Share Repurchases in South African Law*, F.H.I Cassim and Rehana Cassim

The amendment, in favour of the American solvency and liquidity rule, gave freedom for the company to make payments to its shareholders without profit however this was under certain terms. These payments are done only if the articles of association allow so. Further there has to be a reasonable belief that after such payment, the company will be able to pay its debts as they become due in the ordinary course of business and if its consolidated assets, fairly valued will exceed the consolidated liabilities of the company. It is generally believed that this amendment additionally changed the position of company law in South Africa in that it afforded more protection of shareholders. This is different to the capital maintenance rule in that creditors are not as protected as before the amendment and instead of looking to company capital, they now have to look into other alternatives means to claim their debt from the company.

CHAPTER 3
THE SOUTH AFRICAN CONTEXT

3.1 Introduction

In its policy paper which explained the need for reform of company law in South Africa, the department of trade and industry discussed how company law should be one that is in line with the spirit of our constitution, the social context which changed since 1994. Further, it has to be one best suited for all South African citizens and be able to keep up with international business practise. It is therefore necessary to discuss the social context in which this law is to apply and to determine if the 2008 companies act is best suited for the South African society as intended by its creators.

3.2 Structure social context

South Africa is regarded as one of the most unequal societies in the world and this is also true with regards to the income inequality. This means that there is a substantial difference in terms of the financial position of the wealthy and poor and this inequality was found to be between race groups.[3] The South African economy is said to be divided into two. The "first economy" which is representative of the financial and industrial part of the economy and it has an established infrastructure and economy base with great potential for further growth and development and the "second economy" which presents both untapped potential and a developmental challenge for the country.[4]

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[3] Haroon Bhorat, Carlene van der Westhuizen dn Toughedad Jacobs, *Income and non-income inequality in post-apartheid south Africa: What are the drivers and possible policy interventions*?, Development policy research unit DPRU working paper 09/138, August 2009 ISBN Number: 978-1-920055-74-5, at page 57

[4] *South Africa: economy overview* sourced at http://southafrica.info/business/economy/econoverview.htm ,sourced on the 19th October 2009 at 12:25

The growth on poverty alleviation and change towards income equality has been a slow one since 1994 despite great expectations. This seems to be a sign that there should be more vigorous policy implementation which drives growth in the business sector and the economy as a whole. Black people are the majority of the citizens or people living in the country and the majority of people who are living in poverty. Some reasons attributed to this is that this group of people previously oppressed in the apartheid era and have seemingly been unable to recover from such oppression in an economic sense and in a way that would count them as being equal or put them on the same level as their white counterparts.

Income in the form self-employment is the second highest contribution source income to income inequality.[5] It is clear that this, together with skills training which results in high wage income which takes first place in the source of income inequality, should be encouraged and introduced in the groups at the lower rank of income earning. This means that policy which allows and encourages business involvement by people who fall within the category of those at the bottom of the scale in terms of income earning in the country should be concentrated on.

3.3. Black economic empowerment

Black economic empowerment is a policy that has been brought into action due to the past social situation in South Africa. During the apartheid era the South African government systematically excluded black people[6] from significant and meaningful participation in business and in the economy. This meant that black people were not able to participate in business practise, let alone own their own companies. This however did not have a positive effect on the South African economy as it was struggling to grow at a time when other countries and economies like it were flourishing.

[5] Haroon Bhorat et al, at page 19
[6] A black person in the BEE context refers to Africans, Indians, Coloured and Chinese people.

In 1994 change in government power, the introduction of democracy, a constitution that afforded the right to equality for its entire people and consequently equal economy opportunity for all citizens eventually, brought with it the black economic empowerment policy. This policy which is to redress the wrongs of the past is also to initiate and facilitate a growth strategy in the economy. There was a need for a change for the previously disadvantaged people who would otherwise not be able to participate in business. The need was for policy that had as its objective the changing of the face of business and ensuring that equal opportunity is given to all South African citizens. This policy is therefore not a "take from the rich and give to the poor" policy but it is one to ensure equality in our economy and in opportunities as our constitution requests.

The broad based black economic empowerment act no 53 of 2003 ("**BEE act**"), was enacted to put into effect the vision black empowerment which is to have the economy be transformed to one representative of the demographical make-up of the country. The act has one of its objectives the affording of all citizens access to South Africa's productive resources, skills, ownership of productive assets and the possession of advanced skills. This policy has been criticised[7] to only serve an elite of this previously disadvantaged group, however the view is also that the mistakes and injustices of the past cannot be left unaddressed.

The policy, to be able to achieve its purpose of transformation, has to function together with the laws of the industries and sectors in which this BEE act is to be applicable. This means that in the context of company law these laws should be ones that allow for this policy to take effect and to be applicable without too many hurdles. This policy is therefore not just about employment

[7] Inkata Freedom Party, Mangosuthu Buthelezi has been know as a supporter of this view.

but also about stimulating economic grow across the spectrum of all citizens and not just the historically disadvantaged persons.[8]

Since the inspection of the BEE act, there has been some positive effect. BEE has represented about 5% of South Africa's growth in 2005, a year after the BEE act came into effect[9], and was part of the reason why the Johannesburg stock exchanges had 47% total return on equities traded on in 2005.[10]

The policy is therefore to enable black people to own and participate in business, however it is common knowledge that to do so one has to have the resources. To achieve the empowerment of black people there had to be direct empowerment through ownership and control of enterprises and assets. This is or was an unreachable achievement for majority of historically disadvantaged citizens in South Africa. The company law therefore had to be particularly instrumental in the achieving of the objectives of the BEE policy. With a companies act[11] which was enacted in the same era that brought oppression to black people, it was questionable if the BEE policy and BEE act could be adequately applied to its utmost potential.

The effect, if any, that the companies' acts, the 1973 and the 2008 acts, have on the social context and or BEE will be discussed in each section below.

[8] This has a positive effect on majority of South African citizens as it stimulates growth and most citizens will then be able to sustain themselves and there will be boarder participation in the economy.
[9] The act came into effect on 7 January 2004
[10] South Africa: more fast facts. sourced at http://www.southafrica.info/about/414421.htm on the 16 September 2009
[11] The Companies Act 71 of 1973

CHAPTER 4
COMPANIES ACT 61 OF 1973

4.1 Introduction

After the amendment of the 1973 act by the 1999 act, a company was afforded the ability to purchase its own shares, to finance others to purchase its own shares and to pay out dividence out of capital. The 1973 Act in this paper will be discussed also after its amendment by the 1999 act and as it stands presently.

4.2 Payment of Dividends

On the approval by special resolution, which is a two thirds majority of the shareholders voting in a general meeting, and unless prohibited by the memorandum of incorporation ("Memo") of a company prohibits, a company may pay out dividend to its shareholders.[12] This dividend can take different forms such as, fully paid up capitalisation of shares or the generally used form which is cash.

Dividend is paid out when a company has funds or profits to do so and is paid out to the relevant shareholders in a way provided for in the memo of the company. The idea that the company can only pay out dividend out of its profits was changed by the introduction of the solvency and liquidity rule by the 1999 amendment act into South African company law.

