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Abstract:

The amendment of the Companies Act 61 of 1973 in 1999 by Companies Amendment Act 37 of 1999 made it possible for the first time, in South Africa, for a company to acquire its own shares and for a subsidiary to acquire shares in its holding company. The position introduced by the 1999 amendments was repealed in 2011 with the coming into effect of the Companies Act 71 of 2008.

I have compared capital maintenance rule under the Companies Act 61 of 1973, as amended in 1999 with capital maintenance rule under the Companies Act 71 of 2008. I have also examined in detailed the requirements to be complied with when a company acquires its shares as well as the requirements to be complied with when a subsidiary acquires shares in its holding company.

Key words: Acquisition of shares, Memorandum of incorporation, Capital maintenance rule, share repurchase, share buyback, Companies Act 71 of 1973, Companies Act 61 of 2008, solvency and liquidity test, distribution, board, shareholders.

Chapter 1:

Introduction

This study will follow a comparative and analytical research methodology. It has five chapters. Chapter 2 looks at the historical background of the South African capital maintenance rule. Chapter 3 critically compares capital maintenance rule under the Companies Act 61 of 1973 ("the 1973 Act") and under the Companies Act 71 of 2008 ("the 2008 Act").

Chapter 4 examines the requirements to be met when the company acquires its shares under the 2008 Act. This chapter will analyse the relevant parts of section 46 and 48 of the 2008 Act, which respectively deal with distribution and share buyback. The chapter will further examines requirements to be complied with when a subsidiary company acquires shares in its holding company under the 2008 Act.

Chapter 5 will then conclude by highlighting critical issues identified and discussed in each chapter.

Chapter 2:

Historical Background to Capital Maintenance Rule

Introduction

The origin of the South African capital maintenance rule date back to the 17th century and was imported from English common law as developed in the well-known England case of *Trevor v Whitworth.*[1] The court's decision in *Trevor v Whitworth* effectively prohibited a company buying back its shares on the basis that the money paid by shareholders on subscription for the shares in the company serves as a guarantee for its creditors. The English common law rule on capital maintenance did not only prohibit the company from buying its own shares but also prohibited the company from paying dividends out of the capital as decided in the matter between *Guinness v Land Corporation of Ireland*.[2] The English courts further developed capital maintenance rule in the matter between *Ooregum Gold Mining Co v Roper*[3] when it prohibited issuing of shares at discount of their par value. These common law rules were then imported into South Africa and become the philosophical benchmark for our capital maintenance rule.[4]

In the South Africa context, a company could not part with its capital unless it is in the ordinary course of its business.[5] The South African common law rule effectively prohibited the use of the company's capital for other purposes other than its business operations. Since the acquisition by the company of its own shares, the paying of dividends out of the capital and issuing of shares at discount to their par

[1] 1887 12 App Cas 409 (HL) 420.

[2] 1883 22 ChD 349 CA (356).

[3] 1892 AC 125.

[4] Cilliers *et al* (2000) 322.

[5] Jooste R "the maintenance of capital and the companies bill 2007" 2007 (4) *SALJ* at 710.

value could not be held to constituted company's ordinary course of business, they were thus prohibited.

The rationale behind capital maintenance rule was that "the contributed capital of the limited liability company constituted the fund to which creditors of the company must look for the satisfaction of their claims, and that this fund should be maintained".[6] From this perspective, the capital maintenance rule was therefore designed primarily to protect the interest of creditors. But the rule was also developed to protect the interests of shareholders in that if the company acquires its shares, that acquisition will change the share capital structure of the company and will therefore change the distribution of the voting rights of the shareholders.[7]

In South Africa, the rule was affirmed in the matter between *Unisec Group Ltd v Sage Holdings Ltd*[8] where it was stated, according to Blackman[9] that "in reaching their conclusion, all the Law Lord were influenced by the fact that the Joint Stock Companies Act of 1867 required the memorandum to stipulate the nominal capital and laid down a formal procedure for reduction of capital. It was held that the legislature clearly intended that capital should only be maintained and thus this policy would be violated if companies were allowed to purchase their own shares". According to Blackman further stated "the rule prohibiting the company from purchasing its own shares was further extended by section 39(1), which prohibited a subsidiary from being a member of its holding company, and which provided that any allotment, issue or transfer of shares of a company to its subsidiary was void" [10]

The rule against share buyback was however abolished with the introduction of the Companies Amendment Act 37 of 1999 ('the Amendment Act").[11] This

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[6] *Ibid* note 4 above.

[7] Van der Linde KE "*Share repurchases and the protection of shareholders*" 2010 (2) *TSAR* 288.

[8] 1982 (1) SA 337 (W)

[9] Blackman MS *et al* "*Commentary on the Companies Act*" Revised Version Service 8, 2011 (1) Juta & Co Ltd 5 -41.

[10] *Id.*

[11] The Amendment Act came into effect on 30 June 1999.

amendment introduced sections 85 to 90 of the 1973 Act. In summary, sections 85 to 90 of the 1973 Act provided for a company to acquire the shares issued by it under certain circumstances[12], for directors and shareholders to be liable for causing the company to acquire its shares in contravention of section 85[13], procedure to be followed when the company intends to acquire its shares[14], the enforceability of the contract entered into with the company to acquire its shares[15], for the subsidiary of the company to acquire shares in its holding company[16] and circumstances under which a company can pay its shareholders.[17]

The introduction of these provisions signalled the new dawn for capital maintenance rule in South Africa, as it, for the first time, allowed companies to acquire their own shares. These provisions constituted the South African capital maintenance rule until they were repealed by the 2008 Act.[18] Sections 46 and 48 of the 2008 Act now form the backbone of the South African capital maintenance rule. Section 46 requires authorisation by the board before distribution[19] can be effected. Section 48 authorises the company or its subsidiary to acquire share in it when it complies with certain requirements.

The next chapter will critically compare capital maintenance rule under the 1973 Act with capital maintenance rule under the 2008 Act.

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[12] Section 85 of the 1973 Act.

[13] Section 86 of the 1973 Act.

[14] Section 87 of the 1973 Act.

[15] Section 88 of the 1973 Act.

[16] Section 89 of the 1973 Act.

[17] Section 90 of the 1973 Act.

[18] The Companies Act 71 of 2008 came into effect on 01 May 2011.

[19] *Distribution* is defined in Section 1 of the 2008 Act.

Chapter 3:

Capital Maintenance Rule Under the 1973 Act and 2008 Act

3.1. The comparison of Capital Maintenance Rule under the 1973 Act[20] and the 2008 Act

3.1.1. Introduction

According to Van der Linde, capital maintenance, in its basic form, entails that the share capital may not be returned to shareholders during the existence of the company, except as expressly allowed by legislation.[21] In South Africa, capital maintenance was, for a considerable time, regulated by common law, which prohibited company from paying divided from capital,[22] from acquiring its share[23] and from issuing shares at the discount to their par values.[24] The common law position was changed, for the first time, by the introduction of the Amendment Act,[25] which effectively abolished common law rule of capital maintenance. The legal position that was introduced by the Amendment Act was further repealed by the 2008 Act.[26]

In this Chapter, I will compare the South African capital maintenance rule under the 1973 Act and the 2008 Act with specific reference to the circumstances under which a company can acquire its share, the requirements to be complied with when the company acquires its shares, the procedure to effect the acquisition, the liability of directors and the enforceability of the contracts for acquiring own shares. I will

[20] The 1973 Act as amended by the 1999 Amendment Act.

[21] Van der Linde K E (2008) "*Aspects of the regulation of share capital and distribution to shareholder*" LLD-thesis, University of South Africa at 21.

[22] Guinness v Land Corporation of Ireland (1883) 22 ChD 249 CA.

[23] Trevor v Whitworth (1887) 12 App Cas 409 HL.

[24] Ooregum Gold Mining v Roper (1892) AC 124 HL.

[25] See footnote 10 above.

[26] See footnote 17 above.

begin with the provisions of the 1973 Act and followed by the provisions of the 2008 Act.

