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A Critical Analysis of the New Capital Maintenance Rules in terms of the Companies Act 71 of 2008

Mini dissertation by

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ENGLISH SUMMARY

A Critical Analysis of the New Capital Maintenance Rule in terms of the Companies Act 71 of 2008

by

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Degree: Magister Commercii

In conducting this study I want to give more clarity about the New Companies Act and how it compares to the Current Companies Act. According to the study and the results, the New Companies Act gives more protection to, specifically the shareholders and the creditors.

The New Companies Act is much wider in some instances and gives more clarity. On the other hand the are still a lot of aspects that needs to be addressed. In this study I took a look at Sections 38, 226 and 85 of the Current Companies Act and then I compared it to Sections 44, 45, and 48 of the New Companies Act.

With all the changes that have been brought to the New Companies Act it now, puts South African Law in line with the International standards of Company Law.

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CHAPTER 1

1.1 Introduction to the Study

The long-awaited overhaul of company law is underway[1] and here are just a few of the significant changes to the current Companies Act.[2] The reason for the redrafting of the Companies Act is that the government is seeking for one form of corporate entity, modernising of the capital maintenance rules, to take cognisance of interests in other than those of the shareholders, to make use of electronic submissions of statutory documents, to crack the whip on corporate governance and to establish powerful and effective enforcement mechanisms.[3]

The current Companies Act does not have a wide enough over-view and contains very little on corporate governance, transparency (which will be ensured through greater accountability by directors and the appropriate participation of all the shareholders)[4], accountability, modern merger methods and the minority shareholder protection.[5] All of the above issues will be addressed in the[6] New Companies Act.[7]

The New Companies Act[8] will simplify company incorporations.[9] There is a desire to ensure that Company Law is more understandable and more simplified by containing as few rules and prohibitions as possible.[10] Currently a company's

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1 Harty Rushmere TheEfiles Volume 13 October 2004 : The Proposed New Companies Act by Adam Levin p1
2 Companies Act 61 of 1973
3 Harty Rushmere TheEfiles Volume 13 October 2004 : The Proposed New Companies Act by Adam Levin p1
4 CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
5 CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
6 Ibit
7 Companies Act 71 of 2008
8 Ibit
9 CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
10 Harty Rushmere TheEfiles Volume 13 October 2004 : The Proposed New Companies Act by Adam Levin p2

constitutional documents are known as the memorandum and articles, where in the New Companies Act it will be known as the memorandum of incorporation (MOI) which will set out the rights, duties and responsibilities of the shareholders, directors and others in relation to the company.[11] There will be certain provisions in the Act[12] that can be limited and altered in terms of the MOI, but there will be some provisions that cannot be limited or altered.[13] The reason for this is specific protection that is built into the Act will apply[14] and the legislator meant for this specific provisions to be there and not to be limited or altered.

Shareholder participation on a bigger scale is also a new stipulation in the Act[15] because it is modernised in the way that shareholders play a bigger part not only at general meetings of the company but otherwise as well, which is inflexible in the current Act.[16]

Where it comes to take-overs and mergers the New Companies Act[17] still uses the same methods to achieve the take-over as in the current Act[18] but the process in itself is simpler.[19] The New Companies Act[20] also stipulates new rules regarding mergers and amalgamations where two companies can now merge into one entity without any confusion or problems, but before there can be given effect to such a merger the solvency and liquidity test[21] (which is the replacement for the archaic and ineffective capital maintenance rules)[22] must first be satisfied as well as certain other approvals set out specifically for the merger.[23]

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[11] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[12] Companies Act 71 of 2008
[13] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[14] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[15] Companies Act 71 of 2008
[16] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[17] Companies Act 71 of 2008
[18] Companies Act 61 of 1973
[19] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[20] Companies Act 71 of 2008
[21] Section 4 : Companies Act 71 of 2008
[22] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[23] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1

Under the New Companies Act[24] minority, shareholders will have more protection, which will be in line with the modern company law trends.[25]

Further more if a shareholder is not satisfied with a proposed merger or amalgamation he/she may send an objection notice to the company and if the notice is not withdrawn the shareholder may demand that the shares must be paid out to him/her[26] (at a fair value of course) if the resolution for such merger or amalgamation is supported by less than seventy five percent of the shares entitled to vote at the meeting.[27]

The New Companies Act[28] will without a doubt bring some changes in many companies in South Africa, but before all of that will take place, there are still a lot of aspects to consider. Given the wide over view above there will now be a critical analysis on certain sections of the New Companies Act[29] specifically Sections 44, 45, 46 and 48 compared with the current Companies Act.[30]

1.2 Research Question

The question on everybody's mind in terms of the New Companies Act[31] is how does it compare to the current Companies Act[32] and does it really provide better protection for companies or not, and how does it compare with other legal systems?

[24] Companies Act 71 of 2008
[25] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[26] Section 164 : Companies Act 71 of 2008
[27] CH Coulson Harney Advocates March 2007 : New Companies Act for South Africa p1
[28] Companies Act 71 of 2008
[29] Ibit
[30] Companies Act 61 of 1973
[31] Companies Act 71 of 2008
[32] Companies Act 61 of 1973

1.3 Research Objectives

The study will be guided by the following objectives:

(1) Conducting a critical analyses on the New Companies Act[33], specifically the capital maintenance rules, and

(2) In conducting the critical analyses, we will be able to see what protection does the New Companies Act[34] provide for existing and future companies, and

(3) After comparing the New Companies Act[35] and the current Companies Act[36] we will be able to see if our South African company law is in line with the international standards of other legal systems, specifically company law and more specifically the capital maintenance rules.

1.4 Importance and Benefits of the Study

From a theoretical perspective, the proposed study will make a valuable contribution to the application of the basic principles by looking at brand new concepts as well as brand new concepts incorporated in existing concepts. Furthermore will this be one of the first studies done in the New Companies Act[37] that will hopefully shed some light on the uncertainties of this New Act.[38]

From a practical perspective, the findings of the study may assist new and old companies to have a greater understanding for the New Companies Act[39] and

[33] Companies Act 71 of 2008
[34] Ibit
[35] Ibit
[36] Companies Act 61 of 1973
[37] Companies Act 71 of 2008
[38] Ibit
[39] Ibit

have piece of mind, as well as how to conduct their business accordingly to the New Companies Act[40] and what to do to protect themselves.

1.5 Research Design and Methodology

A critical study will be conducted in order to establish the platform for the research as well as understanding the basic concepts of the New Companies Act.[41] Research will be done not only locally but international as well about the topic. South African legislation and case law will be used in this study and through using this; it will be able to determine the outcome of the study.

1.6 Limitations of the Study

This study will only cover the following aspects:

(1) A comparison between the current Companies Act and the New Companies Act, specifically capital maintenance rules;

(2) What kind of protection will be available for both old and new companies in terms of capital maintenance;

(3) How does South African company law compare to international company law.

The reason that the study will only cover certain aspects is because the field is much to wide to cover everything in detail so for that reason there will be an extensive focus on specific areas of the South African company law, namely Sections 44, 45, 46 and 48 of the New Companies Act 71 of 2008 compared with Sections 38, 85 and 226 of the current Companies Act 61 of 1973.

[40] Companies Act 71 of 2008
[41] Companies Act 71 of 2008

1.7 Summary

As mentioned above a critical analyses will be done in terms of the New Companies Act 71 of 2008 and then the founding's will be compared with the current Companies Act 61 of 1973, after the comparison with each other there will be another comparison with international company law. The question will be "Why?" The answer to the question will be for companies to know the future position of legislation concerning their companies itself and their business as well as to see if the South African company law is in line with the international company law.

CHAPTER 2

2.1 Introduction

There have been many questions surrounding Section 38 of the Current Companies Act.[42] In this chapter, we will look at this section, and how it compares to the New Companies Act.[43]

Section 38 of the Current Companies Act[44] was incorporated into South African Company Law from the 1948 English Companies Act to impede companies from trafficking their own shares.[45] The intention initially was that it should be an extension of the rule where a company cannot purchase its own shares (by reducing its capital unlawfully) to protect the interests of the creditors and minority shareholders.[46]

So in other words, primary this capital maintenance rule was enforced for protection and where creditors and minority shareholders could assume that no part of the company's capital would be used for anything other than payouts in the legitimate course of business or where it was authorized by the Act.[47]

Certain specific rules were deduced from this general provision including the prohibition against the purchasing of a company's own shares.[48] When the legislator scratched the prohibition against a company purchasing its own shares in 1999, he/she failed to remove the prohibition in Section 38[49] itself,[50] which complicates the situation even more.

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42 Companies Act 61 of 1973
43 Companies Act 71 of 2008
44 Companies Act 61 of 1973
45 Business Map Foundation July 2003: Financing Empowerment-The Implications of Section 38 of the Companies Act by Heidi Miller and Mzi Mgudlwa of Sonnenberg Hoffmann Galombik p2
46 Business Map Foundation July 2003: Financing Empowerment-The Implications of Section 38 of the Companies Act by Heidi Miller and Mzi Mgudlwa of Sonnenberg Hoffmann Galombik p2
47 www.jgm.co.za Edition 3 July 2007: Going Nowhere Slowly: The New Section 38 p3
48 Ibit
49 Companies Act 61 of 1973

2.2 The Obscurities of Section 38(2) (d)

One very mysterious provision is obtained in Section 38(2) (d)[51] which was inserted by Section 3 of the Companies Amendment Act 37 of 1999.[52] Anyone who knows a bit about corporate law will know that Section 38(1) of the Current Companies Act[53] contains a prohibition against a company giving any financial assistance for the purchase of or subscription of its shares.[54] Furthermore, Section 38 of the Current Companies Act[55] explicitly prohibits a subsidiary from giving financial assistance to any person for the purchase of or the subscription of any shares in the holding company.[56] To include a subsidiary in Section 38(1) of the Current Companies Act[57] it ignores the principle of company law, which is the concept of separate legal personality, which was laid down in *Salomon v A Salomon and Co Ltd* 1897 AC 22 (HL) where a subsidiary is to be regarded as a separate entity from its holding company.[58] In *Adams v Cape Industries Plc* 1991 ALL ER 927 (ChD and CA) Slade LJ made the following statement:[59]

"Our law for better of worse, recognizes the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities."