4.3 Divisible profits (profits available for dividends) (s 90)

[12] Pretorius, Delport, Havenga & Vermass *Hahlo's South African Company Law through the cases* (1999) at page 139.

Section 90 of the 1973 act, as amended by the 1999 act, provides that company may make payment[13] to its shareholders on the discretion of the directors and irrespective of profitability. This is done after provision for transfers for reserves has been made and additionally the writing off of previous losses or any other purpose has been made. Only a voting that brings out an ordinary resolution, which is a mere majority by the shareholders voting at a general meeting, is required of the shareholders for payment to be made to shareholders. This was a good change from the previous law before the amendment act which was based on the capital maintenance rule and which did not allow for pay outs if there was no profit in the company funds.

There are a few conditions that are to be satisfied before payments can be made. These are that the articles of the company allow must allow for such and that it must be certain that the company will after the payment be able to pay its debts as they become due in the ordinary course of business and if its consolidated assets, fairly valued will after payment exceed the consolidated liabilities of the company ("**the solvency and liquidity test**").[14] Some rules of common law which will not be discussed under here may still apply in certain circumstances.[15] This is one of the sections where the change and move towards new principles of company law could be witnessed. A change towards a company principles which afforded protection to the company and its shareholders and giving creditors less protection as they have to pursue other avenues in the payment of their debts. There is nothing that states that payment must be made to all shareholders rather than only to one or some of

[13] Cilliers, Benade et al Cilliers & Benade, *Corporate Law* 3rd ed, lexisnexis butterworhts Durban, (2000). The term payment is discussed at page 351 : "Payment is extensively defined and also includes any direct or indirect payment of money or transfer of property (dividend in *specie*. However, it excludes the acquisition of shares in terms of section 84, as well as the redemption of redeemable preference shares, the issue of capitalisation shares and the acquisition of shares in terms of an order of court (for example in terms of section 252)".

[14] Sec 90 of *Companies Act 61 of 1973.*

15 Depending on the provisions of the articles, the common law principles pertaining to the computation and the nature of the dividend will therefore still applies. Common law rules will still apply if the articles or companies act still refer to divisible profits. Cilliers, Benade et al Cilliers & Benade, Durban, (2000).

them and payment can be made on money or by way of a transfer of the company's assets.

This is a change in the for the positive as it means that payment, subject to the conditions, can be made to investors regardless if there is profit in the company. An investor in South Africa, at this stage could then be at ease knowing that there need not have to wait until a company records a profit to see the fruits of their investment.

4.4 Financial assistance (s 38)

The statutory prohibition of financial assistance for purchase or subscription of own shares is regulated by section 38 of the 1973 act. Section 38 widely prohibits a company from *giving, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise and any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares of the company.*[16] This prohibition extends to subsidiaries and holding companies but however has exceptions.

With the preservation of capital of the company in mind, the protection of shareholders and creditors, this provision was brought about to restrict persons who wanted to buy shares and to acquire control of a company or assets in a company but did not have the necessary resources. This was first discussed by the Jenkins committee as they saw it necessary to "curb" possible abuses of company resources. This was seen to be necessary as a person, in this instance, would be putting the interest of shareholders and creditors at risk and the only possible remedy would be then be a claim for damages against the directors should the company fail as a consequence. The person would be using the company this avenue as they could not secure any other loan. The company would therefore be giving financial assistance

16 Cilliers, Benade et al Cilliers & Benade, (2000) supra note 13 at page 329.

without adequate security or consideration or it might just be giving away its funds. The purpose of the provision was therefore to protect the interests of shareholders and creditors of the company from the reduction of capital and the company exposing its fund to possible risk, amongst other things. Further, this provision was to unsure that those who acquired shares in the company did so out of their own resources.

The prohibition of financial assistance was to the exception of instance which are listed in section 38(2)(a) to (d). These are the lending of money if that is the main business of the company, the provision of financial assistance to purchase of shares for shares to be held in trust on behalf of or by employees, financial assistance to bona fide employees to enable them to purchase shares in the company or in the holding company and financial assistance for the acquisition of shares in terms of section 85 of the 1973 act.

The giving of financial assistance and the purpose for which it was given are the two elements of the s 38 prohibition.[17] The giving of financial assistance is defined in an ordinary sense as there is no definition in the present act. In determining if a transaction falls under the ambit of financial assistance the transaction as a whole must be considered and its commercial realities must be examined. The question to ask is whether, as a whole, the transaction can be described as giving financial assistance by the company.[18] Numerous tests have been created to be able to answer this question and one of them is the impoverishment test. This test asks if the company as a result of the transaction that was in connection with the purchase of its shares has become poorer. This test is however not always relevant in all transactions. In answering the question of whether financial assistance was given, one must also look at whether the giving of financial assistance was the main goal of the transaction. If such is not the main or primary goal it must at least have

17 Blackman *et al, Commentary on the Companies Act,* LAWSA Volume 4(1). Lipschitz v UDC Bank Ltd 1979 (1) SA 78 (A) was very instrumental in interpretation of section 38 and this case dealt with the elements of the provision as well.
18 *Ibid*.

been essential for the transaction to be entered into.[19] In other words the transaction would not have carried on but for the giving of financial assistance. Finally the financial assistance must be financial (of monetary value) and if it is not financial then such is not prohibited.

The second element which must be considered is for the *purpose which* financial assistance *was given (or in connection with)*. This element is satisfied if the company's sole purpose for giving financial assistance was to enable someone to purchase or subscribe for shares in the company. [20] The position taken by Blackman[21] in his interpretation of section 38 is that when coming to the issue of when financial assistance is a subsidiary purpose, the purpose must *have been necessary in the sense that, had use of the financial assistance to acquire its shares not been one of the company's purposes, the financial assistance would not have been granted.* [22]

Section 38 is also contravened when the financial assistance is given in "connection with" (an alternative to "for the purpose off") the purchase or subscription of or for shares. These words are relevant in situations where the purpose of the giving of financial assistance was not established but the act was in a close relationship to the purchase of shares of a company and the conduct was similar to that of a company which was giving the prohibited assistance with the purpose described in the section. Each case in this instance is considered on its own merits and facts. The transaction must also be financial assistance for the purchase of shares or in connection with that purchase, just because the purchase facilitates or eventually assists in a purchase or subscription does not mean it is prohibited and that it was given for the purpose of or in connection with the purchase or subscription.

19 *Ibid.*
20 *Ibid* .
21 *Ibid* .
22 Blackman 1979 (1) SA 78 (A) at page 1 of 3, For the purpose of in connection with Section 38 of the present companies Act.

The 1999 amendment act should have made provision for financial assistance on condition that the solvency and liquidity rule was satisfied and not just the made provision section 85 acquisition. Section 38 seems to be a statutory extension of the capital maintenance rule in that it carries on the principle that capital is fixed and certain. Section 38, despite the amendment of the act, is therefore one of the sections that leave a residual of the capital maintenance act.

The 1973 as amended by 1999 act, as though to follow criticism, was further amended by the Corporate Laws Amendment 24 of Act 2006.[23] Section 40 of this act permitted the giving of financial assistance by a company for the purchase of its shares. This act made way for a company to be able to grant financial assistance to companies for the purchase of its own shares or subscription of shares. This is on condition that approval from the shareholders by a special resolution is achieved and that after the transaction the company will be able pass the solvency and liquidity test. This section as amended requires that the solvency test must be satisfied after the transaction and the liquidity test must be met after the provision of the financial assistance and for the duration of the transaction. This means the company must have its consolidated assets, fairly valued exceed its consolidated liabilities after the financial assistance is given and for the time the transaction is on going.

