

ACQUISITION of SECURITIES: SECTION 48 of the  
COMPANIES ACT 71 of 2008

by

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**I hereby declare that I have read and understood the regulations governing the submission of dissertations for the relevant degree, including those relating to length and plagiarism, as contained in the rules of the University, and that this dissertation conforms to those regulations.**

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I, the undersigned,

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Do hereby state as follows:

1. I am registered with the University of Pretoria for the degree of Master of Laws in the Corporate Law field of study under Student No. 87487803.
2. The dissertation, which I hereby submit for the degree of Master of Laws at the University of Pretoria is my own work and has not previously been submitted by me for a degree at this or any other tertiary institution.

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## CHAPTER 1

### INTRODUCTION

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#### 1. INTRODUCTION

This dissertation considers section 48 of the Companies Act, 2008<sup>1</sup>, as enacted on 1 May 2011, which regulates the circumstances and rules under which a company may acquire its own shares. A short overview of the capital rule development in South African law and specifically in terms of the Companies Act, 1973<sup>2</sup> will be included. The dissertation will focus mainly on unlisted companies and the listing requirements of the JSE<sup>3</sup> will not be included.

#### 2. THE DISSERTATION QUESTION AND OBJECTIVE

The question that this dissertation will come to answer is firstly how section 48 of the Companies Act, 2008 will impact and change company law in general in South Africa. Secondly the focus will fall on specific key elements in section 48 such as

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<sup>1</sup> The Companies Act 71 of 2008.

<sup>2</sup> The Companies Act 61 of 1973.

<sup>3</sup> The JSE Ltd is the only stock exchange in South Africa.

the solvency and liquidity test<sup>4</sup>, the liability of directors and the protection of shareholders.

### **3. METHODOLOGY**

The methodology that will be followed is to firstly give a brief background in chapter 2 of the history and development of capital rules in South African company law. Secondly in chapter 3 the rules and procedures that a company had to follow to acquire its own shares in terms of sections 85 to 89 of the Companies Act, 1973 will be considered as an introduction to chapter 4. In chapter 4, section 48 of the Companies Act, 2008 with reference to the solvency and liquidity test in sections 4 and 46<sup>5</sup>, protection of shareholders and liability of directors will be dealt with. Lastly chapter 5 will contain my conclusion to the study.

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<sup>4</sup> Section 4 of the Companies Act 71 of 2008.

<sup>5</sup> The Companies Act 71 of 2008.

## CHAPTER 2

### ORIGIN AND DEVELOPMENT OF THE CAPITAL RULES

#### 1. HISTORY OF CAPITAL RULES

Capital rules in general were developed to protect the share capital of a company. The main aim therefore was to protect shareholders and creditors against the depletion and/or devaluation of their interest in the company. In *Trevor v Whitworth*<sup>6</sup> the court stated “*persons who deal with and give credit to a limited company naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call, and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has subsequently been paid out, except in the legitimate course of business.*”<sup>7</sup>

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<sup>6</sup> *Trevor v Whitworth* [1887] 12 App Cas 409 (HL) 423-424.

<sup>7</sup> Also see Benade et al. *Entrepreneurial Law* 188.

The capital maintenance doctrine was formed and was further developed by the English company law in the late nineteenth century. Three basic capital rules were developed, namely:

- A company may not use the share capital to pay out dividends.
- A company may not purchase its own shares.
- A company may not issue any shares at a discount.

The rules have received criticism for being complex and falling short of their main aim, to protect shareholders and creditors<sup>8</sup>.

The capital maintenance concept is described by Cassim as follows: "*The issued share capital of a company is seen as a guarantee fund or a permanent fund intended for the payment of the claims of the creditors of a company, with the result that the issued share capital of a company may not be reduced, nor may it be returned to shareholders except where the Companies Act or the common law authorises it.*"<sup>9</sup>

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<sup>8</sup> Cilliers et al. *Corporate Law* at 322. See also Van der Linde "A Company's Purchase of its own shares" at 68.

<sup>9</sup> Cassim and Cassim. "The Capital Maintenance Concept" at 188-189.



The specific rule that a company may not repurchase its own shares was at least 100 years old and was not effective in protecting creditors of the company. Van der Linde argues as follows: *“The reasoning behind the rule is that company creditors rely on the share capital as a guarantee fund from which their debts are to be paid.”* Due to the age and ineffectiveness of this rule to protect shareholders and creditors there was an obvious need to develop and improve the rule. There was a general realisation that protection of shareholders and creditors could be achieved by other means than the maintenance of share capital<sup>10</sup>.