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50 Business Map Foundation July 2003: Financing Empowerment-The Implications of Section 38 of the Companies Act by Heidi Miller and Mzi Mgudlwa of Sonnenberg Hoffmann Galombik p2
51 Companies Act 61 of 1973
52 The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 493
53 Companies Act 61 of 1973
54 The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 493
55 Companies Act 61 of 1973
56 The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 493
57 Companies Act 61 of 1973
58 The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 493
59 The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 493

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For the purposes of Section 38(1) of the Current Companies Act,[60] this general principal will not apply, but the holding company and its subsidiary will be regarded as **one** (my emphasis) entity.[61] Section 38(1) of the Current Companies Act[62] does not apply in reverse, meaning, a holding company will not be prohibited from giving financial assistance for the subscription or purchase of shares to its subsidiary[63] or shares in its subsidiary, which is identical to Section 54 of the English Companies Act 1948.[64] Subsection 151-3 of the English Companies Act 1985 "which prohibit the giving of financial assistance by a company for the purchase of its shares, do not apply to financial assistance given by a holding company for the acquisition of shares in its subsidiary company."[65] Having looked at the broad prohibition against the giving of financial assistance, Section 38(2) of the Current Companies Act[66] specifies four exceptions/permitted transactions,[67] but only Section 38(2) (d) of the Current Companies Act[68] will be relevant here. For ease of reference, I will quote Section **38(2) (d)** of the Current Companies Act 61 of 1973:

"The provisions of subsection (1) shall not be construed as prohibiting

(a) . . .

(d) 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 such shares."

[60] Companies Act 61 of 1973
[61] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 493
[62] Companies Act 61 of 1973
[63] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 494 and in South African Mercantile Law Journal Volume 13 2001: Financial Assistance for the Acquisition of Shares in Accordance with Section 85 of the Companies Act-A Reply to Delport p 437
[64] G Brian Parker and Martin Buckley Buckley on the Companies Act 14 edition (1981) volume 1 at 156, like in The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 494
[65] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 494 and like in, Paul L Davies Gower and Davies' Principles of Modern Company Law 7 edition (2003) 261 n 52
[66] Companies Act 61 of 1973
[67] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 494
[68] Companies Act 61 of 1973

The routs of the general prohibition can be traced back to 1926 when the Greene Committee (Company Law Amendment Committee Report 1926 Cmnd 2657 paragraphs 30-1)[69] shed light on the potential for abuse that arises when speculators/financiers uses the company's funds to pay for the purchase by them of the company's shares.[70] Lord Greene gave attention to this undesirable practice in *Re VGM Holdings Ltd* 1942 (1) ALL ER 226; 1942 Ch 235 (CA) and was referred to by Schreiner JA in *Gradwell (Pty) Ltd v Rostra Printers Ltd* 1959 (4) SA 419 (A).[71] The recommendation that was made by the Greene Committee that such undesirable practices should be prohibited was adopted in:[72]

- England by Section 45 of the Companies Act 1929
- South Africa by Section 86(bis) (2) of the Companies Act 1926
- Canada in 1927
- New Zealand in 1933 and in
- Australia in 1937

When the prohibition against the giving of financial assistance was enacted, it was also not permissible for a company to buy back its own shares (*Trevor v Whitworth* 1887 (12) App Cas 409 (HL)),[73] which is now regulated by Section 85 of the Current Companies Act[74] [inserted by Section 9 of the Companies Amendment Act 37 of 1999], where a company now has the power to repurchase its own shares and Section 48 of the New Companies Act regulates the repurchasing of shares by a company itself.[75] However, later there will be given some attention to the repurchasing of shares.

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[69] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 495
[70] Ibit
[71] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 495
[72] Ibit
[73] Ibit
[74] Companies Act 61 of 1973
[75] Companies Act 71 of 2008

Now just to have a look at what Section 38(2) (d) of the Current Companies Act[76] really says. The first part of the subsection specifically excludes, from the general prohibition in Section 38 (1) of the Current Companies Act[77] "the provision of financial assistance for the acquisition of shares in a company by the company".[78] It is implied in the provision that a company is allowed to give "financial assistance" to itself to enable itself to acquire its own shares-and it is this part of Section 38 (2) (d) of the Current Companies Act[79] that has risen the most questions.[80] Just to clarify what has been said, the person who acquires the shares is the company, so the exclusion applies to financial assistance given to the company by the company.[81] It is clear that this cannot be the case-it is impossible.

In terms of Section 153 (2) (b) of the English Companies Act 1985 the giving of financial assistance is not prohibited if "the assistance is given in good faith in the interest of the company." This is not even relevant in terms of South African Law.[82] Furthermore, Sections 153 (1)-(4) of the English Companies Act 1985 provides a list of transactions that are excluded from the general prohibition against the giving of financial assistance.[83] Section 23 of the English Companies Act 1985 stipulates, "a body corporate cannot be a member of a company which is its holding company and any allotment or transfer of shares in a company to its subsidiary is void".[84] In other words, a subsidiary can still not be a shareholder in its holding company in English law, the reason for this prohibition is to prevent a company from trafficking its own shares indirectly.[85] Even after the re-forming of

[76] Companies Act 61 of 1973
[77] Ibit
[78] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 496
[79] Companies Act 61 of 1973
[80] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 496
[81] Ibit p 497
[82] Ibit
[83] Ibit p 498
[84] Ibit p 499
[85] Ibit and like in Palmer's Company Law Release 93, November 2003, 6100/2-3, paragraph 6.430

Section 23 of the 1985 Companies Act that was replaced by Section 129 (1) of the 1989 Companies Act, the prohibition still applies in English law.[86]

In terms of Section 89 of the Current South African Companies Act,[87] a subsidiary is well allowed to acquire shares in its holding company in accordance with Sections 85-88 of the Current Companies Act.[88] Section 85 of the Current Companies Act[89] is the safeguard of the minority shareholders and creditors. This provision will ensure that when financial assistance is given by the holding company to its subsidiary for the acquiring of shares in the holding company, it will not be seen as indirect financial assistance given by the holding company for its own shares.[90] Neither will it be a matter of Section 38(2) (d) of the Current Companies Act[91] permitting that was never prohibited by Section 38 (1) of the Current Companies Act,[92] namely, financial assistance by the holding company to its subsidiary for shares in the holding company.[93]

Just to summaries the effect of Section 38(2) (d) of the Current Companies Act[94]

- A subsidiary will be able to give financial assistance where a holding company acquires its own shares.[95]
- A holding company will be able to give financial assistance where a subsidiary acquires shares in the holding company.[96]
- A co-subsidiary of a subsidiary will be able to give financial assistance where a subsidiary acquires shares in the holding company.[97]

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[86] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 499
[87] Companies Act 61 of 1973
[88] Ibit. But the shares that a subsidiary acquire in its holding company in South African law may only be to a maximum of ten per cent in accordance with the shares that 's already issued.
[89] Companies Act 61 of 1973
[90] Within the scope of Section 38 of Companies Act 61 of 1973
[91] Companies Act 61 of 1973
[92] Companies Act 61 of 1973
[93] Ibit
[94] Ibit
[95] South African Mercantile Law Journal Volume 13 2001: Financial Assistance for the Acquisition of Shares in Accordance with Section 85 of the Companies Act-A Reply to Delport p 441
[96] South African Mercantile Law Journal Volume 13 2001: Financial Assistance for the Acquisition of Shares in Accordance with Section 85 of the Companies Act-A Reply to Delport p 441

If it were not for the exceptions created in Section 38(2) (d) of the Current Companies Act,[98] the giving of financial assistance would have been prohibited by Section 38 (1) of the Current Companies Act[99] in all three instances above.[100]

Section 38 of the Current Companies Act[101] is a very complicated section with many questions attached to it. It was not the legislator's intention to modify the prohibition against the giving of financial assistance.[102] Now we have a "New Section 38" in the New Companies Act 71 of 2008, namely, Section 44. Later on in the chapter there will be taken a look at this new section and how it compares to the current Section 38.