4.4.1 The effect on BEE policy

The restriction of financial assistance in the 1973 act, before it was amended in 2006, also had a hindering effect on the implementation of BEE. BEE partners could not go to companies for financial assistance but had to

[23] Sec 38(2A), sec 9 of the Corporate Laws Amendment Act 24 of 2006.

approach third party financing houses[24] or come up with complex preference share structures to implement their deals.[25]

The solvency and liquidity test in the 2006 act is some what of a burdensome statement for directors. This is because if the funding is to endure over a long period, BEE transactions as they are usually for a long period of time, then the directors must be certain that during this time the liquidity test in at all time during the transaction and before is satisfied. Indications after the amendment were however positive as many transactions that included BEE partners were concluded in the after such new amendment.[26]

The 2006 act amendment was better suited for South African company law in that the principles and spirit of our constitution are those that promote giving opportunities to persons who were previously disadvantaged in the apartheid era. One of the policies that have been formed to curtail and attempt make some right of the wrongs people suffered is the Black Economic Empowerment policy ("BEE") and this amendment had a positive effect on this policy[27] and the amendment seemed to be one that was towards facilitation of the funding of BEE transactions.[28] It further cancelled the complicated manner in which BEE partners could be funded as now there was no necessity to come up with complicated share structures to enable such. The amendment further expanded investors' options when looking for finance and tended to facilitate shareholder diversification. [29]

There however needed to be a complete removal of the capital maintenance rule to new and more updated provisions which will regulate the maintaining

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[24] Which have stricter policy when lending out money.

25 Stephen Kenney-good and Candice Isaac of Denys Reits Attorneys, *Black Economic Empowerment: a windy road ahead?*, published on 30 April 2009, sourced at www.denysreitz.co.za on 18 September 2009.

26 Stephen Kennedy- Good of Denys Reitz, *The companies act was recently amended to provide that a company may now provide finance to a purchaser to take up share in the company,* sources at www.deneysreitz.co.za on 18 September 2009.

[27] *Ibid.*

[28] *Ibid.*

[29] *Ibid.*

of capital in companies on the basis of a modernised and up to date maintenance of capital and grant financial assistance to all persons and not just companies.

4.5 Acquisition of own shares (s 85)

Before the 1999 amendment act, section 119 of the companies act prohibited a company from purchasing its own shares even if expressly empowered to do so by its memo.[30] This prohibition originated in the Trevor v Whitworth case, and the purpose of the prohibition was *to protect the creditors of the company by preventing unlawful reduction of the company's capital and to protect the shareholders by preventing the company from trafficking its own shares.*[31] This prohibition was taken away by the coming into effect of the 1999 amendment act.

Section 85(1), as amended, allows for a company to acquire its own shares. This is possible only if such is authorised by the articles of association of the company and approved by shareholders by a special resolution of a particular acquisition or by a general resolution/approval which is valid only until the next general meeting. Such a transaction will result in the reduction of capital as the shares acquired by the company are cancelled together with the rights and privileges attaching to the shares, such as voting rights or dividend rights.

There main requirement is that the company must satisfy the solvency and liquidity test before and after the acquisition of its own shares. This is tested in an objective manner and both tests, solvency and liquidity, must be satisfied. Further, this is embodied in section 85(4)(a) and (b) of the present act as amended by the 1999 amendment act. There is no restriction on the source of the funds utilized to acquire the company's shares, all that is required is that there be a reasonable grounds for the belief that the company

[30] Cilliers, Benade et al supra n13.
[31] F.H.I Cassim and Rehana Cassim supra n2 at page 1.

is liquid and solvent. Payment in contravention of the liquidity and solvency tests will result in the illegality of the share repurchase agreement.[32]

The prejudice to creditors is excluded due to the requirement that the company must satisfy the solvency and liquidity test. If s 85 is not complied with then the creditor can apply to court to have the consideration and shares taken back to the original owners. Directors become severally and jointly liable in terms of common law and in terms of section 86(1) and (2) if the solvency and liquidity test is not satisfied before and after the shares are acquired.

There is initial protection to shareholders is that shares are acquired only if authorised by a special resolution. The company is required to send an offering circular to all shareholders in the class of shares and if there is acceptance of more than what was excepted then the company must accept all offers on a pro rata basis. This makes it difficult to eliminate a specific shareholder as when others accept then the pro rata basis would take effect.

The 2007 amendment is one that moves towards a new suited law which does not have residual of the capital maintenance rule.

4.6 Repurchase of shares

Redeemable preference shares can be purchased by a company but these must be substituted by either shares which have been issued for the purpose of the redemption or capital redemption reserve fund which is created out of divisible profits.[33] This is so the contributed capital is effectively maintained. Section 252 also allows for a shareholder who has been prejudiced to have their shares be bought back by the company or other member and consideration given to the prejudiced shareholder (also known as the

32 F.H.I Cassim and Rehana Cassim supra n2 at page 2.
[33] Cilliers, Benade et al supra n13 at page 337.

oppression remedy). Repurchase of shares can also occur as part of a scheme for reduction of capital.

4.7 Shares at a discount

The common law principle is that shares cannot be sold at a discount. This is the concept of capital fund preservation on which creditors may take reliance.[34] The 1973 act however changed the common law principle by allowing shares to be sold at a discount only in certain circumstances with the order from the court or by special resolution.

Shares in the 1973 act are separated into par value ("PV") shares and no par value shares ("NPV") unlike in the 2008 act where there is only NPV shares. The act allows for issue of PV shares at a discount only if the shares which are issued at a discount must be of a class already issued by the company; at the date of issue at least one year must have elapsed since the date on which the company became entitled to commenced business or since the date of the first issue of that class of shares; the issue be authorised by a special resolution specifying the maximum rate of discount; the issued shares be sanctioned by the court and it may further make an order on such terms and conditions as it deems fit; the shares in question must be issued within one month after the date on which the court's sanction has been obtained or within such extended time as the court may allow.[35]

In the case of NPV shares, the class of shares that has already been issued may not be issued at a price lower than the total reached by dividing: that part of the stated capital account contributed by such NPV shares by, the number of NPV shares already issued unless the lower issue price is authorised by a special resolution.[36]

[34] Cilliers, Benade et al supra n13 at page 327
[35] Cilliers, Benade et al supra n13 at page 328
[36] Ibid

Allowing the issue of shares at a discount is a great move for BEE partners however this is not a simple thing to do as there are many conditions that have to be observed.