Van der Linde<sup>11</sup> further points out that there are several advantages of a company being able to purchase its own shares, namely:

- It can protect itself by buying back its own shares to guard against speculators who manipulate the share prices in the financial markets.

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<sup>10</sup> Van der Linde “A Company’s Purchase of its own Shares” at 68.

<sup>11</sup> Van der Linde “A Company’s Purchase of its own Shares” at 68 - 69.

- It can facilitate the transfer of shareholding where the remaining shareholders lack the funds to acquire the shares of a shareholder who wants to retire or dies.
- The company can acquire the shares of an employee who resigns especially in terms of an employee shareholder scheme.

The strict rules were eroded over time and developed and improved to address the inadequate protection provided for creditors and shareholders.<sup>12</sup>

## **2. DEVELOPMENT OF CAPITAL RULES IN SOUTH AFRICA**

The capital rules, as discussed, were taken up in the Companies Act, 1973. Cassim describes it as follows: *“The South African Companies Act 61 of 1973 adopts a strange and a curious ambivalence towards the nineteenth-century common law concept of the maintenance of the share capital of a company. In some respects the Companies Act still holds on to this archaic and outdated concept, while in other respects it boldly sweeps away the concept and replaces it*

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<sup>12</sup> Cassim "The New Statutory Provisions on Company Share Repurchases" at 760

*with the more modern twin tests of “liquidity” and “solvency” as a form of creditor protection*<sup>13</sup>.

The biggest stride with regard to a company acquiring its own shares was taken with the Companies Amendment Act 37 of 1999 and specifically the substitution of section 85 of the Companies Act 1973 with section 9 of the Companies Amendment Act of 1999.

Section 85 of the Companies Act, 1973 conferred the right to companies to acquire<sup>14</sup> or purchase their own shares under certain circumstances. Sections 85 to 89 of the Companies Act 1973 prescribed the procedures to be followed by a company wishing to acquire its own shares. For the first time in South African company law the concept of the solvency and liquidity test was introduced and sections 85(4)(a) and (b) of the Companies Act, 1973 prescribed how and when the test should be applied.

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<sup>13</sup> Cassim and Cassim “The Capital Maintenance Concept” at 188.

<sup>14</sup> S 85(1) of the Companies Act, 1973 does not define the word or term “acquire” but it is intended to include the purchase and subscription for the share of the company. Cassim 1999 (116) SLJ. See also Cassim “The New Statutory Provisions on Company Share Repurchase” at 761.

Despite the amendments made by the Companies Amendment Act 37 of 1999, sections 81 and 82 of the Companies Act, 1973 prohibited the issue of shares at a discount unless certain precautions had been complied with. Section 79 also restricted a company from paying interest or shares out of share capital. Not all capital maintenance rules were thus abandoned by the amendments introduced by the Companies Amendment Act 37 of 1999.

The development of South African Company law and specifically the capital maintenance rules did not take place overnight but were introduced over time by amendments to the Companies Act, 1973. Cassim describes it as follows: *“Perhaps this conflict in the underlying philosophy and policy of the South African Companies Act is a direct result of the patchwork and piecemeal reform that has taken place in South African corporate law during the 30-year existence of the Companies Act of 1973”*<sup>15</sup>.

It remained important to protect shareholders and creditors of the company against abuse by the company and to this extent

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<sup>15</sup> Cassim and Cassim. “The Capital Maintenance Concept” at 189.

sections 85 to 89 of the Companies Act, 1973 and specifically section 85(4) that introduced the doctrine of maintenance of solvency and liquidity, was an important step in achieving that.

That the legislation was long overdue can be seen in Cassim's remarks on this: "*It is unduly narrow, rigid and restrictive to prohibit a company from purchasing its own shares,*" and: "*The suggested reforms are long overdue and are to be welcomed.*"<sup>16</sup>

The amendments to the Companies Act, 1973 brought South African company law in some way in harmony with other jurisdictions where companies in countries like Australia, Canada and England have been allowed to acquire their own shares. The amendments to the Companies Act, 1973 was mainly based on the Canadian model and not the English model<sup>17</sup>.

It is clear that although the amendments in the Companies Act, 1973 and specifically that of section 85 were a big step

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<sup>16</sup> Cassim "The New Statutory Provisions on Company Share Repurchases" at 760 - 761.