2.3 The Safeguards for Minority Shareholders and Creditors

The solvency and liquidity tests have been incorporated as a substitute for the capital maintenance rules in the share repurchase provisions.[103] These tests will give more than enough protection to the minority shareholders and the creditors in relation to a share repurchase.[104] Similarly, they should be ample safeguards in relation to giving financial assistance to third parties acquiring shares.[105] If additional safeguards are required, it would be open to the legislator to circumscribe special circumstances under which financial assistance may be

[97] South African Mercantile Law Journal Volume 13 2001: Financial Assistance for the Acquisition of Shares in Accordance with Section 85 of the Companies Act-A Reply to Delport p 441

[98] Companies Act 61 of 1973

[99] Ibit

[100] South African Mercantile Law Journal Volume 13 2001: Financial Assistance for the Acquisition of Shares in Accordance with Section 85 of the Companies Act-A Reply to Delport p 441

[101] Companies Act 61 of 1973

[102] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 500

[103] Business Map Foundation July 2003: Financing Empowerment-The Implications of Section 38 of the Companies Act by Heidi Miller and Mzi Mgudlwa of Sonnenberg Hoffmann Galombik p2

[104] Ibit

[105] Business Map Foundation July 2003: Financing Empowerment-The Implications of Section 38 of the Companies Act by Heidi Miller and Mzi Mgudlwa of Sonnenberg Hoffmann Galombik p2

given as well as to limit the extend of the financial assistance.[106] This kind of reforming would be in line with international company law.[107]

For example, the New Zealand Companies Act of 1993 treats the concept of financial assistance by a company for the purchase of its shares in the same way as a company repurchasing its own shares.[108] This is subject to compliance with the solvency test,[109] where is South African Company Law compliance with the solvency **and** (my emphasis) liquidity test must be met (*Capitex Bank v Qorus Holdings Ltd* 2003 (3) SA 302 (W) at 309 B-C)[110] which restricts the funds that is available for the repurchase of shares to the net assets of the company.[111]

The **liquidity test** prohibits a company from making any payment to acquire shares in it self, if there are reasonable grounds to believe that the company is, or would be after the payment, not able to pay its debts as they become due in the ordinary course of business.[112]

The **solvency test** prohibits a company from making any payment to acquire shares in it self, if there are reasonable grounds to believe that the consolidated assets of the company would, (after the payment) be less than the consolidated liabilities of the company.[113]

The solvency and liquidity test in South African Company Law is regulated by Section 85 of the Current Companies Act,[114] specifically Section 85(4) (a) and

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[106] Ibit
[107] Ibit
[108] Ibit
[109] Ibit
[110] The South Africa Law Journal Volume 122 Part 3 2005: Unraveling the Obscurities of Section 38(2)(d) of the Companies Act by F H I Cassim p 495
[111] Business Map Foundation July 2003: Financing Empowerment-The Implications of Section 38 of the Companies Act by Heidi Miller and Mzi Mgudlwa of Sonnenberg Hoffmann Galombik p2
[112] Business Map Foundation July 2003: Financing Empowerment-The Implications of Section 38 of the Companies Act by Heidi Miller and Mzi Mgudlwa of Sonnenberg Hoffmann Galombik p2
[113] Ibit
[114] Companies Act 61 0f 1973

(b). Section 4 of the New Companies Act[115] regulates the solvency and liquidity test.

The twelve-month period that is mentioned in Section 4 of the New Companies Act[116] is not mentioned in Section 85 of the Current Companies Act.[117] The reason for this is unknown.

Furthermore both Acts mention the words […reasonable grounds for **believing**…][118] and […it **appears** that the company will be able…][119] which has the practical implication that neither a company nor its directors has to have one hundred per cent certainty that the company would stay solvent and liquid for the next twelve months after the making of a distribution.

Section 4 of the Current Companies Act[120] is much wider than Section 85(4) of the Current Companies Act[121], which is better in the sense that there will be a better understanding with regards to the solvency and liquidity test.

2.4 The Interpretation of Section 44 of the New Companies Act[122]

Just by looking at Section 44(2) of the New Companies Act,[123] already there is an inconsistency. In the sense that the wording of the section in incorrect. The reason I say the wording is incorrect, is that is says, "the board may authorise the company" (represented by the board).[124] This is not right, because the board should not, in the first place, authorise the company, the company should

115 Companies Act 71 of 2008
116 Companies Act 71 of 2008
117 Companies Act 61 of 1973
118 Section 85(4): Companies Act 61 of 1973
119 Section 4(1)(b): Companies Act 71 of 2008
120 Companies Act 71 of 2008
121 Companies Act 61 of 1973
122 Companies Act 71 of 2008
123 Companies Act 71 of 2008
124 The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p31

authorise the board (as agents of the company).[125] Why would the wording make a difference? Because the contracting party will still be the company, and not the Board, with all its rights and obligations.[126] If it is read the way that it is set out in the section, then indirectly, the company's separate legal entity is being taken away or being ignored, and then the case of *Salomon v A Salomon and Co Ltd* (1897) AC 22 (HL), where the general principal of separate legal entity was established, will have no effect what so ever. But never the less, the board may authorise the company to give financial assistance, subject to the Memorandum of Incorporation (MOI) to any person for the subscription of shares/securities of the company/related company/inter-related company if the MOI specifically permits the giving of such financial assistance and if it is in accordance with any requirements/conditions that is set out in the MOI.[127] The financial assistance must be either for:

- an employee share scheme under Section 97 of the New Companies Act 71 of 2008; or
- pursuant to a special resolution of the shareholders which approves such financial assistance.[128]

Furthermore, the board must be satisfied that:

- immediately after giving the financial assistance, the company will comply with the solvency and liquidity test, and
- the terms under which the assistance is given or will be given are fair and reasonable to the company.[129]

[125] Because of the company's separate legal entity, and also see The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9
[126] The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p31
[127] The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p31
[128] Ibit
[129] The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p32 and Section 44 (3) of the New Companies Act 71 of 2008

If the Board make a resolution to provide financial assistance, it will be void if, it is inconsistent with the MOI of the company or if it is inconsistent with Section 44[130] of the New Companies Act 71 of 2008. If the resolution that was made by the Board is in conflict with the provisions of Section 44 of the New Companies Act,[131] it will not be void **unless** it is declared void by a court in terms of Section 218 of the New Companies Act.[132]

When it comes to the solvency and liquidity test a company will satisfy the tests if, all the reasonable and foreseeable financial circumstances of the company is taken into consideration at the time of the financial assistance and the assets of the company are equal to, or exceeds the liabilities of the companies, and it appears that the company would be able to pay its debts as they become due in the ordinary course of business[133] (for a period of twelve months).

The solvency and liquidity test as mentioned above is a subjective test[134], the reason I say it is subjective is because the **BOARD** must be satisfied that the company will be solvent and liquid. If the test was objective it would have been **THE REASONABLE PERSON/BOARD.** If for any reason the company becomes insolvent or illiquid and the Board were satisfied that the company was solvent and liquid it will not have an effect on the transaction nor with the directors be held liable in terms of Section 77 of the New Companies Act.[135]

In terms of the Directors liability, if a Director was present at the meeting and did not vote against the resolution he/she would be held liable for any loss, damage or costs that was incurred by the company[136] if the above mentioned resolution was declared void in terms of Section 218 of the New Companies Act.[137] Although the resolution/agreement is in contravention with Section 44 of the New

[130] Ibit
[131] Companies Act 71 of 2008
[132] Companies Act 71 of 2008 and also see Piet Delport. ISBN 978 0 409 04523 9 p32
[133] Piet Delport. ISBN 978 0 409 04523 9 p32
[134] Piet Delport. ISBN 978 0 409 04523 9 p32
[135] Companies Act 71 0f 2008 and also see Piet Delport. ISBN 978 0 409 04523 9 p32
[136] Piet Delport. ISBN 978 0 409 04523 9 p33
[137] Companies Act 71 0f 2008

Companies Act[138] or a provision in the Memorandum of Incorporation [MOI] and will be void, it must still be declared void by the court in terms of Section 218 (1) or Section 77 (5)(a) of the New Companies Act,[139] **only then** will non-compliance result in Director's liability under Section 77 (3)(e)(iv) of the New Companies Act.[140] However, the general liability provision does not require this.[141]

If the action by the Board of the company was in contravention of Section 44 of the New Companies Act,[142] the company or any Director could apply to a court for the setting aside of the decision by the Board.[143]

Another difference in this[144] section, compared to Section 38 of the Current Companies Act[145] is that no where in this section it says, [.. no company shall give ..],[146] instead its says, [.. a company may ..], which means that this[147] section is not as strict as the Current Section 38.[148] Another reason for saying this is that, in Section 38 of the Current Companies Act[149] it mentions that you will be guilty of an offence if you do not comply, where in Section 44 of the New Companies Act[150] it does not mention anything of an offence that you will be guilty of but it well mentions that a Director will be "liable", just like in Section 38 of the Current Companies Act[151] mentions.