3.1.2. Capital Maintenance Rule under the 1973 Act

Capital maintenance rule under the 1973 Act was regulated by sections 85 to 90. Section 85 provided that unless prohibited by this section or any other law, a company may acquire its share provided it is authorised by its article and the acquisition is approved by its members by a special resolution. The special resolution to approve the acquisition may either be general approval or specific approval.[27] If the approval is general approval, it shall be valid until the next annual general meeting but it may be varied or revoked by special resolution by the general meeting at any time prior to such annual general meeting.[28]

According to the provisions of the 1973 Act, a company was prohibited from making any payment to acquire its shares if there was a reasonable ground for believing that the it was or would, after the payment, be unable to pay its debts as they become due in the ordinary course of its business [29] or its consolidated assets, fairly valued, would be less than its consolidated liabilities, after the payment.[30] The shares acquired in terms of this section shall be cancelled as issued share and restored to the status of authorised.[31] The repurchased shares that have been cancelled are called 'treasury shares'.[32] 'Treasury shares' are, however, not permitted in South Africa company law.[33] Cassim states the following about the status of the reacquired shares that have been cancelled: "….such shares do not

[27] Section 85(2) of the 1973 Act.

[28] Section 85(3) of the 1973 Act.

[29] Section 85(4)(a) of the 1973 Act.

[30] Section 85(4)(b) of the 1973 Act.

[31] Section 85(7) of the 1973 Act.

[32] Cassim FHI "*The new statutory provisions on company share repurchases: A critical analysis*" (1999) 116 *SALJ* at 761.

[33] *Ibid* note 32 above.

carry any voting or dividend rights in the hands of the company, but the company is at least able to reissue the shares".[34] The company was prohibited from acquiring its shares if, as a result of the acquisition, there would no longer be shares in issue other than convertible or redeemable shares.[35]

Accordingly, in terms of the 1973 Act, a company could acquire its shares under the following circumstances:

- if the acquisition is not prohibited by section 85 or any other law;
- if the acquisition is authorised by its article;
- if the acquisition is approved by its members by a special resolution, [36] and
- if the acquisition would not result in no share in issue other than convertible or redeemable shares.

3.1.3. Capital Maintenance Rule under the 2008 Act

The Capital maintenance rule under the 2008 Act is regulated by section 48 read with section 46. Section 48 provides that subject to subsections (3) and (8), and if the decision to do so satisfies the requirements of section 46 – the board of a company may determine that the company will acquire a number of its own shares. Section 46 provides that a company must not make any proposed distribution unless it reasonably appears that the company will satisfy the solvency and liquidity test[37]

[34] *Ibid* note 32 above.

[35] Section 85(9) of the 1973 Act.

[36] Section 85(2) of the 1973 Act: The special resolution to approve the acquisition may either be general approval or specific approval.

[37] In terms of section 4, a company satisfies solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time- the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and it appears that the company will be able to pay its debts as they became due in the ordinary course of business for a period of – 12 months after the date on which the test is considered

immediately after completing the proposed distribution and the board of the company, by resolution, has acknowledged that it has applied solvency and liquidity test as set out in section 4, and reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.

Section 48 thus regulates the acquisition by the company of its shares and section 46 regulates distribution. Distribution is defined in section 1 of the 2008 Act as a direct or indirect transfer by a company of money or any other property of the company, other than its own shares, to or for the benefit of its shareholder(s), whether - in the form of a dividend, as a payment in lieu of a capitalisation shares, as a consideration for the acquisition by the company of any of its shares or by any company within the same group of companies, of the shares of a company within that group of companies.

Accordingly, in terms of the 2008 Act, a company could acquire its shares under the following circumstances:

- if the acquisition is not in conflict with section 48(3) & (8)[38]; and
- if the decision[39] to acquire own shares satisfies the requirements of section 46.[40]

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or in case of distribution contemplated in paragraph (a) of the definition of distribution in section 1, 12 months following that distribution.

[38] Subsection (3) provides that a company may not acquire its own share and a subsidiary of a company may not acquire shares of that company, if, as a result of that acquisition, there would no longer be any shares of the company in issue other than –(a) shares held by one or more subsidiaries of the company; (b) convertible or redeemable shares. Subsection (8) provides for the requirements that the decision by the board to facilitating an acquisition by the company of its own share in terms of section 48 need to be complied with.

[39] Decision in this regard refers to decision by the board to acquire shares.

[40] Section 46 of the 2008 Act regulates distribution.

3.1.4. The differences between capital maintenance rule under the 1973 Act and the 2008 Act

The glaring difference between the provisions of the 1973 Act and the 2008 Act is that first, the 1973 Act requires the acquisition to be authorised by the article of association while the 2008 Act does not make provision for such authorisation by the article of association. There are differing views among authors as to whether the 2008 Act nullifies the provisions of the Memorandum of Incorporation in this regard.

Van der Linde accepts that the 2008 Act does not expressly make provision that the acquisition by the company of its share be authorised in the Memorandum of Incorporation, but she is of the view that an acquisition by the company of its share, which is in violation of the Memorandum of Incorporation will be open to challenge by shareholders and will expose directors to liability for breach of their duties.[41]

Jooste is of different view. According to him, “it appears that a distribution or acquisition which complies with the relevant requirements of sections 46 and 48, as the case may be, is valid even if it conflicts with the Memorandum of Incorporation. So provisions in the Memorandum of Incorporation that prohibit certain distributions or acquisitions altogether, or permit them only if certain conditions are met, are ineffective”.[42] Jooste goes further and says his view is based on section 15(2)(a)(ii)[43] and the definition of ‘alterable provision’ in section 1[44] and concluded that section 48 is not an alterable provision.[45]

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[41] Van der Linde KE (2008) *Aspects of the regulation of share capital and distribution to shareholder,* LLD-thesis, University of South Africa at 479).

[42] Cassim & Jooste (eds) 2011 at 275.

[43] Section 15(2)(a)(ii) of the 2008 Act provides that the Memorandum of Incorporation of any company may-(a) include any provision- (ii) altering the effect of any alterable provisions of this Act.

[44] In terms of Section 1 of the 2008 Act alterable provision means a provision of this Act in which it is expressly contemplated that its effects on a particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by that company’s Memorandum of Incorporation.

[45] *Ibid* note 41 above.

Another glaring difference between the 1973 Act and the 2008 Act is in respect of the approval by shareholders. In terms of the 1973 Act, shareholders are required to approve the acquisition by the company of its own shares by special resolution which can either be general approval or specific approval. The 2008 Act does not make provision for shareholders to approve the acquisition by the company of its shares, instead, the 2008 Act makes a provision for the board of directors' decision to be approved by a special resolution of the shareholders only if the shares are to be acquired by the company from the director or prescribed officer of the company or person relating to the director or the prescribed officer of the company.[46] This provision clearly does not apply to repurchase by the company from its shareholder who is not a director or prescribed officer.

Van der Linde also accepts, in this regard, that the 2008 Act does not expressly make provision that the acquisition by the company of its share be approved by its shareholders.[47] However, she states that "although it is not required that the Memorandum of Incorporation authorise repurchase, nothing prevents the regulation of repurchases in a Memorandum".[48] This thus suggests that the requirement for approval by shareholders of share repurchase can be introduced through the inclusion of such in the Memorandum of Incorporation. Van der Linde's proposition is at odds with Jooste's view. Jooste is of the view that "there is nothing in section 48 that expressly contemplates that the effect of section 48 may be negated, restricted, limited, qualified, extended, or otherwise altered in substance or effect by a company's Memorandum of Incorporation.[49] Jooste thus argues that the effect and substance of section 48 cannot be altered by Memorandum of Incorporation.

In summation, Van der Linde's argument that the lack of authorisation by the company's Memorandum of Incorporation and the lack of approval by shareholder of

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[46] Section 48(8) of the 2008 Act.

[47] Van der Linde K "*Share repurchases and the protection of shareholders*"2010 (2) *TSAR* 302: She state, in this regard, that the New Companies Act dispenses with authorisation in the company's constitution and the shareholder approval by resolution.

[48] *Ibid* note 46 at page 303.

[49] Cassim & Jooste (eds) 2011 at 275.

the acquisition by the company of its shares in terms of the 2008 Act can be introduced through Memorandum of Incorporation, appears to be a weak argument relative to the argument of Jooste that the provision of section 48 cannot be altered.

One can perhaps argue that it might have not been the legislature's intention to exclude shareholders' participation when the company decides to acquire its shares considering the effect that such acquisition can have on the share capital and the shareholding of the company. Amendments are thus being called upon to provide a shareholder with a right to have a say when a company decides to acquire its own shares.

3.2. Solvency and liquidity test under the 1973 Act and the 2008 Act

One of the key requirements to be complied with when the company is acquiring its shares is that it should comply with solvency and liquidity test. Both the 1973 Act and the 2008 Act have solvency and liquidity test as a requirement to be complied with before the company could acquire its shares. Since the solvency and liquidity test in the 2008 Act is not a replica of the solvency and liquidity test in the 1973 Act, the differences between the tests in these Acts will be examined in detail in this section.