4.8 Alteration of capital (s 75)

A company, with a special resolution approval by the members of the company and if authorised by the articles of association, can alter its share capital. This is subject to section 56 and 102 and if the articles of association does not allow for alteration of articles then the company can first alter the articles of association and the approval to alter by special resolution and at the same time, if required. This is provided for by section 102 of the act which also states that in the issuing of new shares the right of the existing shareholders of that class must not be prejudiced and this increase in capital must not amount to fraud to the minority. There are instance of what form alteration can take an these listed in section 75(1)(a) to (i).[37]

4.9 Conclusion

The present act was initially not one that was absolutely suited for South African context despite the many attempts to amend it. Financial assistance, as regulated and before the 2006 amendment, had a negative effect on BEE and such was great motivation and reason to amend the act and move more into one best suited for South Africa. The 2006 act made a substantial difference and had positive effect on the BEE transaction but more needed to be done.

The need for reform is evident as the principles which were the basis of the 1973 act were not only complex and outdated but were no longer suited for the South African business practice. There was therefore a need for law that

[37] Cilliers, Benade et al, supra n13 at page 338. These included: increase of shared capital, consolidation of shares, subdivision of share, conversion of PV shares into NPV shares, Cancellation of unissued shares and Conversion of shares into shares of another class.

would be able to function not only in the unique social context of South Africa but one that would keep up with the best international business practises. Further shareholders in this act were not adequately protected in terms of their investment as they should have been rather the focus was on the protection of creditors and to ensure that their rights were realised.

CHAPTER 5
COMPANIES ACT 71 OF 2008

5.1 Introduction

The 2008 companies act was a piece of legislation brought due to the need for reform in the South African company law. The 1973 legislation had become outdated as it was based on principles not only established in another jurisdiction and then applied in the South African law, but based on principles established about a hundred years ago.

There was clearly a need for change in the South African company law as the context in which the 1973 act was established had vastly changed and new policy, such as BEE, was present in the new social context and such had to be considered. A new law that would keep up with international business practise, consider the changes of South Africa's social context, its developing economy and its highly praised constitution had to be legislated. The 2008 act completely removed the capital maintenance rule and is based on the american solvency and liquidity rule which is more flexible with regards to capital maintenance in general. The explanatory memorandum of the Companies Act states that *in order to promote efficiency, par value shares and nominal value should be replaced with a "capital maintenance regime based on solvency and liquidity*.[38]

The policy paper that discussed the review on the companies act states the this was to ensure that the new legislation is one that is appropriate to the legal, economic and social context of South Africa as a constitutional democracy and open economy. [39]

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[38] Kathleen van der Linde, TSAR 2009 (1), *The regulation of share capital and shareholder contributions in the Companies Bill 2008*, at page 39.
[39] *South African company law for the 21st century – guidelines for corporate law reform* (policy paper) Government Gazette no 26493 of 23 June 2004,

5.2 Solvency and liquidity rule (s 4(1))

A company will satisfy the solvency and liquidity test if, in 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 aggregated liabilities of the company ("**solvency test**") **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 (**liquidity test**).[40] This test is considered when the company has the intention to make a distribution[41] and the board of a company may be required to make acknowledgement that the test has been applied and satisfied in some instances.

P. Delport is of the view that this test is a subjective one as the board of directors ("**the board**") are the ones that must be satisfied that the company is actually solvent and liquid.[42] K. van der Linde is of the view that the test is an objective one as it not stated who must be make the reasonable determination[43] and she further states that the resolution of the board that the test has been met is set as an additional requirement in certain instances[44].[45] It seems that the test will be both objective and subjective when the additional requirement that the board must make an acknowledgement resolution is present and objective when not. It is uncertain who will be responsible for applying the test when the additional requirement for the resolution by the board is not present, however the board as the body that governs the company will have to take on such duty and will be held liable if the test is not

[40] Sec 4(1) of Companies Act no 71 of 2008. Section 4 also states that if a director can, on other basis, base or determine another fair evaluation bases on other information, such can be included to determine a fair value in terms of the solvency and liquidity test.
[41] Distribution in terms of the 2008 act will be discussed below.
[42] Piet Delport, *The New Companies Act Manual*, 2009 Lexis Nexis Durban, at page 32.
[43] Sec 46(1)(b).
[44] Sec 46(1)(c).
[45] Kathleen van der Linde, TSAR 2009 (2), *The solvency and liquidity approach in the companies Act 2008*, at page 235.

satisfied after distributions are made. The question therefore becomes, whether this does not make the test subjective as the board has to apply the test regardless of whether the additional requirement is present and does this then not make the distinction between section 46(1)(b) and (c) ineffective? It seems that the act in terms of section 46(1) should have read that the board must apply the test on behalf to the company and then further apply the test further for the purpose of their resolution for acknowledgement of the test being applied and satisfied.

Both the solvency and the liquidity test must be satisfied and such satisfaction must be after the completion of distribution or transaction. After this satisfaction any other developments in terms of the solvency and liquidity of the company will not affect the transaction. This test is based on compliant financial statement and accounting records, reasonable foreseeable contingent assets and liabilities and all reasonably foreseeable circumstances.

According to K van der Linde, the solvency and liquidity test have different theoretical justifications in that *the solvency element gives advance recognition to the ultimate priority that creditors enjoy over shareholders upon dissolution of the company by preventing the company form favouring its shareholders through a partial liquidation.*[46] *The liquidity element is justification is that it addresses the expectation of creditors to be paid on time and also fits well with the representation a company is said to make when it incurs debt, that it reasonably expects to be able to pay as and when the debt becomes due.*[47]

The solvency and liquidity rule as basis of the 2008 act has differences from that which was introduced by the 1999 act. The test in the 1973 act as it stands today imposes a negative duty in that the board and the company

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[46] P Delport supra n41 at page 226.
[47] *Ibid*.

must be certain that there is reasonable ground that the test is satisfied.[48] The 2008 act test imposes a positive duty on the board and company to consider and apply the test, in other words there must be actual application of the test.[49] Further, the test in the 2008 act does not refer to consolidated assets and liabilities but to the total assets equalling or exceeding its total liabilities. Further the difference is that the 2008 act states that this test must be met 12 months after the date on which the test is considered and the 1973 act states that the solvency test must be met subsequent to the transaction and the liquidity test must be met subsequent to providing the assistance and for the duration of the transaction.[50]

5.3 Company distribution (s 46)

The interest of shareholders to get returns on their investment in the form of company paying out distributions or dividend and those of the creditors getting paid what debt is due to them is what should be considered and balanced when distribution is made. The interest of creditors in this regard is protected in that there are financial restrictions[51] on the payment or return of capital to shareholders.[52]

Distributions are governed by section 46 and defined in section 1 of the 2008 companies act[53]. This definition results in distribution to include dividends (in

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[48] P Delport supra n41 at 237.
[49] *Ibid.*
[50] Charles Douglas of Bowman Gilfillan, *New legislation aims to facilitate funding of BEE*, sourced at http://www.busrep.co.za/index.php?fSectionld=561&fArticlekd=431104 . Charles is of the view that the 2008 act is *more onerous on the directors as each director who voter for a resolution, or approved an agreement in contravention of the section will be liable to compensate the company or any shareholder for any loss, damage or costs that the company or shareholder may have sustained or incurred in relation to the transaction.*
[51] The financial restriction is in the form of the solvency and liquidity test and that it must be applied and satisfied before distributions are made.
[52] Kathleen van der Linde, *The regulation of conflict situations relating to share capital*, (2009) 21 SA *Merc LJ* 33-50, at page50.
[53] Sec 1 of Companies Act 61 of 2008. "'Distribution' means a direct or indirect- (a) a direct transfer by company of money or other property of the company, other than its own shares, to or for the benefit of one more holders of any of the shares of that company or of another company within the same group of companies whether (i) in the form of dividend; (ii) as payment in lieu of a capitalisation share, as contemplated in section 47; (iii) is consideration for the acquisition – (aa) by the company of any of its

cash or any kind), capitalisation of shares (or payment in cash instead of capitalisation of shares), a repurchase of shares by a company, a debt incurred to or for the benefit of a holder of any of the share and, debt cancellation ("forgiveness of debt") in respect of a holder of any of the shares, the writing off of debt of an existing subsidiary company by a holding company and buying of shares by a holding company in existing subsidiary company[54].[55] A transaction is a distribution if the person it is in the benefit for is a holder of shares in the company or companies in the same group or the company itself.