[138] Companies Act 71 0f 2008
[139] Ibit
[140] Ibit
[141] Piet Delport. ISBN 978 0 409 04523 9 p33 fn 11
[142] Companies Act 71 0f 2008
[143] Piet Delport. ISBN 978 0 409 04523 9 p33
[144] Section 44 of the Companies Act 71 of 2008
[145] Companies Act 61 of 1973
[146] Section 38 of the Companies Act 61 of 1973
[147] Ibit fn 128
[148] Ibit fn 128
[149] Companies Act 61 of 1973
[150] Companies Act 71 of 2008
[151] Ibit fn 148

CHAPTER 3

3.1 Introduction

Section 226 of the Current Companies Act[152] is recognition of the powerful positions that are being held by Directors and Managers of a company.[153] The Directors and Managers of a company can abuse this position for their own benefit, and to the disadvantage of the company as well as its shareholders.[154]

Goldbloot AJ stated the following:

"The clear purpose of section 226 of the act is to prevent Directors or Managers of a company acting in their own interests and against the interest of shareholders by burdening the company with obligations which are not for its benefit but for the benefit of another company and/or the benefit of its Directors and/or Managers."[155]

Provisions are made for exceptions on the basis that in the excepted circumstances there are sufficient safeguards to establish a likelihood that the use of the company's assets, for the benefit of its Directors or Managers or of companies that is being controlled by them, will also be to benefit the company and not at its expense.[156]

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[152] Companies Act 61 of 1973

[153] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 269

[154] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 269

[155] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 269 and also see Standard Bank of SA Limited v Meugarten and others 1988 (1) SA 652 (W)

[156] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 269 and also see S v Pourolis and others 1993 (4) SA 575 (W) [Stegmann J]

Section 226 of the Current Companies Act[157] can be separated into three parts: Firstly, the prohibitions, secondly, the exceptions to the prohibitions, and lastly, the consequences of contravention.[158]

3.2 The Interpretation of Section 226 of the Current Companies Act[159]

With the interpretation of Section 226 of the Current Companies Act,[160] it is important to take into consideration the approach of the courts set out by the Appellate Division in *Bevray Investments (Eiendoms) Bpk v Boland Bank Beperk en andere* 1993 (3) SA 597 (A). Grosskopf JA made the following statement:

"Die breë oogmerk of oogmerke van die bepaling is natuurlik duidelik. Maatskappye word bestuur deur Direkteure en Bestuurders. Hierdie Direkteure en Bestuurders kan hul bevoegdhede misbruik vir hul eie voordeel. Daarbenewens kan die Direkteure of Bestuurders van houermaatskappye hulself onbehoorlik bevoordeel deur hul beheer oor filialmaatskappye. Die wetgewer wou die moontlikheid van sulke wanpraktyke beperk. Die wetgewer het egter nie hierdie oogmerk probeer verwesenlik deur 'n algemene of absolute verbod te plaas op alle transaksies tussen 'n Bestuurder of Direkteur en 'n betrokke maatskappy waardeer die Bestuurder of Direkteur bevoordeel kan word nie. Klaarblyklik sou so 'n verbod onprakties wees. Daar moet noodwendig baie omstandighede wees waarin dit nie onbehoorlik is vir 'n Direkteur of Bestuurder om geldelike voordele te ontvang van die maatskappy wat hy bestuur of wat deur sy maatskappy beheer word nie. Die wetgewer het himself dus beperk tot 'n verbod op sekere bepaalde transaksies wat as *prima face* onaanvaarbaar beskou is, nl die maak van sekere lenings en die voorsiening van sekere sekuriteite. Selfs hier is die verbod egter nie absoluut nie - sekere transaksies wat binne die trefwydte van die verbod val, was nogtans vir die wetgewer

[157] Companies Act 61 of 1973
[158] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 269
[159] Companies Act 61 of 1973
[160] Companies Act 61 of 1973

aanvaarbaar. Om vir sulke transaksies voorsiening te maak, bevat subart (2) 'n langerigerige lys uitsonderings op die verbodsbepalings in subart (1). Die wetgewer se spesifieke oogmerk met art 226 was dus om seker bepaalde vorms van geldelike bystand te verbied onderhewig aan bepalde uitsonderings. Met die een hand verbied hy; met die ander hand veroorloof hy. Daar was dus nie 'n eenvoudige of ongekwalifiseerde oogmwek wat as toetssteen by die uitleg van die artikel gebruik kan word nie."[161]

3.3 The Scope of the Prohibitions

3.3.1 Managers

Section 226 of the Current Companies Act[162] includes "Managers" and Directors. The definition of a Manager can be defined as the following: "any person who is a principal executive officer of the company for the time being, by whatever name he ever may be designated and whether or not he is a Director".[163] There is no doubt that the influential position that is being held by these people can be abused to the disadvantage of the lending company.[164] So, by including these people would be the appropriate thing to do.[165] Take note, that an "officer" includes "any Managing Director, Manager or Secretary".[166] Referring to the above, there is a clear distinction that is drawn between a Manager and Secretary.[167] A Secretary will therefore not be a Manager, any loan that is made

[161] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 272
[162] Companies Act 61 of 1973
[163] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 272
[164] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 272
[165] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 272
[166] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273
[167] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273

to a Secretary, who is not also a Director or Manager, will not be regulated by Section 226 of the Current Companies Act.[168] However, there must be kept in mind, a person that is holding the office of Secretary may also perform functions/duties of that of a Manager, for example, financial management.[169] In this case the person would be a Secretary and a Manager, even if he/she were only designated to a Secretary, in this case Section 226 of the Current Companies Act[170] would apply to him/her.[171]

3.3.2 Directors and Managers in the Group

Section 226 of the current Companies Act[172] prohibits loans that are made by a company to its own Directors and Managers, as well as loans made to the Directors and Managers of the lending company's holding company and any other company who is a subsidiary of the holding company.[173] It is understandable that the extension of the prohibition is made beyond a loan to its own Directors or Managers but as well as too a Director or Manager of its holding company.[174] The reason for the extension is to prevent the potential abuse of power, which the holding company has over the Directors and Managers of its subsidiaries.[175]

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[168] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273 and the Companies Act 61 of 1973

[169] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273

[170] Companies Act 61 of 1973

[171] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273

[172] Companies Act 61 of 1973

[173] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273 and Section 226 (1)(a)(ii) and (iii) of the current Companies Act.

[174] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273

[175] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 273. "It is true that the subsidiary can make a loan to his holding company which, in turn, can make a loan to a director or manager of the holding company[replying on s 226 (2)(a) (...) without falling foul of s 226. But, of course, the holding company itself (not its director or manager) will be indebted to its subsidiary. Also, s37 will provide the subsidiary with some protection."

3.3.3 Body Corporates Controlled by Directors and Managers

The prohibition could easily have been avoided if the company in making a loan to the Director or Manager, rather just make the loan to the company or corporate body that is governed or controlled by the Director or Manager,[176] but Section 226 (1)(b) of the Current Companies Act,[177] covers this aspect. Where it comes to loans directly to a Director or Manager, a loan that is made by a company, to a company that is being controlled by a Director or Manager of its subsidiary will not be allowed, only if the lending company has a holding company.[178] So, the example that is used by Stegmann J in *S v Pourolis and others* 1993 (4) SA 575 (W) is not correct in this respect. He is of meaning that:

"Consider a group of four companies in which a holding company H, has two subsidiary companies respectively called S1 and S2. The fourth company in the group is a subsidiary of S2 and is called S2S…. I now extend the example by introducing a fifth company, X, which is loosely associated with the group. Specifically, one Mr. D, a Director of S2, own a majority of the equity shares of X…. Because Mr. D is a Director of S2 and also controls X, s 226 (1)(b) prohibits loans by S2 to X. *It also prohibits loans to X by S2's holding company H.*"

What is placed in italics in the abovementioned example will only be correct if company H had a holding company.[179] (This is not the case in the example that is given by Stegmann J).

Where a loan is made by a company to a trust that is being controlled by a Director or Manager of a company, the making of the loan is not expressly

[176] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 274
[177] Companies Act 61 of 1973
[178] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 274
[179] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 274

included.[180] However, a trust is not a separate legal entity, in other words, a loan to a Director or Manager who is the controlling trustee of the trust appears to fall short of the prohibition of Section 226 (1)(a) of the Current Companies Act.[181]

Similar reasoning will apply to a loan that is made by a company to a partnership in which the Director or Manager of the company is a partner.[182] A partnership, the same as a trust, is not a separate legal entity and the loan that is made will be to the partners jointly.[183]The loan still fall within the prohibition in s 226 (1)(a) whether or not the Director or Manager is the controlling partner.[184] A loan that is made by a company to a trust where a Director or Manager of the company is a beneficiary but not a trustee, it appears not to be covered by Section 226 of the Current Companies Act,[185] even if the Director or Manager is the sole beneficiary.[186] This creates a very obvious loophole in this Section.[187]

3.3.4 Closed Corporations

Section 55 of the Close Corporation Act 69 of 1984 extends the application of Section 226 of the Current Companies Act.[188] Section 55 of the Close Corporations Act 69 of 1984 makes Section 226 of the Current Companies Act[189] applicable where a relationship between a company and Closed Corporation is of such a nature that if the Close Corporation were a company, it would be the

[180] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 275
[181] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 275
[182] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 275
[183] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 275
[184] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 275
[185] Companies Act 61 of 1973
[186] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 275
[187] South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 275
[188] Companies Act 61 of 1973 and South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 278
[189] Companies Act 61 of 1973

company's holding company.[190] Members and officers of the Close Corporation are on the same level than the Directors and Managers of a company.[191]

3.3.5 Loans, the Provision of Security and Abnormal Credit

Section 226 of the Current Companies Act[192] does not only apply to a loan that is made by the company to its Directors or Managers, but it also applies to certain transactions other than loans.[193] The provision covers securities as well as the extension of abnormal credit.[194] These specific transactions is been singled out because the power that the Director or Manager has can easily be abused in these instances. Obviously, there are other transactions where abuse can also take place, but there is other legislation in place to cover this kind of abuse.[195]

3.4 The Exceptions to the Prohibitions

A possible number of exemptions is contained in Section 226 of the Current Companies Act[196] to the prohibitions in the abovementioned section. The following was said by Stegmann J:[197]

"I think it is appropriate to recognize, as the legislator has done, that, in certain controlled circumstances and to a certain limited extent, the use of a company's