The 1973 Act provided that a company could not make payment in whatever form to acquire any share issued by the company if there were reasonable grounds for believing that[50] the company is, or would after the payment, be unable to pay its debts as they become due in the ordinary course of business[51] or the consolidated assets of the company fairly valued would after the payment be less than the consolidated liability of the company.[52]

[50] Section 85(4) of the 1973 Act.

[51] Section 85(4)(a) of the 1973 Act.

[52] Section 85(4)(b) of the 1973 Act.

The 2008 Act, on the other hand, provides that the decision by the company to acquire its shares must satisfy the requirements of section 46.[53]Section 46 provides that a company must not make any proposed distribution[54] unless it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution[55] and the board of the company, by resolution, has acknowledged that it has applied solvency and liquidity test as set out in section 4, and reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.[56]

Section 4 provides that a company satisfies solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time- the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and it appears that the company will be able to pay its debts as they became due in the ordinary course of business for a period of – 12 months after the date on which the test is considered or in case of distribution contemplated in paragraph (a) of the definition of distribution in section 1, 12 months following that distribution.

As far as the 1973 Act is concerned, it appears that there was a disagreement among some authors as to the relevant time when the requirements for subsection (a) and (b) come into the effect. Cassim was of the view that "the company should be liquid and solvent at the time when the contract was entered into and at the time of payment for the acquisition of its shares, and that after the payment the company should be able to pay its debts as they become due in the ordinary course of business and also be in the position where its assets exceed its liabilities".[57]

[53] Section 48(2) of the 2008 Act.

[54] Distribution is defined in section 1 and includes payment as a consideration for acquiring own shares in terms of section 48.

[55] Section 46(1)(b) of the 2008 Act.

[56] Section 46(1)(c) of the 2008 Act.

[57] Cassim FHI "*The new statutory provisions on company share repurchases: A critical analysis*"(1999) 116 *SALJ* at 768.

However, Kunst is of the view that "the intention of the legislature was that the relevant time when the reasonable grounds for believing that either of the circumstances under paragraphs (a) or (b) existed ware when payment was to be made".[58] This reasoning found backing from the judgement of Foster J in the matter between *Robinson v Wangemann*[59] where it was held that "it was immaterial that the corporation was solvent and had a sufficient surplus to make payment when the agreement was entered into. It is necessary to a recovery that the corporation should be solvent and have sufficient surplus to prevent injury to creditors when the payment is actually made".

The precedent set in *Robinson v Wangemann* was followed by Malan J in the matter between *Capitex Bank Holdings Ltd* v *Qorus Holdings Ltd.*[60] In this matter, the court held that "In view of provisions of sections 85(1) and 38(2)(d), a mere purchase, or mere conclusion of agreement of sale or other transaction relating to acquisition by company of own shares, is not *prima facie* illegal. Only payment made in violation of section 85(4) would resulting in illegality".

As far as the 2008 Act is concerned, there are two key developments that were not featured in the 1973 Act: first, the board is required to acknowledge, by resolution, that it has applied the solvency and liquidity test and concluded that the company will pass the test immediately after completing the proposed distribution.[61] Second, if the distribution has not been completed within 120 days after the board made the required acknowledgement, the board must reconsider the solvency and liquidity test with respect to the remaining distribution to be made pursuant to the original resolution.[62] These provisions were not present in the 1973 Act.

With respect to the relevant time when the solvency and liquidity test applies in terms of the 2008 Act, there appears to be consensus among authors. Jooste states that "the time when the solvency and liquidity test must be satisfied is generally

[58] Kunst *et al* "Henochsberg on the Companies Act"2010 at 181.

[59] 75 F 2d 756 (1935) at 757-8.

[60] 2003 (3) SA (302) (W).

[61] Section 46(1)(c) of the 2008 Act.

[62] Section 46(2)(a) of the 2008 Act.

immediately after the completion of the proposed distribution".[63] Van der Linde distinguishes between "when the test must be considered" and "when the test must be satisfied".[64] As regards when the test must be considered, Van der Linde is of the view that "the solvency and liquidity test must be considered when the company intends to make a proposed distribution".[65] As far as when the test must be satisfied Van der Linde states as follows: "the general principle is that the test must be satisfied after completion of a distribution or transaction".[66] Van der Linde and Jooste are in agreement as far as the time for satisfying the test is concerned. Both the authors are of the view that the test must be satisfied after the completion of the proposed distribution.

My view is that Jooste's approach of considering the time only when the test is satisfied does not take into account that the provisions of subsection (b) but only consider the provision of subsection (c). Van der Linde's approach that the timing for the application of the test ought to be divided into the time when test must be considered and the time when the test must be satisfied is a better approach, as it appears to be in line with the what section 46(1)(a) and (b) require.

3.3. Comparison between share buyback the procedure under the 1973 Act and the 2008 Act

The 1973 Act provided that a company that proposed to acquire shares issued by it could deliver or mail a copy of the written offering circular in the prescribed form to each registered shareholder on record as at the date of the offer stating the number and the class of its issued shares which the company propose to acquire and specify the terms and reasons for the offer;[67] and lodge a copy of the offering

[63] Cassim & Jooste (eds) 2011 at 257.

[64] Van der Linde K "*The solvency and liquidity approach in the Companies Act 2008"* 2009 (2) *TSAR* at 233.

[65] *Id.*

[66] *Ibid* note 64 above.

[67] Section 87(1)(a) of the 1973 Act.

circular with the Register of Companies within 15 days of the date of delivery.[68] The above provisions did not apply if the acquisition by the company of its shares was approved by special approval of its members by special resolution.[69] These provisions also did not apply if the acquisition by the company of its shares was in respect of shares listed on the JSE Securities Exchanges.[70] If, in response to the offer to acquire shares, shareholders proposed to sell a number of shares which was greater than the number offered by the company, the company could acquire from all offering shareholders on a pro rata basis.[71]

The 2008 Act does not make provision for a procedure to be followed when the company acquires its shares. This position is acknowledged by several authors.[72] However, as far as listed shares are concerned, the procedure laid down in the JSE Listing Requirements regarding share repurchase will apply. This assertion finds authority from Jooste who stated that "in the case of listed shares the JSE Listing Requirements would of course be applicable.[73] In terms of the JSE Listing Requirements,[74] in all other instances, except where the acquisition is in terms of section 164[75] of the Act[76], an acquisition of own shares or a purchase by a

[68] Section 87(1)(b) of the 1973 Act.

[69] Section 87(2)(a) of the 1973 Act: Also see Kunst *et al* "*Henochsberg on the Companies Act*" 2010 at 185.

[70] Section 87(7)(b) of the 1973 Act.

[71] Section 87(7) of the 1973 Act: Also see Kunst *et al* "*Henochsberg on the Companies Act*" 2010 at 185.

[72] Van der Linde K "*Share repurchases and the protection of shareholders*" 2010 (2) *TSAR* 307: she stated then that "the 2008 Act will relax the 'procedure' and contains no prescriptions on the steps that should be followed". The 'procedure' in this regard is the procedure to be followed when acquiring own shares. Cassim & Jooste (eds) 2011 at 276: stated that "Not only does the new Act exclude shareholders from deciding on a buy-back, it also contains no provisions aimed at informing shareholders as to the merits or demerits of an offer to acquire their shares. No circulars in the prescribed form, like those required by the 1973 Act, have to be sent to all shareholders when an offer for their shares is made".

[73] Cassim & Jooste (eds) 2011 at 276.

[74] JSE Listing Requirements, 2nd ed, Service Issue 14, 2011, LexisNexis Durban.

[75] Paragraph 5.67 (A) of the JSE Listing Requirements. The gist of section 164 of the 2008 Act is that a shareholder who is objecting to a resolution to amend the company's Memorandum of Incorporation

subsidiary of shares in its holding company (in accordance with Sections 46 and 48 of the Act) constitutes a repurchase of shares, in which case the holding company must comply with paragraphs 5.67(B) to 5.84 of the JSE Listing Requirements".[77] Paragraphs 5.67 (B) to 5.84 of the JSE Listing Requirements, prescribes requirements which a listed company which seeks to acquire its shares must comply with. These requirements range from approval requirements[78], limit on the percentage of shares to be acquired in a year[79], the requirements of the Memorandum of Incorporation[80], the confirmation by directors that they have applied solvency and liquidity test[81] and disclosure requirement.[82] These requirements clearly provide shareholders of listed companies with the desired protection.