The main purpose of section 46 is to protect shareholders and to protect capital (for creditors) and to prevent abuse control situations. So this is to make sure that the creditors are not endangered and that shareholders are not disadvantaged by the disproportionate payments either within a single class of shareholders or among different classes.[56]

A distribution is made only if the distribution is pursuant to an existing legal obligation or a court order, **or** the distribution is authorised by the board of the company by resolution, **and** it reasonably appears that the company will satisfy the solvency and liquidity test right after the distribution **and** finally the board resolution acknowledges that the board has applied the test and reasonably concluded that the company will satisfy the test right after the completion of the proposed distribution.[57] [O*ur emphasis*]. It must be noted

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shares , as contemplated in section 48; or (bb) by any company within the same group of companies, of any shares of that company or of another company in the same group of companies; or (iv) otherwise in respect of any of section 164(19); (b) incurrence of a debt or other obligation y a company for the benefit of one or of companies; or (c) forgiveness or waiver by a company of a debt or other obligation owed to the company by one or more holders of any of the shares of that company or of another company within the same group of companies, but does not included any such action taken upon the final liquidation of the company".

[54] *Ibid*. P. Delport states that it is unclear why if the writing off of debt or buying of shares in subsidiary is "distribution" why such does not have to comply with the solvency and liquidity test.

[55] P Delport supra n41 at page 33 and 34.

[56] Kathleen van der Linde, *The regulation of distributions to shareholders in the Companies Act 2008*, TSAR 2009 (3) 484-501, page 484.

[57] P Delport supra n41 at page 34. Section 46 and P. Delport's manual of the new companies act, op cit note 29. Distribution that does not comply with the section 46 is only void only if the court declares it so as per sec 218 of the act. The liability of any loss or damage or costs sustained by the company due

that both the solvency and the liquidity of the company must be complied with. In other words section 46(1)(a)(ii) requests the board must authorise a distribution,[58] there additionally has to be compliance with the solvency and liquidity test and a resolution from the board that acknowledges that the such a test has been applied and there is reasonable conclusion that the company will satisfy the test immediately after completion of proposed distribution.[59] The requirements for distributions to be made do not include one where there is a requirement that there has to be approval by the shareholders of a company, but the memo of a company can prescribe that there be such a requirement which must be complied with.[60] .

The company thereafter the compliance with all the requirements must fully carry out the distribution. If the distribution is not made and completed within 120 days, according to section 46(2) read with (3), there must be a reconsideration of solvency and liquidity test. The 120 days is counted from the time the directors make a resolution acknowledging that the test has been applied and met. According to K. van der Linde this is in conflict with section 46(1)(b) which states that distribution must be made only if it appears that the company will satisfy the solvency and liquidity test.[61] I agree with this opinion as if distributions are to go ahead when the board makes its acknowledgement then there is no need for section 46(1)(b) as the applying of the test and would be done after compliance with section 46(1)(c) which requires the resolution acknowledging that the test has been applied by the board. K. van der Linde is further of the view that if the directors no longer think that the company's financial situation allows for distribution then such distribution should be prohibited, this seems to be giving directors a lot of

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to transactions under sec 46 will be accounted to the directors as per sect 46 and sec 77(3)(e)(vi) of the 2008 act.

[58] This is unless a distribution is made pursuant to an exiting legal obligation of the company or a court order. This is provided for in sec 46(1)(a)(i).

[59] Sec 46(1)(b) and (c)

[60] Kathleen van der Linde, TSAR 2009 (3) 484-501 supra n55 at page 492.

[61] Kathleen van der Linde, TSAR 2009 (3) 484-501, supra n55 at page 494.

power and the possibility of abuse of such power by directors.[62] The presence of shareholders in the making of this decision could possibly prevent such abuse.

Distributions, as defined in section 1 of the 2008 act, expressly includes those between a companies in the same group. *An action that would quality as a distribution if made to the company's won shareholders will also constitute a distribution if made to shareholders of any other company within a group.*[63] K van der linder further states that, the inclusion of a distribution being one made to shareholders of a subsidiary company by its holding company, there is doubt that the legislature appreciated the possible results of a downward application of the definition within a group, as this goes against the basic nature of distribution being that one invests and gets returns in that specific company and shareholders in a subsidiary do not make an investment in the holding company, so when a company buys shares from shareholders in the subsidiary company and this is a pure transaction as holding company receives something in return.[64] The implication is further that since a distribution can be made in direct or indirect manner the same distribution, as a result, could be regulated as a distribution by more than one company in the group. K van der linde states that the regulation of distributions as a whole in the context of companies in the same group should be removed and regulation according to specific provisions.[65]

Distribution, as regulated in the 2008 act, is a wider concept than that in the 1973 act as amended. The 2008 act has as one of its main purposes the protecting shareholders and creditors having to use other means to get their debt payed either than absolute restriction of paying out dividend from capital of the company by the act. However, the expectation of shareholders sharing

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[62] Ibid. Abuse such as wanting to stop a take over or wanting to get rid of a specific shareholder. The alternative of this opinion is that the directors are held liable by section 77(3)(e)(iv) if not acting in the interest of the company or loss or damage is incurred.
[63] Kathleen van der Linde, TSAR 2009 (3) 484-501 supra n55 at page 490.
[64] Kathleen van der Linde, TSAR 2009 (3) 484-501 supra n55 at page 491.
[65] Ibid.

in the profits of the company they invested in has to be balanced against that of creditors to get payment when it is due.[66]

5.3.1. Director liability

5.3.1.1 General Liability

The common law principles of fiduciary duties of the directors are applicable where a director is held liable for any loss, damage or costs sustained by the company due to the breach of this duty by the director. This beach will ensue where the director fails to disclose a personal financial interest[67], to avoid a conflict of interest[68], to act in good faith and for a proper purpose or in the best interest of the company[69]. Additionally there is liability on the director, according to section 77(2)(b), for breach of the duty to act in the required degree of care, skill and diligence[70] or beach of any provision of the act not mentioned in this section or any provisions of the MOI of the company.[71]

The liability of directors, as in the 1973 act, is to the company only and not creditors. This means creditors cannot bring an action against directors for unlawful distributions even though they can bring a derivative action on behalf of the company with the permission of the court.[72] This general liability will apply to every instance where directors are held liable by the act and this means all the sections to be described below which confer liability on directors will have the common law principles to fiduciary duties apply to them as well if such are not in conflict with the act.