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190 South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 278
191 Ibit
192 Companies Act 61 of 1973
193 South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 278
194 South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 278. Also see Section 226 (1A)(a)(ii). "The extension of abnormal credit, would cover for example, the situation where a company which normally allows a month's credit, allows a Director or manager six month's credit."
195 South African Mercantile Law journal Volume 12 2000: Loans to Directors - an Analysis of Section 226 of the Companies Act by Richard Jooste p 278
196 Companies Act 61 of 1973
197 S v Pourolis and others 1993 (4) SA 575 (w)

assets for the benefit of its directors and managers, and of other companies controlled by them, may also be to benefit to the company as a whole. The legislator has therefore found it appropriate to regulate the matter in a way which is designed to ensure that a company's asset are employed for the benefit of the company as a whole, and not for the private benefit of its directors or managers, or of companies controlled by them, save in particular circumstances. The particular accepted circumstances have been identified by the legislator, presumably on the basis that in accepted circumstances there are sufficient safeguards to establish a likelihood that the use of the company's assets for the benefit of its directors or managers or of companies controlled by them, will also be of benefit to the company and not to its expense. The purpose behind s 226 is to establish a general prohibition against the use of a company's assets in certain proscribed ways for the benefit of its directors or managers, or any company controlled by them, and then to provide a frame-work of exceptions according to which the use of a company's assets in the otherwise proscribed ways for the benefit of it its directors or managers, or companies controlled by them, is to be regulated[198]

3.4.1 Section 226 (1B) of the Current Companies Act[199]

An exception is provided for where for example, company A makes a loan to, or provide security on behalf of company A's holding company, or a subsidiary of company A's holding company. This transaction will fall within the prohibition of Section 226 (1) (b) of the Current Companies Act[200] because the holding company or subsidiary, is being controlled by one or more Directors or Managers of company A or company A's holding company, or a subsidiary of company A's holding company. Furthermore, if a Director of company A's holding company (company H) held more than fifty per cent of the equity share capital of company H, a loan by company A to company H would fall foul of the prohibition in Section

[198] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 282
[199] Companies Act 61 of 1973
[200] Ibit

226 (1) (b) of the Current Companies Act[201] but, it would be exempted by Section 226 (1B) of the above mentioned Act.[202]

A provision/loan that is made for security "upwards" as well as "sideways" are being regulated in terms of Section 37 of the Current Companies Act[203] Section 226 (1B) of the Current Companies Act[204] brings the whole of Section 226 of the Current Companies Act[205] in line with Section 37 of the Current Companies Act.[206]

3.4.2. Section 226 (2) (a) of the Current Companies Act[207]

The prohibition in Section 226 (1) of the Current Companies Act[208] does not apply when a company is making a loan to, or providing security on behalf of the Manager or Director of the company itself. Furthermore it will not apply in the case of where a company or body corporate that is being controlled by one or more of its Managers or Directors except where they have prior[209] consent from all the members of the company by means of a special resolution with regards to the specific transaction.[210] The exception in Section 226 (2) (a)[211] will apply even

[201] Companies Act 61 of 1973
[202] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 283
[203] Companies Act 61 of 1973. This section serves to protect the lending company by way of certain disclosure and liability provisions.
[204] Companies Act 61 of 1973
[205] Ibit
[206] Ibit and also see South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 283
[207] Companies Act 61 of 1973
[208] Ibit
[209] "The word prior was inserted by s 6 of the Companies Amendment Act 82 of 1992 as a result of the decision in *Neugarten and others v Standard Bank of South Africa Ltd.* 1989 (1) SA 797 (A). There it was held that consent subsequent to the transaction was not sufficient to bring the exception in s 226 (2) (a) into play. A proviso to s 226 (2) (a) states, however, that in respect of any such loan made or security provided at any time before the commencement of the 1992 Act, such consent shall be deemed to have been given if the transaction concerned has subsequently, whether before or after that date, been ratified by all the members of the company." Also see South African Mercantile Law journal Volume12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 283.
[210] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 283

whether Manager or Director (of the lending company) to whom the loan is being made, is a Manager or Director of the lending company's holding company or a subsidiary of the holding company.[212] The Appellate Division was of the following meaning:[213]

"Die gewone, letterlike en grammatikale betekenis van die woorde wat die wetgewer in art 226 gebruik het, bide 'n duidelike antwoord op hierdie vraag. Kragtens subart (2) is die verbodsbepalings in subart (1) 'nie van toepassing nie' ten opsigte van, onder andere, 'die maak van 'n lening deur 'n maatskappy aan sy eie Direkteur' onder bepaalde omstandighede. Dit beteken eenvoudig dat waar 'n maatskappy 'n gemagtigde lening aan sy eie Direkteur maak, sodanige transaksie nie geraak word deur enige van die verbodsbepalings in subart (1) nie. So 'n lening word gevolglik nie verbied bloot omdat die persoon wat die lening ontvang, toevallig ook 'n Direkteur van die houermatskappy [subart (1) (a) (ii)] of 'n Direkteur van 'n ander filiaal van die houermaatskappy [subart (1) (a) (iii)] is nie."[214]

3.4.3 Section 226 (2) (b) of the Current Companies Act[215]

The above mentioned section has two exceptions that it contains to the prohibitions.[216] Anything done to provide any Manager or Director with funds:

- to meet expenses incurred or to be incurred by him (for purposes of the company); or

[211] Companies Act 61 of 1973
[212] *Bevary Investment (edms) Bpk v Boland Bank bpk en andere* 1993 (3) SA 597 (A) and also see South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 283.
[213] Ibit
[214] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 284
[215] Companies Act 61 of 1973
[216] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 284

- to enable him to perform his duties as a Director or Manager of the company,[217]

Will be exempt in terms of Section 226 (2) (b) of the Current Companies Act.[218] Now the question can be asked: Will the exceptions be available in Section 226 (2) (b) of the Current Companies Act[219] even where a manager or Director of the lending company (to whom the loan is made) is also a Manager or Director of the lending company's holding company or subsidiary of the holding company?[220] The answer and reasoning of the court will be found in *Bevary Investments (edms) bpk v Boland Bank Bpk*[221] where it was decided that Section 226 (2) (a) of the Current Companies Act[222] will indeed apply in these circumstances,[223] and the answer to the abovementioned question will be "Yes".[224] One should not forget that the exceptions contained in Section 226 (2) (b) of the Current Companies Act[225] is subject to Section 226 (3) of the Current Companies Act[226]

3.4.4 Section 226 (2) (c) of the Current Companies Act[227]

This section exempts any action that is done *bona fide* and in the ordinary cause of business, concerning a company whose business it is to provide security and make loans.[228] If there is a provision in the MOI[229] of the company that states

[217] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 284
[218] Companies Act 61 of 1973
[219] Ibit
[220] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 285.
[221] 1993 (3) SA 597 (A) and also see South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 285.
[222] Companies Act 61 of 1973
[223] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 285.
[224] Ibit
[225] Companies Act 61 of 1973
[226] Ibit
[227] Companies Act 61 of 1973
[228] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 285.
[229] Memorandum of incorporation. This is a revision from the Current Companies Act to the New Companies Act.

that provide security and the making of loans is their objectives, this will not be a sufficient reason for Section 226 (2) (c) of the Current Companies Act[230] to be applicable.[231] In other words it must be the **business** (my emphasis) of the company to provide security and give loans, but do not have to be the sole, main or substantial part of the company's business,[232] it must be a **part** (my emphasis) of the company's business.[233]

3.4.5 Section 226 (2) (d) of the Current Companies Act[234]

This section exempts the provision of the making of loans by a company for the purpose contemplated in[235] Section 38 (2) (b) and (c) of the Current Companies Act.[236] The abovementioned section brings Section 226 of the current Companies Act[237] in line with Section 38 of the Current Companies Act,[238] by this way conflict is being avoided between the two sections.[239] Take this for example: When a company makes a loan to a Director to purchase shares in the company or holding company, the loan will be exempt from the prohibition in Section 38 of the Current Companies Act[240] by Section 38 (2) (c) of the Current Companies

[230] Companies Act 61 of 1973
[231] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 285.
[232] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 285.
[233] Ibit and also compare with s 37 (1) (b); s 38 (2) (a) and s 296 (4) of the Companies Act 61 of 1973
[234] Companies Act 61 of 1973
[235] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 285. "Section 38 prohibits a company from giving financial assistance for the purpose of, or subscription for, it's own shares or those in its holding company. Section 38 (2) (b) exempts from the prohibition the provision of money to a share incentive trust set up for the benefit of employees, including salaried directors. Section 38 (2) (c), in turn, exempts from the prohibition loans to employees other than salaried directors"
[236] Companies Act 61 of 1973
[237] In Companies Act 61 of 1973
[238] Ibit
[239] South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 286.
[240] Companies Act 61 of 1973

Act[241] as well as from the prohibition in Section 226 (1) of the Current Companies Act[242] by Section 226 (2) (d) of the Current Companies Act.[243]

3.4.6 Section 226 (2) (e) of the Current Companies Act[244]

This section makes it possible for a company to help a Manager or Director with his or her housing means.[245] Meaning, a company can make a loan to provide security in terms of the above mentioned, but it must be approved by the company in a general meeting.[246] Consent must be given by all the members informally which will be done by means of the doctrine of anonymous assent.[247]