My view is that it is necessary to afford the shareholders of unlisted companies with the same protection that the shareholders of the listed companies enjoy by incorporating, in the 2008 Act, procedure that the company should follow when acquiring its shares from one of its shareholders. This will not only eliminate uncertainty when transactions of this nature are carried out, it will also bring about transparency where it was non-existent before.

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on the basis that the amendment will materially and adversely affects the class of his shares, may demand that the company pay him the fair value for all the shares of the company held by that shareholder.

[76] The 'Act' in this instance refers to Companies Act 71 of 2008.

[77] Paragraph 5.67 (B) of the JSE Listing Requirements. Also see footnote 74 above.

[78] Paragraph 5.67 (A) (a) of the JSE Listing Requirements.

[79] Paragraph 5.68 of the JSE Listing Requirements.

[80] Paragraph 5.69 (a) of the JSE Listing Requirements.

[81] Paragraph 5.69 (d) of the JSE Listing Requirements.

[82] Paragraph 5.69 (h) of the JSE Listing Requirements. The information required in terms of to satisfy the requirement of this paragraph are listed in paragraph 16.32. They include circular, application for delisting and certified copies of any experts' consents.

3.4. Comparison between the liability of directors for share buyback under the 1973 Act and the 2008 Act

Section 86 of the 1973 Act created liability for the directors[83] who allowed the company to acquire its shares in contravention of section 85(4).[84] Further, the section held directors liable jointly or severally to restore to the company any amount of money paid by the company in acquiring the share and any amount of money not recovered by the company.[85] A director who was liable under this section could apply to court for an order compelling the shareholder who was paid money pursuant to repurchase transaction to pay back the money to the company.[86] Subsection (4) prescribed a three year time frame within which an action to enforce the liability under this section could be instituted.[87] The fact that a director was liable under this section did not mean that he could escape any other liability imposed by any other law or common law.[88]

The liability of directors arising from illegally causing the company to acquire its shares under the 2008 Act is regulated by sections 46(6) and 48(7) read with sections 77(3)(e)(vi) and 77(3)(e)(vii). Section 46(6) creates a liability for a director that was present at board meeting that approves a distribution and participated in the making of the decision but fails to vote against the distribution despite knowing that it was in contravention of section 46.[89] This liability therefore arises from a distribution

[83] Director is defined in section 86 (6) of the 1973 Act as including any director of a holding company.

[84] Section 85(4) of the 1973 Act deals with solvency and liquidity of the company.

[85] Section 86(1) of the 1973 Act.

[86] Section 86(2) of the 1973 Act.

[87] Section 86(4) provides that an action to enforce liability imposed by this section must be instituted within three year after the date of the completion of the acquisition.

[88] Section 86(5) of the 1973 Act.

[89] Section 46(6) provides that a director of a company is liable to the extent set out in section 77(3)(e)(vi) if the director (a) was present at the meeting when the board approved a distribution as contemplated in this section, or participated in the making of such a decision in terms of section 74; and (b) failed to vote against the distribution, despite knowing that the distribution was contrary to this section.

that contravenes section 46, as the acquisition by the company of its own shares constitutes a distribution.[90] Section 48(7), on the other hand, creates liability for a director that was present at meeting when the board approved an acquisition of shares contemplated in this section, or participated in the making of such a decision in terms of section 74[91], and failed to vote against the acquisition of shares, despite knowing that the acquisition was contrary to this section.[92]

The relevant provisions of section 77(3)(e) of the 2008 Act provides that "a director[93] of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequences of the director having been present at the meeting, or participated in the making of a decision in terms of section 74 and failed to vote against – a resolution approving a distribution, despite knowing that the distribution was contrary to section 46 subject to section 77(4)[94], or – the acquisition by the company of any of its shares, or the shares of its holding company, despite knowing that the acquisition was contrary to section 46 or 48.[95] A director who is facing liability in terms of this section may apply to court for an order setting aside the board's decision that contravened this section.[96] The liability under this section is

[90] Section 1 defines distribution as a direct or indirect transfer by a company of money or other property of the company, other than its share, to or for the benefit of one or more holders of any of the shares, or to the holders of a beneficial interest in any such shares, of that company or of another company within the same group of companies, whether- as consideration for the acquisition- by the company of any of its shares, as contemplated in section 48.

[91] Section 48(7)(a) of the 2008 Act.

[92] Section 48(7)(b) of the 2008 Act.

[93] Director is defined in section 1 as "a member of the board of a company, as contemplated in section 66, or an alternative director of a company and include any person occupying the position of a director or alternative director, by whatever name designated". For the purposes of section 77, "director include an alternative director and prescribed officer or a person who is a member of committee of a board of a company or of the audit committee of a company irrespective of whether or not the person is also a member of the company's board".

[94] Section 77(3)(e)(vi) of the 2008 Act.

[95] Section 77(3)(e)(vii) of the 2008 Act.

[96] Section 77(5)(a) of the 2008 Act.

both joint and several[97]; and proceedings to recover any loss, damage or costs arising from liability under this section cannot be instituted three year after the act or omission occurred.[98]

The main difference between the provisions regulating directors' liability under the 1973 Act and the 2008 Acts is that the 2008 Act requires a director to be present and participate in the making of the decision and his or her failure to vote against the resolution that contravenes the share repurchase provisions of the 2008 Act invokes liability. This provision is noticeably not provided for in the 1973 Act prompting Cassim to criticise, then, the provisions of the 1973 Act and called for its reform.[99] He stated that "it is further suggested that section 86(1) –which imposes joint and several liability on the directors of a company for a wrongful repurchase of its shares –be amended so as to ensure that only those directors who had voted for or assented to the wrongful share repurchase would incur personal liability to the company".[100] He also stated about the provisions of the 1973 Act on liabilities of the directors that "what is disconcerting about this section, though, is its failure to provide expressly that the directors who incur liability under it are those who had consented to, or had voted in favour of, the resolution authorising an acquisition of the company's shares".[101]

Cassim's criticisms were confirmed by Van der Linde who stated that "Cassim criticises the liability provision as unreasonably strict and argues that liability should depend on whether or not the director consented to or voted in favour of the resolution authorising the acquisition".[102] Van der Linde goes further and criticises

[97] Section 77(6) of the 2008 Act.

[98] Section 77(7) of the 2008 Act.

[99] Cassim FHI "*The reforms of company law and capital maintenance rules"* 2005 (11) *SALJ* at 289.

[100] *Ibid* note 98 above .

[101] Cassim FHI "*The new statutory provisions on company share repurchases: A critical analysis*"(1999) 116 *SALJ* at 770.

[102] Van der Linde KE (2008) "*Aspects of the regulation of share capital and distribution to shareholder"* LLD-thesis, University of South Africa at 455.

Cassim that "Cassim does not attempt to explain the possible meaning of 'allow'[103] but assumes that liability could be imposed on a director who was absent from the board meeting which resolved to purchase shares.[104] Van der Linde is therefore suggesting that the word 'allow', is designed to exclude, from liability, directors who were not present when the resolution authorising repurchase was made.

This may be the case, but this is not what Cassim is urging. Cassim is urging that the liability provision of the 1973 Act does not expressly state that a director will be liable if she or he consented to or voted in favour of a resolution authorising the repurchase. It stands to reason that the liability provision of the 1973 Act does not draw distinction between directors that were present at the meeting that authorised the resolution who voted positively with those that voted negatively. It is a fact that the 1973 Act did not expressly made the distinction between directors that were present and directors that were absent in a meeting when a resolution to acquire own shares was taken by the board of directors.

For this reason, Cassim was correct and the message he communicated was well received by the legislature hence the 2008 Act makes the provision that directors will be liable if they were present in the meeting, participated in making the resolution but fail to vote against it.

As far as other liability provisions are concerned, there appear to be another difference between the 1973 Act and the 2008 Act. While the 1973 Act gave the director a right to approach court and seek an order compelling a shareholder, which was paid by the company pursuant to acquiring its shares, to pay the company any money paid to that shareholder,[105] in terms of the 2008 Act, a director who has been held liable under section 77(3) has the right to apply to court for an order setting aside the decision of the board.[106] The court may make –any further order that is just

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[103] The word 'allow' is in section 86(1) of the 1973 Act. KE Van der Linde stated that "in fact, he (Cassim) does not refer to the word 'allow' at all".

[104] *Ibid* note 101 above.

[105] Cassim FHI "*The new statutory provisions on company share repurchases: A critical analysis*" (1999) 116 *SALJ* at 771.