5.3.1.2 Director liability in distributions

[66] Kathleen van der Linde, *Merc LJ* 33-50, supra n51 at page 49.
[67] Sec 75 of the 2008 Act.
[68] Sec 76(2) Ibid.
[69] Sec 76(3)(a)-(b). Additionally the director is liable for any benefit he got from the company in this context irrespective of the company's loss or damage.
[70] Sec 76(3)(c)
[71] This is in accordance with the common law principles delict which deals with loss, damages or costs sustained by the company as a consequence of the action of the director.
[72] Sec 165(2)(d) of the 2008 Act.

A director who was present at the meeting or participated in the making of the decision, and failed to vote against the resolution despite knowing that the resolution was against section 46 will be held liable in terms of the common law principles of fiduciary duties as discussed above and such liability will result regardless of whether the court declares the resolution or transaction void. A director is held liable even if he was not present at the meeting but knew of the matter to be decided on in such a meeting. The director is therefore held liable on the voting of the approval of the acquisition of shares.

Directors are further held liable under section 77(3)(e)(vi) as a consequence of that they failed to vote against the decision and if immediately after the distributions the company does not satisfy the solvency and liquidity test and it was unreasonable to vote that it would satisfy this test.[73] The director who was not at the meeting but failed to show his dissent vote to the matter voted on in the meeting will also be liable.

5.3.2 Effect on social context and BEE

Together with the financial assistance and acquisition of own shares to discussed below, BEE owned businesses can expect to get paid out their investment from the company out of capital and no longer have to wait until the company has made profit and this could be a long period of time, especially in economic conditions like the present. This is a positive change as it means more returns or ones that are more often when it is acceptable and reasonable to do so.

5.4 Financial assistance (s 44)

[73] This must occur for there to be liability but if the test is satisfied the conduct of the director is irrelevant and similarly if the test is not satisfied but the director acted reasonably when making the acknowledgement then such director is excused. Also see section 77(4) on what they director is liable for in terms of quantum.

Sections 44 of the 2008 act provides for a company to directly or indirectly grant financial assistance for the purpose of or in connection with the purchase or subscription[74] of a share or option issued or to be issued by the company or a related or inter-related company[75]. The section states that the board may authorise the company to grant financial assistance. This seems incorrect as the company is the contracting party and since it cannot enter into a contract by itself enter it would authorise the board to enter into a contract on its behalf.[76] Financial assistance may be granted provided that the MOI[77] of the company expressly permits the financial assistance **and** the financial assistance is pursuant to an employee share scheme as per section 97 **or** it is pursuant a special resolution of the shareholders, adopted within the previous 2 years. This means financial assistance is either a share scheme or the shareholders must approve it by special resolution. Further the board must be satisfied that the solvency and liquidity test will be satisfied and that the terms under which the assistance is proposed to be given are fair and reasonable to the company. The board must therefore make a resolution acknowledging such. Financial assistance does not include lending money in

[74] Subscription is not defined in the Act but only mentioned in this case.

[75] Related and inter- related is defined in section 2 of the act as : "**an individual is related to another individual if they**- (i) are married, or live together in a relationship similar to marriage or; (ii are separated by no more than 2 degrees of natural or adopted consanguity or affinity; (b) an individual is related to a juristic person if the individual directly or indirectly control the juristic person , as determined in accordance with subsection (2); (c) a juristic person is related to another juristic person it- (i) either of them directly or indirectly controls the other, or the business of the other, as determined in accordance with subsection (2); (ii) either is a subsidiary of the other; or (iii) a person directly or indirectly controls each of them, or the business of each of them, as determined in accordance with subsection (2); and (d) 2 or more person are inter-related if the first and second such persons are related, the second and the third such persons are related, and so forth in an unbroken series;

(2) **For the purpose of subsection (1), a person controls a juristic person, or its business, if-** (a) in the case of a juristic person that is a company- (i) that juristic person is a subsidiary of that first person, as determined in accordance with section 3(1)(a); (ii) that first person together with any related or inter-related person is (aa) directly or indirectly able to exercise or control the exercise of a majority of the voting right associated with securities of that company, whether pursuant to a shareholder agreement or otherwise; (bb) has the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at the meeting of the Board; …. (d) that first person has the ability to materially influence the policy of the justice person in a manner comparable to a person who, in the ordinary commercial practice, can exercise an element of control referred to in paragraph (a), (b), or (c)".

[76] P Delport supra n41 at page 31.

[77] In the Companies act 61 of 2008 the memorandum of association is referred to as a memorandum of incorporation.

the ordinary sense of a business by a company whose primary purpose is the lending of money or an accountable advance.

Directors are to make a resolution acknowledging that the solvency and liquidity test has been applied and satisfied. Any resolution in favour of granting financial assistance or an agreement with respect to the provision of any such assistance is void if it is inconsistent with section 44 or inconsistent with a provision of the MOI. P. Delport is of the view that the disjunctive is not logical. [78] Financial assistance should be prohibited if it does not comply with both the MOI and section 44 and not just one of the two. This is because the MOI of the company is the constitution of the company and should be followed if it is not inconsistent with legislation. As it stands presently stands, section 44 therefore could allow for financial assistance to be granted, if the legislation is followed, regardless of what conditions the MOI imposes on such transactions. This could not seem to have been the intention of the drafters of the 2008 act.

According to section 218(1) financial assistance is not void until a court of law says it is so, despite it being void in terms of section 44(5). This section opens up for loopholes in the application of s 44. There is an opportunity for abuse as people can structure deals and transactions with the intention that such will be declared void by the court before subscription[79] laws come into effect. This can be to the detrimental not only of companies but of bona fide third parties who enter into transactions with the intention to be bound by it.

Section 44 applies not only to instances when financial assistance is given within the company itself or when to a subsidiary company but also when granted to related or inter-related companies. The application of this section then goes far as for inter-related companies which for example, could be when company A grants financial assistance for acquisition of shares in

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[78] P Delport supra n41 at page 32 footnote 4.
[79] Subscription laws regulate how long after a transaction has been completed, matters related to such transaction can still be adjudicated in a court of law.

company D and it (company A) is related to B which is related to C and C to D. In this example the requirements of financial assistance have to be complied with as they are all which are inter-related. This factor makes section 44 much wider in its application than section 38 as it also applies not only to financial assistance for acquisition of shares in the holding company itself but also financial assistance for purpose of acquisition of shares in a subsidiary company.

5.4.1 Loans to directors and companies within a "group" (s 45)

The board may authorise the company to provide direct or indirect financial assistance to a director or prescribed officer of the company or of a related or inter-related company, or related or inter-related company or corporation, or a member of a related or inter-related corporation or persons related to any such company, corporation, director or prescribed officer or member.

A loan that is made to a subsidiary in this context must comply with section 46 of the act which regulates distribution as it falls under the definition of distribution. This means that after there has been compliance with section 45, section 46 must also be complied with in this regard. This means that the solvency and liquidity test will have to comply with as stated in section 46.