<sup>17</sup> Cassim "The New Statutory Provisions on Company Share Repurchases" at 760. See also Van der Linde "A Company's Purchase of its Own Shares" at 68 and Cilliers et al "Corporate Law" at 323.

forward by giving a company the authority to acquire its own shares, there was still place for improvement. Cassim highlights one of them: *“It is not enough to protect creditors and shareholders, the investing public must also be protected,”* and: *“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 clear that Cassim was concerned with the fact that share repurchases under the Companies Act, 1973 had potential for unequal treatment of shareholders<sup>18</sup>.

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<sup>18</sup> Cassim “The Reform of Company Law and the Capital Maintenance Concept” at 287 and 288.

## CHAPTER 3

### ACQUISITION BY A COMPANY OF ITS OWN SHARES – COMPANIES ACT, 1973

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#### 1. INTRODUCTION

The Companies Amendment Act 37 of 1999 amended sections 85 to 89 of the Companies Act, 1973 and thus made provision for a company to acquire its own shares. The process and rules were prescribed in sections 85 to 89 of the Companies Act, 1973 and included for the first time the solvency and liquidity test in section 85(4).

#### 2. THE COMPANIES ACT, 1973 – SECTIONS 85 TO 89

Section 85(1) provided that a company, by way of special resolution and if authorised by its Articles of Association, may approve the acquisition of its own shares. The approval by special resolution may be a general approval or a specific approval.<sup>19</sup> For a particular acquisition where a company gave a general approval, the approval was valid until the next annual general meeting, but it could have been varied or

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<sup>19</sup> S 85(2) of the Companies Act, 1973.

revoked by special resolution at any time before such general meeting<sup>20</sup>.

Van der Linde described it as follows: *“What has to be approved by shareholders is the acquisition of shares by the company rather than a contract or offer as it is the case in the United Kingdom and New Zealand. An approval could have been either a general approval or a specific approval for a particular acquisition. This made a general approval suitable for confirming discretion on directors to repurchase shares when they regarded it as appropriate.”*<sup>21</sup>

In terms of sections 85(5) to 85(8) of the Companies Act, 1973 all repurchased shares had to be cancelled and restored to the status of authorised but unissued shares. There were thus no treasury shares in terms of the Companies Act, 1973 and shares that were repurchased by the company had, according to Cassim, no rights. *“Since the repurchased shares are cancelled in their acquisition, it follows that any rights or privileges attaching to such shares, such as voting or dividend*

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<sup>20</sup> S 85(3) of the Companies Act, 1973.

<sup>21</sup> Van der Linde “Share Repurchases and the Protection of Shareholders” at 299.



*rights, are also extinguished.*<sup>22</sup> It was clear from section 85 that the capital of a company was strictly regulated when the company repurchased its own shares and section 85 was prescriptive of how the repurchased shares influenced the issued share capital of the company<sup>23</sup>. If the company acquired par value shares, the issued capital of the company was decreased by an amount equal to the par value of the shares so acquired<sup>24</sup>.

In the case of a repurchase by a company of its own no par value shares, section 85(6) of the Companies Act, 1973 prescribed the process as follows: the stated capital of the class of shares so acquired shall be decreased by an amount derived by multiplying the number of shares of that class so acquired with the amount arrived at by dividing the stated capital contributed by issued shares of that class by the number of issued shares of that class.

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<sup>22</sup> Cassim and Cassim " The Capital Maintenance Concept" at 193, See also Cilliers et al "Corporate Law" at 322. See also Cassim "The Repurchase by a Company of its Own Shares" at 137.

<sup>23</sup> S 85(5) – (9) of the Companies Act, 1973. See also Pretorius et al " Hahlo's South African Company Law" at 124.

<sup>24</sup> S 85(5) of the Companies Act, 1973.

Section 85(7) of the Companies Act, 1973 further prescribes that the company may have used reserves, including statutory non-distributable reserves to pay for par value shares acquired at a premium over the par value. This was a further step in reforming the strict capital maintenance rules. Confirmation of the fact that shares acquired by the company shall be cancelled as issued shares and restored to the status of authorised unissued shares can be found in section 85(8) of the Companies Act, 1973.

In terms of section 85(9) of the Companies Act, 1973, a company was not allowed to acquire shares if as a result thereof the only shares in issue would have been convertible or redeemable shares. Section 85(9) therefore prevented a company from acquiring all of its own shares or being able to convert all its remaining shares.