[106] Section 77(5)(a) of the 2008 Act.

and equitable in the circumstances, including an order –to rectify the decision, reverse any transaction, or restore any consideration paid or benefit received by any person in terms of the decision of the board.[107] While the principles of the 1973 Act and the 2008 Act are not at odds with each other, the 2008 Act does not only entitles the liable director to recover the money so paid, but it also entitles him or her to get a court order setting aside the decision of the board.

As far as the recovery, by the company from the director, of any payment made pursuant to illegal repurchase is concerned, the 1973 Act stated that a director was liable to restore to the company any amount the company paid pursuant to acquiring its shares, which the company had not recovered. The 2008 Act states, on the other hand, that the director is liable for any loss, damage or costs sustained by the company as a result of any contravention by the director.[108] The principles of the two liability provisions are therefore not different. Both provisions seek to place the company in the position similar to the position prior to payment being made pursuant to share repurchase transaction.

[107] Section 77(5)(b)(ii)(aa) of the 2008 Act.

[108] Section 77(3)(a) –(e) of the 2008 Act outline circumstances under which the director assumes liability.

3.5. Comparison between the enforceability of share buyback contract under the 1973 Act and the 2008 Act

Section 88(1) of the 1973 Act provided that a contract with the company for the acquisition of its shares is enforceable against the company, except when the execution of the contract will contravene section 85(4). The burden of proof lies with the company to show that the execution of the contract will result in the company contravening section 85(4).[109] The company remains obliged to execute the contract of share repurchase until the contract is fully performed; and the shareholders who dispose their shares in terms of this contract retain the status of claimants entitled to be paid as soon as the company is lawfully able to do so.[110] Upon liquidation of the company, the shareholders who disposed of their shares, are to be ranked subordinate to creditors and shareholders whose claims are in priority to the claims of the class of shares which were disposed to the company, but in priority to the claims of the other shareholders.[111]

In terms of the 2008 Act, the enforceability of a contract by a company to acquire its own shares is regulated by section 48(4), which provides that an agreement with a company providing for the acquisition by the company of the shares issued by it is enforceable against the company, subject to subsections (2) and (3).[112] Should the company alleges that compliance with an agreement to

[109] Section 88(2) of the 1973 Act.

[110] Section 88(3) of the 1973 Act.

[111] *Ibid* note 109 above.

[112] Subsection (2) provides the requirements to be complied with when the company acquires its shares. These requirements include compliance with section 46, the determination by the board of the number of shares that the company may acquire; and in case of an acquisition by a subsidiary of shares in its holding company, that the total number shares to be so acquired must not be more than 10% and the voting rights attached to the shares acquired by the subsidiary will not be exercised while the shares are held by the subsidiary and it remains the subsidiary of the company shares it holds. Subsection (3) provides that a company may not acquire its shares, and a subsidiary of a company may not acquire shares of that company, if, as a result of that acquisition, there would no

acquire own shares will result in it contravening subsection (2) and (3), it must apply to court for an order;[113] and in such proceedings, the company bears a burden of proof that compliance with the agreement will result in it contravening subsection (2).[114]The company has two years within which to apply to court for an order reversing an acquisition that is contrary to section 46.[115] If the company, successfully, applied for an order reversing the acquisition, the court may order the person who sold his or her shares to the company to return the amount paid by the company[116] and the company to issue shares that are equivalent in number and are of the same class to those acquired from the seller.[117]

In far as the 1973 Act is concerned, there appears to be some differences between some authors as regards grounds under which the contract to acquire own shares can be enforceable. Van der Linde is of the view that "due to the fact that section 88 merely cross-refers to section 85(4) it seems that the company has to prove only that there are 'reasonable' grounds for believing that it will not meet the solvency and liquidity criteria".[118] However, Kunst is of the view that a contract to acquire own shares may be unenforceable on other grounds other than a breach of section 85(4).[119] Kunst, states two other grounds in terms of which repurchase contract will not be enforceable, namely, "a contract for the acquisition by a company

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longer be any shares of the company in issue other that shares held by one or more subsidiaries of the company; or convertible or redeemable shares.

[113] Section 48(5) of the 2008 Act: in terms of this section, if the court is satisfied that the company is prevented from fulfilling its obligations pursuant to the agreement, the court may make an order that – is just and equitable, having regard to the financial circumstances of the company, and ensures that the person to whom the company is required to make payment in terms of the agreement is paid at the earliest possible date compatible with the company satisfying its other financial obligations as they fell due and payable.

[114] Section 48(5)(b) of the 2008 Act.

[115] Section 48(6) of the 2008 Act.

[116] Section 48(6)(a) of the 2008 Act.

[117] Section 48(6)(b) of the 2008 Act.

[118] Van der Linde KE (2008) "*Aspects of the regulation of share capital and distribution to shareholder"* LLD-thesis, University of South Africa at 462.

[119] Kunst *et al* "*Henochsberg on the Companies Act*" 2010 at 186(1).

of its own shares which has the result that there will no longer be any shares other than convertible or redeemable shares, is void and unenforceable since it is prohibited by section 85(9); and also since (under section 85(1)) a company may only, by special resolution, if so authorised by its articles, acquires its own shares, any such acquisition which ensues without such authorisation is of no force and effect".[120]

While Van der Linde's interpretation is focusing only on the provision of section 88(1), Kunst is interpreting all the requirements to be complied with in order for the repurchase contract to be enforceable. Kunst's approach is therefore better than Van der Linde's, as it considers all the requirements to be complied with as opposed to considering only those that are in section 88(1).

Unlike the 1973 Act, the 2008 Act requires the company to acquire own shares to be enforceable not only when it complies with the solvency and liquidity test, but also other requirements such as board's resolution approving such acquisition and the availability of shares other than shares held by the subsidiary of the company, convertible or redeemable shares post share repurchase.[121] According to Van der Linde, this section is a departure from section 88(1) of the 1973 Act where non-compliance with solvency and liquidity is the only basis for unenforceability.[122] This is, in actual fact not a departure from the provisions of the 1973 Act, but it is in line with it. This viewpoint finds support from Kunst whose view is that a share repurchase contract, in terms of the 1973 Act, does not only have to comply with the solvency and liquidity test but also with other requirements such as a board's resolution approving such a repurchase and that there should be other shares other than those held by the subsidiary or redeemable or convertible shares.[123]

[120] *Ibid* note 119 above.

[121] Cassim & Jooste (eds) 2011 at 279.

[122] Van der Linde KE "*The regulation of distribution to shareholders in the Companies Act 2008*" (2009) 3 *TSAR* at495.

[123] *Ibid* note 118 above.

3.6. Comparison between the acquisition by a subsidiary of shares in its holding company under the 1973 Act and the 2008 Act

The acquisition by a subsidiary of shares in its holding company was regulated by section 89 read with section 39 of the 1973 Act. In terms of section 89, a subsidiary company could acquire shares in its holding company subject to complying with applicable provisions of sections 85, 86, 87 and 88. The subsidiary company could only acquire a maximum of 10 per cent in aggregate of a number of shares of the holding company.[124] This section did not apply to the acquisition of shares by a holding company in a subsidiary.

Section 39 of the 1973 Act dealt with the voting rights attached to the shares that were acquired by a subsidiary company in the holding company. It provided that if shares in a company were acquired in accordance with section 89 by its subsidiary, for as long as such shares were held by the subsidiary – (a) no voting rights attaching to such shares could be exercised; and (b) the percentage of votes able to be cast at any meeting of shareholders were reduced by a number of shares held by the subsidiary.[125] The provision of section 39(1) did not apply to a subsidiary that acquired shares in accordance with section 89 acting in a representative capacity or as a trustee provided the holding company or the subsidiary itself was not beneficially interested under the trust.[126]

In terms of the 2008 Act, the acquisition of shares by a subsidiary company in its holding company is regulated by section 84(1)(b), in terms of which the board of a subsidiary company may determine that it will acquire shares of its holding company if the decision to do so satisfies the requirements of section 46. Section 48(1)(b) further provide that the shares to be held by a subsidiary company in its holding company should not exceed 10 per cent, in aggregate, of the number of issued shares of any class of shares and no voting rights attached to those shares may be

[124] Section 89 of the 1973 Act.

[125] Section 39(1) (a) and (b) of the 1973 Act.