3.4.7 Section 226 (2) (f) of the Current Companies Act[248]

With this section, when a company makes a loan or when they provide security (on behalf of a Manager or Director of a subsidiary of a company) the loan will be exempt, but the Director or manager must not also be a Director or Manager of the company itself.[249] Section 226 (2) (f) of the Current Companies Act[250] seems to have a loophole. The reason for this is that, if the Director or manager of the subsidiary is not a Director or manager of the company itself, but is a Manager or Director of the company's holding company, the exemption will apply.[251] The

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241 Ibit
242 Ibit
243 Ibit also see South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 286.
244 Companies Act 61 of 1973
245 South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 286.
246 Ibit. No special resolution is necessary and not all of the members have to give their consent formally.
247 South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 286. And also see *Sugden and others v Beaconhurst Dairies (pty) Ltd and others* 1963 (2) SA 174 (E); *Gohlke and Schneider and another v Westies Mineral (edms) Bpk and another* 1970 (2) SA 685 (A).
248 Companies Act 61 of 1973.
249 South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 287. "The one or other exemptions may apply. Such a loan or provision of security is, of course, prohibited only in the first place if the company providing the loan or security has a holding company"
250 Companies Act 61 of 1973.
251 South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of

court supported this in *Bavary Investments (edms) Bpk v Boland bank Bpk en andere ,*[252] the court held that " the exception in s 226 (2) (a) applied even if the director or manager to whom the had been made was also a director of the lending company's holding company or a subsidiary of it."[253]

3.5 The Interpretation of Section 45 of the New Companies Act[254]

Concerning Section 45 of the New Companies Act,[255] a company **may** give financial assistance (directly or indirectly) to a Director of a company/related company/inter-related company or corporation, if the Board[256] is satisfied that:

- immediately after giving the assistance, the company would met the requirements of the solvency and liquidity test, and
- the terms under which the assistance is given are fair and reasonable to the company."[257]

The financial assistance that is being given must be for:[258]

- an employee share scheme in terms of Section 97 of the New Companies Act,[259] or

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Section 226 of the Companies Act by Richard Jooste p 287.

252 1993 (3) SA 597 (A).

253 South African Mercantile Law journal Volume 12 2000: Loans to Directors – an Analysis of Section 226 of the Companies Act by Richard Jooste p 287.

254 Companies Act 71 of 2008

255 Ibit

256 "The Board must give written notice of that resolution to all shareholders, unless every shareholder is also a director of the company, and to any trade union representing its employees, within 10 business days after the resolution, if the total value of all loans, debts, obligationsor assistance contemplated in the resolution, together with any previous such resolution during the financial year, exeeds one-tenth of 1% of the company's net worth at the time of the resolution, or within, or within 30 business [days] after the end of the financial year, in any other case (s 45 (5))." [As quoted from The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p 66]

257 The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p 66

258 The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p66

259 Companies Act 71 of 2008

- a special resolution of the shareholders that was taken within the previous two years that approved such assistance, or generally for a category of potential recipients (and the specific recipients must fall in the category- Section 45 (3) of the New Companies Act 71 of 2008).[260]

The resolution that was taken by the Board to provide the financial assistance will be void if it is inconsistent with the company's MOI or Section 45 of the New Companies Act.[261] If the giving of financial assistance does not comply with Section 45 of the New Companies Act,[262] the Directors would be held liable in terms of Section 77 of the New Companies Act[263] only if the transaction is declared void in terms of Section 218 of the New Companies Act.[264] "Why?" the question may be, well, now, anyone can hold anyone liable for any damages and nothing in the Act will be void unless the **court** declares it void. This can have the effect that, indirectly, the working of some of the sections in the New Companies Act 71 of 2008 will have no effect.

[260] The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p66
[261] Ibit and also see Companies Act 71 of 2008
[262] Companies Act 71 of 2008
[263] Ibit
[264] Ibit

CHAPTER 4

4.1 Introduction

Up until 1999, South African Corporate Law was one of the few remaining common law jurisdictions which still prohibited companies from purchasing their own shares.[265] Eventually this concept was thrown overboard.[266] Although this concept is not of use anymore, there must still be effective maganisms in place for the protection of the creditors and shareholders, as the abuse of the company's power in terms of the repurchasing of shares might put the creditors and shareholders at risk.[267]

In *Capitex Bank Ltd v Qorus holdings Ltd*[268] which was the first case in dealing with the new statutory provisions regarding repurchasing of shares by a company, the court ruled that while the statutory provisions have dramatically changed the capital maintenance rule and the protection it afforded to shareholders, the rule continued to have some lasting function in South African law in that it remains an important guideline to protect creditors and shareholders against abuse of the power of a company and its Directors to repurchase it's own shares.[269]

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[265] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 3
[266] Ibit
[267] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 4
[268] 2003 (3) SA 302 (W)
[269] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 4

Section 85 (1) of the Current Companies Act[270] now allows a company to repurchase its own shares.[271] The provisions that make it possible for a company to repurchase its own shares facilitate a share repurchase for:

- an employee share scheme, or
- a share repurchase to settle debt of the company, or
- a share repurchase from the estate of a deceased shareholder, or
- a share repurchase for a parcel of shares.[272]

There must be taken into account that when a company is repurchasing its own shares it comes down to a distribution that the company is making. In terms of the New Companies Act[273] distributions is being regulated by Section 46 of the New Companies Act[274] and the repurchasing of shares is being regulated by Section 48 of the new Companies Act.[275] When making a distribution a company must ensure that, it stays solvent and liquid, which in turn is regulated by Section 4 of the new Companies Act.[276] Later on, we will look at the New Companies Act and how it compares to the current Companies Act.[277]

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[270] Companies Act 61 of 1973
[271] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 4. It must be authorized in the MOI (This is a revision from the Current Companies Act to the New Companies Act.) As well as approved by a special resolution that was taken by the members of the company. An also see South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 51
[272] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 4.
[273] Companies Act 71 of 2008
[274] Ibit
[275] Ibit
[276] Ibit
[277] Companies Act 71 of 2008 compare with Companies Act 61 of 1973 (specifically on the concept of Capital maintenance).

4.2 Acquisition of Own Shares: General

Like mentioned before, a company can now acquire its own shares if it is authorized in the MOI and if it is approved by a special resolution by the members of the company.[278] When a company acquire its own issued shares, the shares that is repurchased must be cancelled[279] which will then make the shares, authorized unissued shares.[280] This differs from the legislation in the USA and UK where the companies are not forced to cancel the shares that they have repurchased.[281] The reason for this is that the company's share capital will be reduced by the shares that is acquired.[282] The repurchasing of shares may not exceed twenty percent of the company's share capital in one financial year.[283] The price of the shares that is being repurchased may not be higher than ten percent above the weighted average of the market value for the five business days immediately after a repurchase.[284]

A company will not be allowed to acquire all of its shares and furthermore when a company is acquiring its own shares it may not have the effect that the only issued shares that is left would be the redeemable preference shares.[285] With share repurchasing the Directors must provide a statement which states that the solvency and liquidity tests have been met and that the company would be able

278 www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 2

279 South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 53

280 www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 2

281 South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 51

282 Ibit

283 South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 53

284 Ibit

285 www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 2

to pay their debts as they come due in the ordinary cause of business for the following twelve months and that the assets would exceed the liabilities..[286]

4.3 Protection of Creditors and Shareholders

Where it comes to a company acquiring its own shares it may only be done if there are reasonable grounds to believe that the company would be able to pay its debts as they become due in the ordinary cause of business (which refers to the liquidity tests) and that the assets would exceed the liabilities (which refers to the solvency test).[287] It is the responsibility of the Directors to make sure that the requirements of the tests are met.[288] If the company does not stay solvent and liquid and become insolvent and liquid the Directors will be responsible for the loss and they will have to repay the company the money that the company could not otherwise recover.[289] Furthermore a creditor will be able to go to court for an order where it will force the shareholder to return the money to the company and compel the company to reissue the shares to the shareholder.[290]

This responsibility of the Directors will be in addition to any other liability that maybe incurred by the Current Companies Act[291] or in terms of common law.[292] When a company does not stay solvent and liquid it is not a criminal offence, but

[286] South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 53

[287] www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 2

[288] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 5

[289] Ibit "…subject to any relief granted by the court en the exercise of its discretion under s 248 to excuse a director who has acted honestly and reasonably and who ought fairly to be excused [s 86(1)].