Section 87 of the Companies Act, 1973 prescribed the procedure that a company had to follow for a share repurchase. Sections 87(1) to (5) prescribed the process that a company had to follow to acquire unlisted shares from all registered shareholders. The company had to deliver or mail

a copy of the written offering circular on the prescribed form to each registered shareholder on record as at the date of the offer. The circular had to contain certain information, such as the number and class of shares which the company proposed to acquire, and also specifying the terms and reasons for the offer<sup>25</sup>.

Section 87(2)(b) of the Companies Act, 1973 required a company to lodge a copy of the offering circular with the Registrar within 15 days of the date that it is delivered or mailed to the shareholders of the company. It was important for the company to remember to lodge the special resolution timeously with the Registrar in terms of section 202 and in accordance with sections 200 and 203 of the Companies Act, 1973, failing which the special resolution would lapse and be void unless the court otherwise directed.

There were two exclusions in sections 87(2)(a) and (b)<sup>26</sup> specifying a repurchase of listed shares and when shares were acquired in terms of a special resolution and the approval was a specific approval in terms of section 85(2) of

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<sup>25</sup> S 87(1) to (5) of the Companies Act, 1973.

<sup>26</sup> The Companies Act, 1973

the Companies Act, 1973. Section 87(4) of the Companies Act, 1973 dealt with the scenario where in response to an offer by the company to repurchase shares, the shareholders proposed to dispose of a greater number of shares than the company offered to acquire. In such circumstances the company was required to repurchase from all the shareholders who offered to sell, pro rata as nearly as possible disregarding fractions. The company should have further notified the Registrar of Companies within 30 days on the prescribed form of the date, number and class of shares that it had acquired<sup>27</sup>.

### **3. SOLVENCY AND LIQUIDITY TEST**

Sections 85(4)(a) and (b) of the Companies Act, 1973 provided that a company was prohibited from making any payment in whatever form to repurchase any share if there were reasonable grounds for believing that the company is, or would after payment be unable to pay its debts as they became due in the ordinary course of business. This is known as the liquidity test. The test further stipulated that a company was also prohibited from repurchasing shares if there were

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<sup>27</sup> S 87(5) of the Companies Act, 1973.

reasonable grounds to believe that after the payment the company's consolidated assets fairly valued would be less than the consolidated liabilities of the company. This is known as the solvency test.

The solvency and liquidity tests were objective tests and the directors had to make sure that both tests had been satisfied before a share acquisition took place<sup>28</sup>. In *Capitex Bank Ltd v Qorus Holdings Ltd*<sup>29</sup> the court held that any payment made in contravention of sections 85(4)(a) and (b) of the Companies Act, 1973 would result in an illegality. The burden of proof lay with the company to convince the court that section 85(4) of the Companies Act, 1973 had been contravened.

Section 90 of the Companies Act, 1973 regulated any payments by a company to its shareholders. This clearly included the return of capital or acquiring of its own shares by a company<sup>30</sup>. The protection of creditors was assured by the solvency and liquidity requirements. The creditor also had the same right of recovery as a director against a selling

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<sup>28</sup> Cassim and Cassim "The Capital Maintenance Concept" at 191 .

<sup>29</sup> *Capitex Bank Ltd v Qorus Holdings Ltd and Others* 2003(3) SA 302 (W).

<sup>30</sup> Van der Linde "Capital Maintenance is Dead" at 155.

shareholder if any money was paid to the shareholder in breach of section 85(4) of the Companies Act, 1973<sup>31</sup>.

It is clear that although the solvency and liquidity tests were a big improvement on the capital maintenance rules, the tests were not without deficiencies in the Companies Act, 1973. The reasonable ground requirement in section 85(4) didn't require the directors to hand in any form or report from an auditor or any independent financial entity to substantiate their assessment of the company's ability to comply with section 85(4). Unlike the listing requirements of the JSE Limited there was no way for a shareholder to get information on how the company calculated the price at which to acquire the shares from shareholders, and this may place the shareholder in a disadvantaged position in relation to the company.

Section 85(4) also failed to make provision for a period in which the company had to remain solvent and liquid. This has been addressed in the new act<sup>32</sup>.

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<sup>31</sup> Cassim and Cassim "The Capital Maintenance Concept" at 192.