[126] Section 39(2) of the 1973 Act.

exercised while the shares are held by the subsidiary, and it remains a subsidiary of the company.[127]

The acquisition of shares by the subsidiary in the holding company in terms of the 1973 Act has to comply with some of the requirements applicable when a company acquires its own shares. These requirements include approval by special resolution of the members[128] and compliance with solvency and liquidity test.[129] Kunst stated that "the reference in section 89 to comply with the provisions of sections 85, 86, 87 and 88 does not require that the shares acquired by the subsidiary be cancelled since section 39 recognises that voting rights attached to such shares".[130]

With respect of the limit imposed on numbers the shares that a subsidiary may acquire in its holding company, section 89 of the 1973 Act prescribed a maximum of 10 per cent. According to Kunst, the implication of this limitation is that if a company has more than one subsidiary, the subsidiary companies, together, may not acquire more than 10 per cent in aggregate of the shares in their holding company.[131] As far as the voting rights are concerned, Kunst is of the view that the issued shares in the holding company, excluding the ten per cent held by the subsidiary, are to be counted as hundred per cent shares for the purposes of determining whether or not a resolution has been passed.[132] In other words, the ninety per cent shares, which exclude the ten per cent shares held by the subsidiary will be regarded as being hundred per cent for voting purposes.

The 2008 Act requires a subsidiary company that acquires shares in its holding company to comply with certain requirements. These requirements include authorisation by the board and compliance with solvency and liquidity test. While I

[127] Section 48 (2) (b) (i) & (ii) of the 2008 Act.

[128] Section 85 (1) of the 1973 Act.

[129] Section 85 (4) of the 1973 Act.

[130] Kunst *et al* "*Henochsberg on the Companies Act*" 2010 at 186(2).

[131] *Id.*

[132] Kunst *et al* "*Henochsberg on the Companies Act*" 2010 at 80(1).

will not discuss these requirements in detail here as they are discussed in Chapter 4 below, I will nevertheless point out one key difference between the 1973 Act and the 2008 Act, namely, approval by shareholders of the subsidiary company authorising the acquisition by the subsidiary of share in its holding company. In terms of the 1973 Act, a resolution by shareholders approving the acquisition by a subsidiary of shares in its holding company is required while in terms of the 2008 Act, a resolution by the board, not shareholders, will suffice. This is also being discussed in detail in Chapter 4 below and will not be repeated here.

Chapter 4:

Company acquiring its shares and subsidiary acquiring shares in its holding company under 2008 Act

4.1. Introduction

In the previous chapter, the differences between share buyback provisions of the 1973 Act and the 2008 Act were outlined. In this chapter a focus will only be on assessing share buyback provisions of the 2008 Act. These provisions will be critically analysed, with specific reference to the requirements that need to be complied with. The interrelation between sections 46 and 48 of the 2008 Act will also be considered. I will first consider the acquisition by the company of its own share and followed by the acquisition by a subsidiary of shares in its holding company.

4.2. Acquisition by the company of its own shares

In terms of section 48(2)(a) of the 2008 Act, a board of a company may determine that the company will acquire a number of its shares if a decision to do so satisfies the requirements of section 46 and does not contravene subsection (3) and (8).[133] Section 48 does not apply when the company pays its shareholder pursuant to shareholder appraisal rights[134]and when the company redeems any redeemable shares.[135] Therefore, the acquisition by the company of its own shares has to comply with requirements of section 46 and section 48(3) and (8). Section 46 requires a resolution by the board of the company authorising distribution. Distribution is defined broadly in section 1 and could mean direct or indirect transfer of money or other property of the company by the company, to or for the benefit of one or more of its shareholder, as a consideration for the acquisition by the company of any of its shares as contemplated in section 48. Therefore the acquisition by the company of

[133] See footnote 37 above.

[134] Section 48(1)(a) of the 2008 Act.

[135] Section 48(1)(b) of the 2008 Act.

its own share constitutes a distribution. Consequently, the acquisition by the company of its share has to comply with the requirements of distribution, namely,

- Distribution must be authorised by the board of the company;[136]
- It reasonably appears to the directors that the company will satisfy solvency and liquidity test immediately after the completion of the proposed distribution;[137] and
- The board has acknowledged by resolution that it has applied solvency and liquidity test and reasonable concluded that the company will meet the test.[138]

Another requirement to be complied with when a company acquires its own shares in terms of section 48 is that the acquisition should not be in contravention of section 48(3). In terms of section 48(3), a company may not acquire its own shares, if as a result of that acquisition; there would no longer be shares of the company in issue other than shares held by one or more subsidiaries of the company; or convertible or redeemable shares. The last requirement to be complied with is contained in section 48(8), which provides that the decision by the board of the company facilitating the acquisition by the company (a) must be approved by a special resolution of the shareholders of the company if any shares are to be acquired by the company from a director or prescribed officer of the company, or a person related to a director or prescribed officer of the company; and (b) is subject to the requirements of sections 114 and 115 if considered alone, or together with other transactions in an integrated series of transactions, it involves the acquisition by the company of more than 5% of the issued shares of a particular class of the company's shares.

[136] The only exception to this rule is when the distribution is pursuant to existing legal obligation of the company or a court order: Section 46 (1)(a)(i) of the 2008 Act .

[137] Section 46(1)(b) of the 2008 Act.

[138] Section 46(1)(c) of the 2008 Act.

The requirement about approval by a special resolution by the shareholders is only applicable when the shares to be acquired by the company are from a director or prescribed officer of the company or person related to them. Further, the requirement of complying with section 114 and 115 applies only when the acquisition by the company of its own shares is through scheme of arrangement of which approval by special resolution of shareholders entitled to vote is required.[139]

The requirements to be complied with when company acquires its shares from its director, prescribed officer or person related to its director or prescribed officer as well as the requirements to be complied with when the company acquire its own shares through scheme of arrangement do not extend to any other kind of acquisition other than these types of acquisitions. In other words, these requirements do not apply to any other acquisition other than the acquisition that is outlined here above. The other requirements to be complied with when company acquiring its own share, namely, the requirements for board resolution, requirement to compliance with solvency and liquidity test and the requirements that the company should not remain with shares held by its subsidiaries, or convertible or redeemable apply to all kinds of share repurchase transaction.

In the ensuing section, only the requirements that apply to all kinds of share repurchase transaction are considered in detail. I now turn to examine each of the requirements, namely, (i) authorisation by the board; (ii) solvency and liquidity test; and (iii) no shares other than shares held by the subsidiaries of the company; or convertible or redeemable shares.

[139] Section 114 deals with scheme of arrangement and section 115 deals with approval requirements by shareholder entitled to vote for the purposes of this section.

4.2.1 Authorisation by the board

In terms of section 46(1)(ii) of the 2008 Act, a company must not make any proposed distribution unless the board of directors of the company, by resolution, has authorised the distribution. The requirement that the distribution be authorised by the board does not apply where the distribution is pursuant to an existing legal obligation of the company, or a court order.[140]

Since a share repurchase transaction constitutes a distribution, a company cannot acquire its own share without authorisation by board to do so. The board of directors of the company do not require shareholders' approval to engage in share repurchase transaction.[141] In other words, the board of directors can take a resolution causing a company to acquire its own shares from one of its shareholders without getting permission from the company shareholders.[142] This state of affairs has been criticised by some authors, such as Jooste and Wainer.[143] Jooste stated that "it is questionable whether the shareholders should be excluded from the making of such a decision. Their interests are also at stake and not just those of the creditors".[144] Jooste goes further and quotes from Cassim's article: '*The reform of company law and capital maintenance concept*' to emphasise the importance and the effect of share repurchase on shareholders as follows:

> "*a share repurchase entails a change in the ownership of the company's share, and ….may thus be used to change control of a company or, for that matter, to prevent a change of control; or it may be used to manipulate the*

[140] Section 46 (1) (a) (i) of the 2008 Act.

[141] The only exception is when the shares to be acquired by the company are from a director or prescribed officer of the company or person related to them and when the acquisition by the company of its own shares is through scheme of arrangement. In these instances, approval by special resolution of shareholders is required.

[142] Jooste R "*Issues relating to the regulation of distributions by the 2008 Companies Act*" 2009 (126) *SALJ* at 637: It is stated that "it is evident that the board of directors of a company needs no authorisation from the shareholders of the company to make distribution".

[143] Wainer HE "*The new Companies Act: Peculiarities and anomalies*" (2009) 4 *SALJ* at 820.