The board may authorise this financial assistance if it is pursuant to an employee share scheme as per section 97 **or** it is pursuant a special resolution of the shareholders, adopted within the previous 2 years. Just as section 44 the board must be satisfied that the solvency and liquidity test will be satisfied only that the "that the terms under which the assistance is proposed to be given are fair and reasonable to the company" has been removed in this context. Further just as in section 44, loans in this regard or financial assistance does not include lending money in the ordinary sense of a business by a company whose primary purpose is the lending of money or an accountable advance.

Any resolution in favour of granting financial assistance or an agreement with respect to the provision of any such assistance is void if it is inconsistent with section 46 or inconsistent with a provision of the MOI. Such non compliance will result in there being liability for directors in terms of section 77(3)(e)(v) only if a court declares the transaction void in terms of section 218(1).

The shareholders of the company, who are not directors and trade unions representing employees, if any, must be sent the written resolution ten business days after the board adopts such resolution if the loan exceeds 1% of the company's net worth at the time or within thirty business days after the end of financial year in any other case. It is not clear why a resolution must be sent to employees as they are not members of the companies and do not make any capital investment in the company.

The issues that arise are similar to those discussed in section 44, as it also covers loans to inter-related and related companies.

5.4.2 Directors liability

Directors who were present at the meeting when the board voted on the resolution or agreement or who participated in the making of the decision and who failed to vote against the resolution, are held liable for any loss, damage or costs sustained by the company if the resolution which they voted for declared void by the court as per section 218(1).[80]

The company or a director who is, or may be liable may apply to court for an order setting aside the decision by the board and the court can do so in part or whole, absolutely or conditionally.[81] The court can further make a justifiable and equitable order including rectifying the decision, reversing any

[80] Sec 44(6) and 77(3)(e)(iv)
[81] P Delport supra n41 at page 33.

transaction, or restoring any consideration paid or benefit received by any person in terms of the decision of the board.[82] Further, the court can order the company to indemnify any director who is or may be liable for liability or costs and damage. This is if the board acted in contravention of section 44. The common law fiduciary duties of the directors are still applicable in the new act where they are not excluded or where not in conflict of the provisions of the act. It would then be justified to ask if the directors acted in the interest of the company in reaching their decision and not for their own interests when deciding if they are liable in terms of common law rules.

5.4.3 The effect on BEE

The 2008 act allows financial assistance to persons and not just to companies unlike the 2006 amendment act. Either than this difference the provisions are similar despite their difference in wording.

Due to the fact that the substantive content of the two acts, the 1973 as amended by the 2006 act and the 2008 act, are similar the effect on BEE by the 2008 act is likely to be very similar to the previous one. As shown by the activities after the 2006 act[83] the 2008 act is likely to have a positive effect on BEE transactions and business owed by BEE policy beneficiaries.

Section 44 is however not without some criticism in terms of its allowance to granting of financial assistance. Section 218(1) can become a real issue for BEE partners in that they could get into deals which could possibly be declared invalid by the courts. The implementation of BEE policy is largely based on financial assistance as BEE businesses or companies are usually not ones that have the finances to participate in the economy due to the history of oppression in this country. Section 218(1) could result in there being

[82] Ibid.
[83] Companies after the 2006 amendment act struck BEE deals and entered into BEE transactions one example being Rainbow Chicken concluded a deal in terms of which 15% of its equity was sold to a broad based black consortium and company employees for R915,6 million.

a great loss for parties in section 44 transactions. In light of that view this abuse, this could lead to collapse BEE business and give big corporations the opportunity to go back on their deals at a later stage. This also gives such corporations that offer financial assistance to BEE business an opportunity to get out of transactions they feel they are not satisfied with and do not want to be bound by anymore without using the correct methods which could not be extremely detrimental to their BEE business partners.

5.4.4. The effect on the social context

BEE policy has as its beneficiaries individual who were previously disadvantage and majority of the people covered by this policy are those who despite their ability and skills were unable to get the opportunities of participating in business.

The effect on the social context will be that those people who could not be able to participate in business will be able to not only participate, but also be able to acquire shares and assets in big companies which could otherwise be difficult to do by using third party financiers who are vigorous in their granting of financial assistance or loans.

5.6 Acquisition of own shares (s 48)

Section 48 of the 2008 act states that a company may acquire its own shares for consideration but it has to comply with section 46 which regulates distributions.[84] This may be acquisition of shares in a holding company by a subsidiary company, provided that the aggregate number such of shares (or held on behalf of subsidiary) does not exceed 10% of the number of any class

[84] Sec 48(2)(a). Kathleen van der Linde is of the view that this is as that share repurchases entails a reorganisation of the capital of a company as well as a distribution to the extent that the company gives consideration and that it makes sense to regulate the distribution aspects in one provision and the reorganisational aspects in another. Kathleen van der Linde, TSAR 2009 (3) 484-501 supra n55 at page 492.

of shares. Additionally these shares that the subsidiary acquires do not come with any voting rights.

Section 48 acquisitions also include share repurchase, redemptions remedy, oppression remedy as per section 163(2)(g) and all financial restrictions apply to them. This means it includes instances where a shareholder relinquishes rights in respect of a share in a company whether for consideration or not. If consideration is given then such is distribution, even this consideration is in cash or otherwise.

Acquisition cannot occur if the only shareholding left in the company would be those held by one or more subsidiaries of the company, or just convertible or redeemable shares would be left. This regulation is not necessary for subsidiaries as they cannot hold more than 10% of shareholding in the company. A company is bound by the transaction unless they cannot comply with the agreed terms of the transaction without breaching section 48(2)-(3) of the act as properly done by the act in this instance.[85] There must be compliance with section 48(2)(a) which makes reference to section 46 and (3), and section 46 (liquidity and solvency) or the acquisition will be invalid even if section 46 is complied with. This is different from the 1973 act where one has to only not comply with solvency and liquidity for there to be invalidity and unenforceability of the transaction.[86]

The company can apply to the court for an order to reverse the acquisition if it did not comply with section 46 or 48 and if it was within the 2 years after the acquisition. The order in this regard can be for everything to be returned to the original owner or that the purchaser of the shares is to be issued an equivalent of acquired shares of the same class as the acquired shares. P. Delport is of the view that reversal might be unfair and prejudicial for a bona fide third party who was not aware that the relevant internal regulations or

[85] P Delport supra n41 at page 35.
[86] Kathleen van der Linde, TSAR 2009 (3) 484-501, supra n55 at page 492.

laws had not been complied with and that there seems to be no remedy available for the third party in the act as such situations are is not included or covered in the statutory *Turquand* rule of section 20(7)-(8) of the 2008 act.[87]

If the company made resolution that did not comply with all provisions as required or if the solvency and liquidity test was not satisfied the court can make an order that is just and equitable. Namely, the court can order for payment returned to the relevant person and for such to be made at the earliest possible date subject to other financial obligations as they fall due and payable.[88]

Due to the cross reference by section 48 to section 46 there is some uncertainty as to at what instance the decision to allowing acquisition of the shares is said to be done as all the requirements have been complied with. The impression made is that under section 46 to make distribution, a repurchaser resolution can be taken only if the company is solvent and liquid at the time of the resolution.[89] On this impression the issue becomes that in that the order of events in approving an acquisition is that the decision to acquire shares is taken and thereafter the acknowledgment will follow such decision then how is this to occur with the manner in which the act the act states that the solvency and liquidity test must be satisfied when the decision to acquire is made. *It is contrary to the scheme of the act to require compliance with the solvency and liquidity requirements at the time of the decision to acquire shares rather than at the time of completion of the distribution.*[90] The question then becomes that how does the board pass such resolution that test is met at the time of the of the decision to acquire shares without doing having to do two tests, one when the decision is made and then another when acknowledging that the company will pass the solvency and