<sup>32</sup> The Companies Act, 2008.

Cassim describes it as follows: *“The provisions of the Companies Act relating to share repurchases are in some important respects defective and lacking in technical quality.”*<sup>33</sup>

#### **4. LIABILITY OF DIRECTORS OF A COMPANY ACQUIRING ITS OWN SHARES – COMPANIES ACT, 1973**

Section 86 of the Companies Act, 1973 dealt with the liability of directors and shareholders under certain circumstances. The directors were jointly and severally liable to restore to the company any amount paid contrary to section 85(4) in acquiring shares issued by it. The directors received reprieve if the company could recover the amount paid or if they were granted relief by the court under section 248 of the Companies Act, 1973.

Section 86(2) of the Companies Act, 1973 however assisted a director who is liable under section 86(1) of the same act to apply to court for an order compelling a shareholder or former shareholder to pay to the company any money that was paid to such shareholder contrary to section 85(4).

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<sup>33</sup> Cassim and Cassim “The Capital Maintenance Concept”.

It will be difficult to determine from which shareholders the shares had been purchased if the company is listed on the Johannesburg Stock Exchange. In such an instance, it will be a challenge to enforce the personal liability of directors or shareholders.

The directors were not liable to creditors or shareholders and their only recourse was against shareholders who received payment contrary to section 85(4). Sections 86(3)(a), (b) and (c) of the Companies Act, 1973 gave a shareholder and a creditor, who was a creditor by reason of cause of debt which arose before such acquisition or who was a creditor at the time of the acquisition, a right of recovery by way of court order against any shareholder or former shareholder to pay to the company any money or consideration that was paid or given by the company to acquire the shares and was in contravention of section 85(4). The court could then order the company to issue an equivalent number of shares to the shareholder or former shareholder or make such order as it thought fit.



Directors could further be held liable in terms of the common law, any other acts and the Companies Act, 1973 and an action to enforce a liability against a director must have been instituted within three years after the date of completion of the acquisition<sup>34</sup>.

In terms of the common law the directors have a fiduciary duty towards the company. Included is the duty to act in good faith for a proper purpose and for the benefit of the company.

Section 86(6)<sup>35</sup> stated that a director of a company includes any director of a holding company of such company. Van der Linde states that: *“If the solvency and liquidity requirements are not satisfied by the subsidiary, its own directors as well as the directors of its holding company may be held liable to restore to the subsidiary the amount paid for the shares.”*<sup>36</sup>

Cassim had two basic suggestions to improve section 86 of the Companies Act, 1973 and specifically the working of sections 86(1) and 86(2). Firstly he suggested that not all

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<sup>34</sup> S 86(4) and (5) of the Companies Act, 1973.

<sup>35</sup> The Companies Act, 1973.

<sup>36</sup> Van der Linde “A Company’s Purchase of its own Shares” at 71.

directors be held liable for the wrongful share repurchase but that those directors that voted against the repurchase should receive reprieve and not be held liable towards the company. This suggestion has been taken up in the Companies Act, 2008. Secondly, section 86(2) must also be amended to modify the absolute liability of the shareholder that sold his shares to the company to repay money he received in contravention of section 85(4). Cassim suggested that an innocent shareholder who had no knowledge or suspicion of the contravention of section 85(4) by the directors ought to receive statutory protection not to pay back any money to the company<sup>37</sup>.

## **5. PROTECTION OF SHAREHOLDERS OF A COMPANY ACQUIRING ITS OWN SHARES – COMPANIES ACT, 1973**

The first stage of protection for shareholders where a company bought its own shares lied in the requirement that a special resolution by the shareholders had to be adopted<sup>38</sup> and also authorised by the Articles of the company.

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<sup>37</sup> Cassim “The Reform of Company Law and the Capital Maintenance Concept” at 289.

<sup>38</sup> S 85(1) of the Companies Act, 1973.

If a general approval was granted, then the approval was only valid until the next annual general meeting. To further protect shareholders, such a general approval could be varied or revoked by special resolution by any general meeting at any time prior to such annual general meeting<sup>39</sup>.

Van der Linde is of the opinion that the protection was flawed because of section 87(2)(a) of the Companies Act, 1973 and that a company "*could easily avoid proper disclosure and the equal treatment of shareholders prescribed by section 87 by using a specific approval rather than a general approval*"<sup>40</sup>.