[144] Cassim & Jooste (eds) 2011 at 276.

market price of the company's shares. Share repurchase clearly have a ….. potential for unequal treatment of shareholders. In short, the share repurchase power may be abused and it may, unless safeguards are provided, enable one group of shareholders to obtain an unfair advantage over other shareholders…..It is not enough to protect creditors – shareholders and the investing public must also be protected. This is clearly acknowledged and recognised in the JSE Securities Exchange Listing Requirements on share repurchase".[145]

The above passage shows that if safeguards are not provided for, share repurchase can be used to perpetuate some mischief. Wainer stated that "the requirements of section 46 (which deal with distributions) are simply board authorisation, and satisfaction of the solvency and liquidity test. Thus, most surprisingly, section 48 empowers a company to buy its own (or its holding company) shares without any involvement of, or authority from (or indeed even notification to) the shareholders."[146] The writer goes further and states that "it seems most unlikely that the omission of a requirement for a special resolution in section 48 was intentional, as there is a significant reduction in the protection of the interest of shareholders".[147] Wainer suggested that section 48 be amended to incorporate a requirement that share repurchase be approved by special resolution of the shareholders. Van der Linde acknowledges that the 2008 Act does not require any form of authorisation by the shareholders when the company is acquiring its own share, however, she is of the view that the company's memorandum of incorporation can impose such a requirement and the directors will then be forced to comply with it when the company is acquiring its own shares.[148]

I am of the view that the criticism for not incorporating, in the 2008 Act, shareholders' approval when a company acquires its own share is a justifiable

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[145] *Ibid* note 144 above.

[146] *Ibid* note 146 above.

[147] *Ibid* note 146 above.

[148] Van der Linde KE "*The regulation of distribution to shareholders in the Companies Act 2008*" (2009) 3 *TSAR* at 492.

criticism and the call for the amendment of section 48 in this regard to make provision for shareholder approval is fair and reasonable.

4.2.2. Solvency and liquidity test[149]

According to Van der Linde, one of the objectives of company law reform in South Africa was to replace par value shares and nominal capital with a capital maintenance regime based on solvency and liquidity.[150] Van der Linde further submits that the new Companies Act[151] expands the field of application of the solvency and liquidity requirements from beyond regulation of distributions to being used as a protection measure of the rights of creditors.[152] Cassim expands on the purpose of the solvency and liquidity test and stated that it is not only protecting creditors but also minority shareholders.[153]

Section 46 requires that a company must not make any proposed distribution unless it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution;[154] and the board has passed a resolution acknowledging that it has applied the solvency and liquidity test and it reasonably concluded that the company will satisfy the solvency and liquidity test immediately after the completion of the proposed distribution.[155]

Section 4(2)(b) provides that the board or any other person applying the solvency and liquidity test to a company must consider a fair valuation of the company's assets and liabilities, including any reasonable foreseeable contingent assets and liabilities irrespective of whether or not arising as a result of the proposed

[149] See paragraph 3.2 above for a definition of solvency and liquidity test.

[150] Van der Linde K "*The solvency and liquidity approach in the Companies Act 2008"* 2009 (2) *TSAR* at 224.

[151] This is the 2008 Act.

[152] *Ibid* note 148 above.

[153] Cassim & Jooste (eds) 2011 at 246.

[154] Section 64 (1) (b) of the 2008 Act.

[155] Section 64 (1) (c) of the 2008 Act.

distribution,[156] and may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances.[157]

Section 4(2) (c) provides that unless it is authorised by the memorandum of incorporation of the company, when applying solvency and liquidity test in respect of a distribution, which involves direct or indirect transfer of money or other properties of the company, a person is not to include, as a liability, any amount that would be required, if the company were to be liquidated at the time of the distribution, to satisfy preferential rights upon liquidation of shareholders whose preferential rights upon liquidation are superior to the preferential rights upon liquidation of those receiving the distribution.[158]

According to Van der Linde, the solvency and liquidity test comprises two elements, namely, the solvency element and the liquidity element.[159] The solvency element of the test entails that the assets of the company should exceed its liabilities after the distribution has been carried out.[160] This is also referred to as solvency in the bankruptcy sense and is determined through balance sheet.[161] Van der Linde is of the view that "the solvency element of the test will be satisfied at a particular time if, considering all reasonably foreseeable financial circumstances of the company at the time the fair value of the company's assets equals or exceeds its fairly valued liabilities".[162] Van der Linde further states that "a solvency or balance sheet test determines the net assets or liabilities at a specific moment in time".[163] The solvency

[156] Section 4(2) (b) (i) of the 2008 Act.

[157] Section 4(2) (b) (ii) of the 2008 Act.

[158] Section 4 (2)(c) of the 2008 Act.

[159] Van der Linde K "*The solvency and liquidity approach in the Companies Act 2008"* 2009 (2) *TSAR* at 225.

[160] *Id.*

[161] *Id.*

[162] *Ibid* note 159 at 226- 227.

[163] *Ibid* note 159 at 227.

element applies to a group of companies if the company doing the distribution is a member of group of companies.[164]

The liquidity element of the test, on the other hand, refers to the firm's ability to satisfy its debts as they become due in the ordinary course of its business.[165] The liquidity test involves cash flow analysis.[166] Van der Linde is of the view that "the liquidity element will be satisfied if, considering all reasonably foreseeable financial circumstances of the company at the time, it appears that the company will be able to pay its debts as they become due in the course of business for a period of twelve months.[167] The liquidity element does not apply to the group of companies but only applies to individual company.[168] The 2008 Act requires the company to able to pay its debts within twelve months after distribution was carried out.

With respect to the timing when the solvency and liquidity test should be applied, Van der Linde is of the view that it is imperative to differentiate between the time when the test should be considered and the time when the test should be satisfied.[169] Van der Linde is of the view that "the solvency and liquidity test should be considered when the company intends to make a proposed distribution".[170] The author is further of the view that solvency and liquidity test "must be satisfied after completion of a distribution or transaction.[171]

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[164] KE Van der Linde stated, in this regard, as follows: "*as the proposed test is currently formulated, the consolidated assets have to be taken into account whenever a group of companies makes a distribution and not only when it makes a distribution to the shareholder of another company in the group*".

[165] Van der Linde K "*The solvency and liquidity approach in the Companies Act 2008"* 2009 (2) *TSAR* at 225.

[166] *Ibid* note 165 above at 226.

[167] *Ibid* note 165 above at 229.

[168] *Id.* Van der Linde stated in this regards: "*unlike the solvency element, which seems to refer to the financial position of a group of companies, the liquidity element does not apply in the group context but only to individual companies*".

[169] *Ibid* note 165 above at 233.

[170] *Id.*

[171] *Id.*

As far as the justifications of the solvency and liquidity test is concerned, Van der Linder stated the following: "a solvency element gives advanced recognition to the ultimate priority that creditors enjoy over shareholders upon dissolution of the company by preventing the company from favouring its shareholders through partial liquidation. The justification for a liquidity element is that it addresses the fundamental expectation of creditors to be paid on time and also fits well with the representation a company is said to make when it incurs debt, namely, that it reasonably expects to be able to pay as and when the debt become due.[172]

Jooste writes that the solvency and liquidity requirement must be complied with irrespective whether the distribution is pursuant to a board resolution, an existing obligation or a court order.[173] The solvency and liquidity test is viewed as "an appropriate restriction on distributions to shareholders and a suitable protection measure in other transactions that may adversely affect the interest of creditors.[174]

[172] Van der Linde K "*The solvency and liquidity approach in the Companies Act 2008"* 2009 (2) *TSAR* at 227.

[173] Cassim & Jooste (eds) 2011 at 247.

[174] *Ibid* note 172 at 239.

4.3. Subsidiary acquiring shares in its holding company[175]

A subsidiary that needs to acquire shares in its holding company has to comply with certain requirements in terms of section 48 of the 2008 Act. In the ensuing section, I will examine these requirements in detail.

In terms of section 48(2)(b) of the 2008 Act, the board of a subsidiary company may determine that it will acquire shares of its holding company if the decision to do so satisfies the requirements of section 46.[176] But the shares to be acquired by the subsidiary from the holding company is limited to not more than 10% in aggregate and the shares so acquired will not have voting rights as long as the subsidiary remains the subsidiary of the holding company whose shares it holds.[177] Section 48(3) of the 2008 Act provides that irrespective of any law, agreement, memorandum of incorporation and an order, a subsidiary of the company may not acquire share of that company if, as a result of that acquisition, there would no longer be any shares in issue other than (a) held by one or more subsidiaries of the company or (b) convertible or redeemable shares.