[87] P Delport supra n41 at 36.
[88] Kathleen van der Linde, TSAR 2009 (3) 484-501, supra n55 at page 494.
[89] Kathleen van der Linde, TSAR 2009 (3) 484-501, supra at n55 at page 493. Such resolution is taken by the board as an acknowledgement that the company is solvent and liquid and will be right after the transaction is complete.
[90] Ibid.

liquidity test at completion of distribution. K van der Linde states that to solve this issue and make this section clear there should be no reference to section 46 in section 48.[91] It seems that it would be sufficient if section 46 is known to have to be complied with in terms of the solvency and liquidity requirement for there to be acquisition. Removing the cross reference to section 46 in section 48 and having a clause that states that section 48 acquisitions are considered as distribution would be enough to make certain that the distribution together with section 48 requirements are complied with.

If a company cannot repurchase shares, due to financial restriction or for whatever reason, it can approach the court for relief. The ranking in claims for such would be that there would be a concurrent ranking with the creditors claims. This is different from the 1973 position where unpaid vendor-shareholders rank as creditors after all creditors and shareholders of preference classes, but before the non-selling shareholders of their class.

5.6.1 Director liability

Directors are liable as in all distributions under section 77(3)(e)(viii). If a director is present at the meeting, or participated *in the making of the decision in terms of section 74 and fails to vote against such decision even though knew that the acquisition is against section 46 or 48, the director will be liable for loss damages, or costs sustained by the company as a direct or indirect consequence.*[92]

5.6.2 Effect on BEE and social context

Since this may be acquisition of shares in a holding company by a subsidiary company, it provides that a BEE partner who is a subsidiary of can acquire shares in the holding company. These acquisitions would however not have

[91] Ibid.
[92] P Delport supra n41 at page 36.

voting rights which dampens on the effect on BEE partners as they would not be able to have an effect on the holing company in regard to making impact on decisions which need to be voted on.

A transaction in the new act could be one that is for the financial assistance (section 44) of a BEE company to acquire shares in its holding company (section 48) subject to the rules of distribution (section 46). It is clear that the coming into effect of the 2008 act, as one of its main purposes, was to afford BEE partners opportunities to participate in business and to make it simpler to effect the BEE policy and finally to allow for growth in business practise for such persons.

5.7 Capitalisation of shares (s 47)

The capitalisation of shares is generally not a distribution. This occurs when the company issues capitalisation shares to shareholders for no consideration. Section 47(1) states that these can be issued across class unless the MOI provides otherwise. The issue of distribution comes into play when the company issues such shares for consideration in cash. In this case the solvency and liquidity test has to be complied with just like any other distribution regulated by section 46. Additionally the board must decide to offer cash payments as an alternative to capitalisation of shares only if it certain that all shareholders will accept the offer of cash as consideration.

5.8 Alteration of shares

The MOI of the company must set out the classes and number of shares, rights, limitations and the terms of each class. The MOI may set out a class of shares without rights and terms, which may only be issued after the board has determined such rights and terms.

The authorisation, number and classification of shares may be changed in the MOI only by an amendment of the MOI by special resolution of the shareholder or the board of the company except to the extent that the MOI provides otherwise.[93] This is similar to the 1973 act which provides that a company can, with a special resolution approval by the members of the company and if authorised by the articles of association, alter its share capital.

If such authorisation is not given by one or the other then such can be retroactively ratified by the shareholders or the board. If not then the issue is a nullity[94] and the consideration paid for the shares must be repaid. [95] The impression is that the board and the shareholders by special resolution have concurrent jurisdiction and that the power of the board can be changed by such special resolution.[96] The board should not be given such power but such should be given to members/shareholders who will vote in the general meeting and who invest and hold the shareholding in the company.

Section 38(3)(d) states that the directors will be personally liable, as per section 77(3)(e)(i), if was present at the meeting when the board approved the issue of shares and failed to vote against this decision despite knowing that this was not authorised in accordance with section 36.

5.9 Conclusion

The new act has brought change and it is clear that the interests of the company, shareholders and creditors are covered by it. Despite there being differences in the systems between the 2009 and the 1973 act are very similar with regards to the level protection of creditors. This protection in the 2008 act, solvency and liquidity test is afforded by restrictions on distribution. This is further supplemented by the personal liability by directors where the

[93] Sec 36(3) of the 2008 Act.
[94] Only null and void if the court has further declared so as per section 218(1) of the act.
[95] P Delport supra n41 at page 18.
[96] Ibid.

requirements and restrictions were not complied with. In terms of distributions, the capital maintenance rule afforded creditors protection because it restricted the payment of capital to shareholders and the company would have to have some profit over its liabilities to make payment to shareholders and this has been changed. The solvency and liquidity test is concerned with net assets of the company and the ability of the company ability to pay debt as it becomes due. K. van der Linde states that the solvency test recognises the ultimate priority that creditors enjoy over shareholders upon dissolution of the complaint.[97] Despite the differences in terms of the citiong of the law, both the 1973 act and the 2008 act have as their puropose to protect the creditor and the level of protection is one that is similar. The 2008 act however, alos grants protection to shareholders of their investment and expectation of returns from such.

Section 218(1) will likely cause a few problems when the act comes into operation. According to this section the court has to declare a transaction[98] to be invalid by section 218(1) for it to be unenforceable or null and void. This is subject to abuse as transactions can be entered into with the intention to have such be declared invalid and unenforceable by the court at a latter stage. This provision can additionally be used as an escape provision when it is believed that the transaction is not satisfactory and the party to the transaction no longer want to be bound by the transaction.

[97] Kathleen van der Linde, (2009) 21 SA *Merc LJ* 33-50, supra n55 at page 49.
[98] It is applicable to sec 36, 44, 46 and 48 amongst a few.

CHAPTER 6
CONCLUSION

The provision that allows for financial assistance, the allowance for company to acquire its own shares, the allowance for loans to companies within a group are provisions that hopefully make a greater impact on the economic growth in terms of BEE and on the poor. The hope is that this impact will be one that is bigger than the impact made by the 1973 as recently amended by the 2006 act and amended throughout the years.

The provisions of the 2008 act are clearly ones that will be better for the South African society. This is in that the previously disadvantaged and the society as a whole, has an opportunity to participate in business due to the regulations that allow for assistance of other companies to be included in the running of companies.

With a stock exchange ranked amongst the top 20 in the world, an upward phase of the business cycle since September 1999, a banking industry that has been ranked amongst the best top 10 in the world, and numerous sectors that are well developed it is not unexpected that this economy needed company law that kept up with the international business practise and one that kept up with this developing economy. Additionally this law had to be sensitive and in harmony with policies that were implemented to redress the mistakes of the past. Whether the 2008 companies act is that law is yet to be seen when it comes into operation in 2010. However, what is certain, is that this law is one that is headed in the right democratically way.

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