[290] www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 3

[291] Companies Act 61 of 1973

[292] www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 3

on the other hand, it is well seen as a criminal offense in countries like Singapore.[293] The Directors is not directly liable[294] to its creditors and shareholders in terms of the Current Companies Act,[295] but in terms of the New Companies Act,[296] the Directors will be directly liable to its shareholders and creditors because of Section 15 (6) of the New Companies Act.[297] The MOI is now a contract between the Directors on the one hand and creditors and shareholders on the other.[298] In terms of the Current Companies Act,[299] the Directors have no fiduciary duty towards the creditors and shareholders,[300] where in the New Companies Act[301] it is a completely different story. Director's liabilities are now being regulated by Sections 75 – 77 in the New Companies Act.[302]

Now, when a company gets a response to their offer to acquire shares and the response is bigger than the initial offer, the company must, as far as possible acquire the shares pro rata.[303] Where in the New Companies Act[304] the company can choose which shares they want to buy back from which shareholders. Where there is a contract to acquire shares it will be enforceable against the company but not if it will be in contravention[305] with Section 85 (4) of the Current Companies Act.[306] If the company is not able to perform, the shareholder will

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293 www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 5
294 Ibit
295 Companies Act 61 of 1973
296 Companies Act 71 of 2008
297 Ibit. Because the MOI is now seen as a contract
298 The company's separate legal entity is indirectly being ignored
299 Companies Act 61 of 1973
300 www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 5
301 Companies Act 71 of 2008
302 Ibit
303 www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 3. Except where the shares are listed on the stock Exchange.
304 Companies Act 71 of 2008
305 www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 3.
306 Companies Act 61 of 1973

remain a claimant and will be entitled to the consideration as soon as the company is able to perform again.[307]

4.4 Insider Trading

Another "let down" in the statutory provisions of the Current Companies Act[308] is where a company wants to repurchase its shares and it is not seen as an insider in terms of the Insider Trading Act 135 of 1998.[309] Insider Trading is now regulated by the Securities Services Act 36 of 2004. As mentioned above the company will not be seen as an insider although it has information that non-public about the securities.[310] What must be remembered is that the Insider Trading Act[311] only applied to natural persons. Although an "individual… that encourages a company to deal, is discourages it from dealing, on the basis of material non-public information would, according to s 2 (1) (b) of the Insider Trading Act, commit a criminal offence,"[312] in other words if a Director of a company encourages the company to deal in its securities, the Director would be committing an offense.[313] In the United Kingdom Section 52 of the Criminal Justice Act 1993 has a similar effect.[314]

[307] www.accaglobal.com. October 2000: Capital maintenance Doctrine in South African Corporate Law by J.T. Pretorius p 3.
[308] Companies Act 61 of 1973
[309] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 7
[310] Ibit
[311] 135 of 1998
[312] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 7
[313] A criminal offence
[314] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 7

On the other hand, in New Zealand, Australia and Canada, a company that is dealing in their own securities is seen as an insider.[315] The New Zealand Law Commissioned Report is of meaning that if a company deals in its own securities it is the **ultimate insider.**[316] It would have been ideal if a company could not repurchase its own shares until the information that they have (non-public information) has been made public.[317] In South African Law, the issue was not properly considered because the Insider Trading Act[318] was enforced before a company was allowed/given the right to repurchase its own shares.[319] Now, the Securities Services Act[320] is regulating this issue.

4.5 Interpretation of Section 46 of the New Companies Act[321]

In terms of the New Companies Act[322] the definition of "distribution" is much wider and in the definition both dividends and capital distributions are being included. Payment that is been made for share repurchasing is included as well.[323]

The provisions are very much the same in the Current Companies Act.[324] The New Companies Act[325] allows the board of Directors to approve shareholder distributions – subject to the solvency and liquidity tests.[326]

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[315] Ibit
[316] Ibit
[317] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 7
[318] 135 of 1998
[319] www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 7
[320] 36 of 2004
[321] Section 46 and 48 of the Companies Act 71 of 2008
[322] Section 1 of The Companies Act 71 of 2008
[323] Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 1. Where in the Current Companies Act it is not included
[324] Companies Act 61 of 1973
[325] Companies Act 71 of 7008
[326] Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 1

Therefore, when the board contemplates a distribution they must first consider the solvency and liquidity of the company, which is now regulated in terms of Section 4 of the New Companies Act[327]. A company will satisfy the solvency and liquidity test if, taking into account, all reasonably foreseeable financial circumstances at the time:

- the company's total assets equal or exceed its total liabilities; and
- it appears that' the company will be able to pay its debts as they become due in the ordinary course of business for the following twelve months after the distribution has been made.[328]

The twelve-month test is a new regulation in the New Companies Act.[329] This new regulation will resolve any uncertainty that the Current Companies Act[330] may have caused with regards to the length of time after the distribution has been made that the company's liquidity must be considered.[331] It is the company's solvency that must be considered immediately after the distribution has been made that is very important. So, share repurchasing is still allowed under the New Companies Act[332] subject to the solvency and liquidity tests that has to be met.[333]

Furthermore, the Board must give attention to what approvals are required for a distribution.[334] In the New Companies Act,[335] it states explicitly that Board

327 Companies Act 71 of 2008
328 Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 1
329 Companies Act 71 of 2008
330 Companies Act 61 of 1973
331 Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 1
332 Companies Act 71 of 2008
333 Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 1
334 Ibit
335 Companies Act 71 of 2008

authorisation is being required, where in the Current Companies Act[336] it does not explicitly refers to Board authorisation.[337] What will the situation be with shareholder approval? Well, if it is listed shares that we are talking about then the listing rules of the Stock Exchange may require shareholder approval.[338] Currently an ordinary resolution in terms JSE requirements.[339] The Companies Act[340] deals with personal liability on a big scale. Therefore, if the Directors make a distribution contrary to the New Companies Act[341] - they will breach the provisions of the abovementioned Act, as well as they will be held liable[342] in terms of Section 77 of the New Companies Act.[343] Therefore, a company will only make a distribution if:

- the distribution is because of an existing legal obligation of the company, or a court order; or
- the distribution is authorized by the Board of the company by resolution; and
- it reasonably appears that the company will satisfy the solvency and liquidity test after the distribution has been made, and
- the Board acknowledges that they have complied with the solvency and liquidity tests and reasonably came to the conclusion that the company will satisfy the tests after the distribution has been made ("Board acknowledgement").[344]

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336 Companies Act 61 of 1973
337 Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 1

338 Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 2
339 Ibit
340 Companies Act 71 of 2008
341 Ibit
342 Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 2
343 Companies Act 71 of 2008
344 The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p 34

In short, the following requirements must be met before repurchasing can take place:[345]

- there must be Board authorization
- the solvency and liquidity tests must be met
- the financial restrictions must be taken into consideration

Once again, if these requirements are not met, the Directors will be held liable in terms of Section 77 of the New Companies Act[346] for breach of their fiduciary duties. The New Companies Act[347] does not mention anything about the liability of shareholders with regards to unlawful distributions or in respect of share repurchasing.[348] With regards to recovery of unlawful distributions from shareholders who received the distribution in good faith and who did not know about the violation is very unusual.[349] Shareholders are exempted from liability (on the basis that they received the shares in good faith) or ignorance of the impropriety of the distribution in New Zealand,[350] California[351] and in the United States of America.[352] On the other hand in England, shareholders from whom shares were bought back by the company have no defense and they are automatically liable to return the money if the company is wound up within one year of the payment.[353]

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[345] TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 499

[346] Companies Act 71 of 2008

[347] Ibit

[348] TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 499

[349] Ibit

[350] Section 56 (1) of the New Zealand Companies Act and also see TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 500

[351] Section 506 (a) of the California Corporations Code and also see TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 500

[352] "The possession depends on state law, but the trend is that shareholders will only be liable If they had knowledge of the impropriety." [as quoted from TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 500]

[353] section 76 of the UK Insolvency Act [also see TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 500]

However, where it comes to distributions that were made otherwise then in terms of a share repurchase, it must be proven that the shareholder knew/had reasonable grounds to believe that the distribution was made in contravention of the provisions before the shareholder can be held liable to return the distribution.[354] "I suggest that the simplest solution is to hold shareholders liable regardless of whether or not they received a distribution in good faith. Practical difficulties in enforcing such recovery should not obscure the basic principle that, ultimately, creditors enjoy preference in respect of the repayment of their debts."[355]

4.6 Interpretation of Section 48 of the New Companies Act

In terms of the New Companies Act,[356] only an ordinary resolution from the shareholders is being required when it comes to the repurchasing of shares.[357] Where it comes to subsidiaries holding shares in their holding company, it is uncertain whether consent is required from the holding company's shareholders in terms of the Current Companies Act.[358] However, in terms of the New Companies Act[359] a resolution of the shareholders of the subsidiary will suffice.[360] When somebody who is related to the company and wants to buy shares from the company, "buy back approvals" will be required to do so.[361]

[354] "s 277 (1) of the British Companies Act 1985; s 847 (2) of the UK Companies Act 2006. The Common law possession is not certain" [as quoted from TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 500]
[355] TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 500

[356] Companies Act 71 of 2008
[357] Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 2
[358] Companies Act 61 of 1973
[359] Companies Act 71 of 2008
[360] Bowmin Gilfillin Attorneys, June 2008: Article 8: Overview of the Shareholder Distribution Section in the Companies Bill by Lance Fleiser p 2
[361] Ibit

Section 48 of the New Companies Act[362] regulates the acquisition by a company of its own shares in itself, as well as the acquisition by subsidiaries of shares in their holding company.[363] The giving of consideration for the acquisition by one company in a group of shares to any other company in the group is seen as a distribution, but such acquisition is not being regulated by Section 48 of the New Companies Act,[364] except where a subsidiary is acquiring shares in its holding company.[365] There are no restrictions on the funds utilised to acquire the company's shares – such restrictions were quite common in the United States.[366]

The New Companies Act[367] does not provide a definition of the term "acquisition". It makes sense that a company cannot really acquire its shares, as it cannot hold rights against itself. However, the term must be understood to include any instance where a shareholder relinquishes rights in respect of a share to the company, whether for consideration or not. If a company gives consideration for this, it will be seen as a distribution. The term evidently includes share repurchases by agreement with the company. An advantage of the New Companies Act[368] is that the redemption of shares is also being regarded as an acquisition, so that the same financial restrictions will apply to repurchases and redemptions. Redemptions must comply with the requirements for distributions set out in Section 4 and Section 46 of the New Companies Act[369], the same goes for acquisition of shares set out in Section 48 of the New Companies Act.[370]