Accordingly, in terms of the section 48 of the 2008 Act, a subsidiary company that acquires shares in its holding company has to comply with the following requirements:

- Resolution by the board approving the acquisition;
- The share acquired by the subsidiary in the holding company should not exceed 10%; and

[175] This is acquisition in terms of section 48(2)(b) of the 2008 Act.

[176] The requirements of section 46 are discussed in the section preceding this one and are, first the board must take a resolution and second solvency and liquidity test must be passed before engaging in this transaction.

[177] Section 48 (2) (b) of the 2008 Act.

- No voting rights attached to those share can be exercised while the shares are held by subsidiary and it remains a subsidiary of that holding company.

I will now consider each of the requirements listed above in detail.

4.3.1 Authorisation by the board

The requirements of board authorisation which are applicable when a company acquires its own shares that are discussed in paragraph 4.2.1 above are also applicable when a subsidiary of a company acquires shares in its holding company.[178] This is confirmed by the definition of a distribution under section 1, which includes direct or indirect transfer of money or other properties of the company as a consideration by any company within the same group of companies.[179]

Essentially, when a subsidiary of a holding company desires to acquire shares in the holding company, the board of directors of the subsidiary should pass a resolution authorising such an acquisition. Such board resolution must comply with the requirements of distribution in terms section 46, namely the company compliance with solvency and liquidity test.

The criticism about not providing shareholders with the opportunity to participate in decision making when the company acquires its shares is also applicable to a situation where a subsidiary acquires shares in its holding company. The criticism includes the fact that directors do not require permission from shareholders to engage into share buyback transaction. This criticism has been dealt with in detail in paragraph 4.2.1 above and I will thus not repeat it here.

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[178] Cassim & Jooste (eds) 2011 at 284 stated that "...section 46 governing distribution applies to the distribution made by a company pursuant to an acquisition by the company of shares in its holding company.

[179] Group of companies is defined in section 1 as meaning a holding company and all of its subsidiaries.

4.3.2. The limit on percentage of shares to be acquired by a subsidiary

Section 48(2)(b)(i) of the 2008 Act requires that the aggregate number of issued shares of any class of shares of the company to be held by the subsidiary in the holding company should not exceed 10% taken together. This means that a subsidiary can acquire and hold shares in its holding company but the percentages of the total shares to be held should not exceed ten.

Wainer[180] has criticised section 48(2)(b)(i) as not being appropriately worded due to the fact it does not cover situation in relation to pre-existing holding. The author illustrated the point by giving the following example: "if company X held 30 per cent of company Y and *thereafter*, company Y bought 100 per cent of company X. In those circumstances, X would hold 30 per cent in Y, its own holding company."[181] The effect of this example is that subsidiary will now have 30% share in its holding company, which effectively contravenes subsection (2)(b)(i).

Jooste also criticised the provisions of subsection (2)(b)(i) but for both similar and different reasons as those advanced by Wainer. Jooste firstly supports Wainer's criticism that subsection (2)(b)(i) does not make it clear whether shares acquired by the subsidiary before they become subsidiary of the holding company must be taken into account when determining the number of shares held by the subsidiary in its holding company.[182] Secondly, Jooste is of the view that the subsection creates uncertainty as the 10 per cent limit is not clear as to whether is per class of shares or per total shares irrespective of class. The author also illustrated the point by making the following example: "company X has three classes of shares, A shares, B shares and C shares. One hundred of each has been issued. Is the maximum limit on the

[180] Wainer HE "*The new Companies Act: Peculiarities and anomalies*" (2009) 4 *SALJ.*

[181] *Ibid* note 179 at 821.

[182] Cassim & Jooste (eds) 2011 at 283.

number of shares that subsidiaries of company X can acquire in company X (i) ten A class, ten B class and ten C class, or (ii) 30 share, irrespective of their class?"[183]

Van der Linde, on the other hand, praised and welcomed the provision section 48(2)(b)(i). However, her praising of the section appears to be based on reasons different from those advanced by Wainer and Cassim. She stated that "these provisions are an improvement on the current situation because they apply to any shares held by a subsidiary and not only to shares acquired after the subsidiary became a subsidiary. The limitation of the percentage of each class of shares rather than of the total number of shares in the company is also welcomed."[184] Her reason for welcoming the provision of section 48(2)(b)(i) is that the section no longer refer to shares acquired but refer to shares held.[185] Van der Linde is therefore satisfied with the provision of this section.

I agree with Wainer and Jooste's s criticism of the section 48(2)(b)(i) as it is currently not clear as to what will happen when a company acquires control over a company, which had shares in the former. Further it also remains unclear as to whether the limit of 10 per cent shares applies to each class or applies to combined classes of shares. Wainer and Jooste's submission that the section be amended to clarify this ambiguity is reasonable and it is welcomed.

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[183] Cassim & Jooste (eds) 2011 at 283.

[184] Van der Linde KE (2008) "*Aspects of the regulation of share capital and distribution to shareholder"* LLD-thesis University of South Africa at 486.

[185] *Ibid* note 183 at 465. She stated, in this regard, that "it is unfortunate that section 89 limits the number of shares that can be acquired rather than held by subsidiaries.

4.3.3. Voting rights of shares acquired and held by the subsidiary in its holding company

In terms of section 48(2)(b)(ii) no voting rights attached to the shares acquired by a subsidiary in its holding company may be exercisable while the shares are held by the subsidiary and it remains a subsidiary of the company whose shares it holds. This means that the subsidiary company which acquired shares pursuant to this section will not participate, as a shareholder, in the making of decisions concerning the affairs of the holding company where it has shares. Further, this has the effect of increasing the votes of the remaining shareholders, as the remaining 90 per cent will be regarded as representing one hundred per cent of the votes.[186]

Jooste writes that the section poses some problems as it "only neutralises the votes of shares held by a subsidiary in a holding company in respect of those shares acquired by the subsidiary when it was a subsidiary."[187] The author goes further to say that the section "does not cover any shares the subsidiary may have acquired in the holding company before it became the holding company of that subsidiary".[188] This view point was supported by Wainer who went further and suggested that "an amendment is required to neutralise the votes of all shares held by subsidiaries in their holding company, irrespective as to when those companies acquired the shares in the holding company.[189]

Since the acquisition by a subsidiary of shares in its holding company constitutes an indirect acquisition of own shares, I agree with the views expressed by Wainer which called for the amendment of the section to curb all the voting rights of a subsidiary in its holding company. Failure to curb the voting rights and by implication allow the subsidiary company to have voting rights in the holding company may result in defeating the purpose of the section of curtail any possible abuse of voting rights by the subsidiary company.

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[186] Kunst *et al* "*Henochsberg on the Companies Act*" 2010 at 80(1).

[187] Cassim & Jooste (eds) 2011 at 285.

[188] *Id.*

[189] Wainer HE "*The new Companies Act: Peculiarities and anomalies*" (2009) 4 *SALJ* at 822

Chapter 5

Conclusion

Capital maintenance rule in South Africa has developed significantly over a period of time, starting from its adoption when it was based on par value shares and nominal capital to when it was based on solvency and liquidity. These developments have, generally, been welcomed as steps toward the right direction. The most significant of these developments was the abolishment of the rule that prohibited a company from acquiring its own shares and the introduction of statutory provisions that allowed the company to acquire its own shares. The capital maintenance rule under the 2008 Act is widely accepted and welcomed.

However, there are still some areas in the provisions of the 2008 Act that deal with capital maintenance rule that need to be either clarified or changed through amendments. These areas include the following:

- The introduction of a provision that will give shareholders the rights to participate and make decision when the company is acquiring its shares or when a subsidiary is acquiring shares in its holding company. This provision can be in form of special resolution by shareholders to effect share buyback transaction. This will ensure that shareholders are also given the protection they require when share buyback transactions are carried out.

- The introduction of a provision that will lay down the procedure to be followed when the company is acquiring its shares or when a subsidiary is acquiring shares in its holding company. This should include notification mechanism for shareholder when share buyback transactions are effected and should be in the same spirit with JSE Listing Requirements for share buyback. This will ensure that the shareholders of unlisted companies enjoy the protection that is enjoyed by shareholders of listed companies.

- The introduction of a provision that will neutralise the voting rights of shares held by a subsidiary company in a holding company, which were acquired prior to the subsidiary company becoming the subsidiary of the holding

company where it hold share. This will ensure that the primary objective of curtailing the voting rights of a subsidiary company in a holding company is not in any way circumvented.

The recommended amendments will remove any potential ambiguity that currently exists and will create the desired certainty in respect of the South African capital maintenance rule.

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