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362 Companies Act 71 of 2008
363 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 487
364 Companies Act 71 of 2008
365 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 488
366 www.westlaw.com. Internationally Company and Commercial Law Review 2004: The Capital Maintenance Concept and Share Repurchases in South African Law by FHI Cassim and Rihana Cassim p 5

367 Companies Act 71 of 2008
368 Ibit
369 Ibit
370 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 488 and also see Companies Act 71 of 2008

The term acquisition is wide enough to cover shares that are repurchased by the company in compliance with a court order.[371] Section 252 (3) of the Current Companies Act[372] provides that a court may order a company to "repurchase" the shares of the shareholders, where Section 163 (2) (g) of the New Companies Act[373] provides that the company/any other person by order of the court can "restore to a shareholder any part of the consideration the shareholder paid for shares."[374] The court can set out conditions;[375] and according to Kathleen Van der Linde, that the requiring shareholder who surrenders shares to the company will be a common condition.[376] In this case, it will be an acquisition by the company.[377]

If there is no acquisition the payment that was restored/recovered will still be a distribution in the form of a transfer of shares, and it must still met the requirements of the solvency and liquidity tests.[378] This seems to be a much better position because the Current Companies Act[379] excluded the court-ordered share repurchase from the definition of "payment".[380] Even though payments in terms of a court order are in principle subject to the solvency and liquidity test, the New Companies Act[381] makes provision that a company "may apply" to court for an order that the payment is made at the earliest possible date not forgetting the company must satisfying its other financial obligations as they fall due in the ordinary course of business.[382]

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371 Ibit
372 Companies Act 61 of 1973
373 Companies Act 71 of 2008
374 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 488
375 Section 163 (2) (g) of the Companies Act 71 of 2008
376 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 488
377 Ibit
378 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 488
379 Companies Act 61 of 1973
380 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 488 and also see Section 90 (3) of the Companies Act 61 of 1973
381 Companies Act 71 of 2008
382 TSAR 2009.3: The regulation of distributions to shareholders in the Companies Act 2008 by Kathleen Van der Linde p 488 and also see Section 46 (5) (a) – (b) of the Companies Act

Where it comes to the liability and validity of a contract with regards to the repurchasing of shares, a contract in terms of the abovementioned will be enforceable against the company.[383] However,[384] it would not be the case where a company cannot execute the contract[385] because if they do, they will breach Section 48 (2) - (3) of the New Companies Act.[386] As mentioned before if a company acquires any shares contrary to Section 46 or 48 of the New Companies Act[387], it **may** apply to court for an order reversing the acquisition. The court may order the person (from whom the shares were acquired) to return the amount paid by the company, **or** order the company to issue a corresponding number of shares to that person.[388]

4.7 The Tax Implications when Repurchasing Shares

In 1993, Secondary Taxation on Companies (STC) was introduced in South Africa.[389] STC payment is being regulated by Sections 64B and 64C of the Income Tax Act[390] together with the definition "dividend" in Section1 of the Income Tax Act.[391] Repurchases by a holding company of its own shares is being seen as a dividend (it represents a distribution) to the shareholders.[392] The company will then be held liable for STC on the amount utilized to buy back the

71 of 2008
[383] The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p 35
[384] Section 48 (4) of the Companies Act 71 of 2008
[385] The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p 35
[386] Companies Act 71 of 2008
[387] Ibit
[388] The New Companies Act Manual. Piet Delport. ISBN 978 0 409 04523 9 p 35 and also see Section 48 (6) of the Companies Act 71 of 2008.
[389] South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 53
[390] Income Tax Act 58 of 1962
[391] Ibit
[392] South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 53

shares.[393] What about the shareholders receiving the money? What are the tax implications for them? Well, it may be a bit complex; like in South Africa, there will be taken a look at the tax status of the shareholder concerned, as well as the jurisdiction of foreign shareholders.[394] What will be payable is the stamp duty/marketable securities tax on registration of transfer of the shares used as currency into the name of the selling shareholders.[395]

Where a subsidiary purchases shares in its holding company, it does have certain tax advantages.[396] "Why?" Well, when looking at the definition of a "dividend" in the Income Tax Act,[397] a repurchase of shares by a company in itself is seen as being a dividend and attracts the STC.[398] So, if the shares are not required to be cancelled, like when a subsidiary buys shares in its holding company, then the STC payments can be avoided.[399] This might be one of the reasons why a subsidiary is being allowed to purchase shares in its holding company. Which amount will the company have to pay STC on? It will be the amount of the dividend in the repurchase with which the profits attributable to shareholders of being reduced.[400] In other words, the normal value of the shares that is being repurchased, as well as all the debits allocated to the share premium

393 www.butterworths.up.ac.za: Capital Consequences of the Resent Amendments brought about by the Companies Amendment Act 37 of 1999 by Bruce Cleaver
394 Ibit
395 Ibit
396 South African Law Journal Volume 133 2001: The Companies Act Changes – Problems and Doubts by Harvey E Wainer p 138
397 Income Tax Act 58 of 1962
398 South African Law Journal Volume 133 2001: The Companies Act Changes – Problems and Doubts by Harvey E Wainer p 138
399 South African Law Journal Volume 133 2001: The Companies Act Changes – Problems and Doubts by Harvey E Wainer p 138
400 South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 54

amount[401] is seen as a dividend.[402] It is obvious that when shares are being repurchased that the transaction is being affected by the Income Tax Act.[403]

401 Section 76 (d) of the Companies Act 61 of 1973

402 South African Business Management 2008, 39 (4). Share Repurchases: Which Number of Shares should be used by JSE – listed Companies when publishing Market Capitalisation in Annual Reports? By P.G. Bester, W.D. Hamman, L.M Brummer N. Wesson and B.W. Steyn – Bruwer p 54 and also see Section 1 of the Income Tax Act 58 of 1962

403 Income Tax Act 58 of 1962

CHAPTER 5

Conclusion

In my opinion, the New Companies Act is in some instances clearer than the Current Companies Act but on the other hand, there are some provisions in the New Companies Act that still needs to be clarified for example Section 218 of the New Companies Act. This provision is indirectly taking away the effectiveness of some of the other sections in the Act, what is leaves us with the question - What is the point of the other sections? Once again, the New Companies Act gives more protection, including Section 218 of the New Companies Act, especially where it comes to creditors and minority shareholders. The Current Companies Act is defective, lacks many technical qualities, does not have a wide enough cover, and contains very little on corporate governance, transparency, accountability, modern merger methods and the minority shareholder protection. With the abolishment of the capital maintenance rule, it brings the South African company law in line with international standards regarding company law.

Where it comes to the aspect of financial assistance and comparing Section 38 of the Current Companies Act to Section 44 of the New Companies Act, Section 38 of the Current Companies Act says, [.. no company shall give ..], where Section 44 of the New Companies Act says, [.. a company may ..], which means that this section is not as strict as the Current Section 38. Section 38 of the Current Companies Act mentions that you will be guilty of an offence, where in Section 44 of the New Companies Act it does not mention anything of an offence, but it well mentions that a Director will be "liable", just like in Section 38 of the Current Companies Act mentions. For me, Section 44 of the New Companies Act gives more power to the Directors which they can abuse greatly. But on the other hand Section 15 (6) of the New Companies Act protects the creditors and minority shareholders because it states that the MOI is now a contract. This can be a very good thing but in the same sentence I'm going to say it can be a very bad thing because what about protecting the Directors?

Where it comes to loans to Directors Section 45 of the New Companies Act regulates this situation. Section 45 of the New Companies Act is very similar to Section 226 of the Current Companies Act. Section 226 of the Current Companies Act is recognition of the powerful positions that are being held by Directors and Managers of a company. The Directors and Managers of a company can abuse this position for their own benefit, and to the disadvantage of the company as well as its shareholders. In term of the New Companies Act, a resolution that was taken by the Board to provide the financial assistance will be void if it is inconsistent with the company's MOI or Section 45 of the New Companies Act. If the giving of financial assistance does not comply with Section 45 of the New Companies Act, the Directors would be held liable in terms of Section 77 of the New Companies Act only if the transaction is declared void in terms of Section 218 of the New Companies Act. So here, it is again, this can be a good thing or a bad thing for creditors and shareholders. A good thing – they can hold the Directors liable for damages but if the decision is not declared void, what stands the creditors and shareholder to do?

Now, where it comes to a company buying back it own shares up until 1999, South African Corporate Law was one of the few remaining common law jurisdictions which still prohibited companies from purchasing their own share. Eventually this concept was thrown overboard. Now companies are allowed to repurchase shares. Section 48 of the New Companies Act regulates the acquisition by a company of its own shares as well as the acquisition by subsidiaries of shares in their holding company. The New Companies Act does not provide a definition of the term "acquisition". A company cannot really acquire its shares, as it cannot hold rights against itself. If a company gives consideration for the shares that they have repurchased, that will be a distribution. An advantage of the New Companies Act is that the redemption of shares is also regarded as an acquisition, so that the same financial restrictions apply to the repurchases and redemptions. Redemptions must comply with the requirements for distributions set out in Section 46 of the New Companies Act, as well as goes for acquisition of shares set out in Section 48 of the New Companies Act. In other words a company is now allowed to repurchase shares but if a company decides to do so the requirements of Section 46 of the New Companies Act must be met, which will lead to the requirements that must be met of Section 4 of the New Companies Act (the solvency and liquidity tests).

In my personal opinion, the New Companies Act is better that the Current Companies Act and it provides better protection. With the capital maintenance rule that have been abolished, our South African company law is now in line with the international standards of company law.

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