Section 85(9)<sup>41</sup> provided some protection against a company using a share repurchase to gain control over the company by specifying that shares may not be acquired if as a result of such acquisition there would no longer be any shares in issue other than convertible or redeemable shares.

Sections 86(1) and (3) of the Companies Act, 1973 provided further protection in specifying the liability of directors in

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<sup>39</sup> S 85(3) of the Companies Act, 1973.

<sup>40</sup> Van der Linde "Share Repurchases and the Protection of Shareholders" at 300. See also Van der Linde "Share Repurchases" at 27.

<sup>41</sup> The Companies Act, 1973.

certain circumstances. Although the directors didn't owe any fiduciary duties directly towards the shareholders, the fact that they had to restore to the company any amount paid in contravention of section 85(4) indirectly benefited the shareholders as a group. The liability of directors was discussed in more detail in paragraph 4 of this chapter.

A further section that protected shareholders was section 85(4) of the Companies Act, 1973 which contained the solvency and liquidity test and thus protected shareholders from directors acquiring the company's shares before satisfying requirements of the test. Any payment contrary to section 85(4) would result in the illegality of the share repurchase agreement<sup>42</sup>.

The solvency and liquidity test did not provide additional protection to preference shareholders but should the company be liquidated and the company still owed consideration in respect of a share repurchase, the rank in priority of claims would benefit certain shareholders<sup>43</sup>.

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<sup>42</sup> *Capitex Bank Ltd v Qorus Holdings Ltd*. See also Cilliers et al *Corporate Law* at 322.

<sup>43</sup> Van der Linde "Share Repurchases and the Protection of Shareholders" at 288.

The solvency and liquidity test<sup>44</sup> was discussed in more detail in paragraph 3 of this chapter.

The second stage of protection of shareholders was taken up in section 87 of the Companies Act, 1973 which set out the procedures to be followed by a company acquiring its own shares. Section 87(1) prescribed that enough information be given to all registered shareholders in writing, stating the terms and reasons for the offer<sup>45</sup>. This provided enough information to all shareholders, or holders of a class of shares to make an informed decision and gave them the right to participate on an equal basis. Section 87(3) specifically extended the protection of sections 160 to 163<sup>46</sup>, which referred to the liability of directors related to untrue statements in a prospectus, to all documents issued in terms of section 87(1). Section 87(1) further prescribed that the notice to shareholders must be in the prescribed form as required by the Articles of the company. The notice must contain the number and the class or kind of its issued shares which the

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<sup>44</sup> S 85(4) of the companies Act, 1973.

<sup>45</sup> S 87(1) of the Companies Act, 1973.

<sup>46</sup> The Companies Act, 1973.

company proposed to acquire, and must specify the terms and reasons for the offer.

To make sure that all shareholders were treated equally section 87(4) provided that where in response to any offer to acquire shares the shareholders proposed to dispose of a greater number of shares than the company offered to acquire, the company would acquire from all the shareholders who offered to sell, pro rata as nearly as possible, excluding transactions effected on a Stock Exchange within the Republic. Further protection by way of further requirements could have been imposed by a Stock Exchange within the Republic<sup>47</sup>.

The procedure set out in section 87<sup>48</sup> was an important step in protecting and treating shareholders on an equal basis. Cassim sees it as follows: *“The procedure for a share repurchase is of crucial importance in preventing abuse of the share repurchase power and discrimination against shareholders holding the same class of shares”*<sup>49</sup>.

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<sup>47</sup> S 87(6) of the Companies Act, 1973.

<sup>48</sup> The Companies Act, 1973.

<sup>49</sup> Cassim and Cassim “The Capital Maintenance Concept” at 192.

Protection to shareholders, from which the company acquired shares, was enacted in section 88 of the Companies Act, 1973. Section 88(1) provided that a contract with a company providing for the acquisition of its own shares is enforceable against the company.

The only exception was if the company couldn't execute the contract without being in breach of section 85(4) of the Companies Act, 1973. The burden of proof that the execution of the contract would have been in breach of section 85(4) lies with the company<sup>50</sup>.

Section 88(3) of the Companies Act, 1973 provided that shareholders who disposed of the shares to the company but had not received payment from the company ranked as claimants entitled to be paid as soon as the company was lawfully able to do so. If the company was liquidated the shareholder ranked subordinate to creditors and shareholders whose claims were in priority of the class of shares which they disposed of to the company but in priority to the claims of

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<sup>50</sup> S 88(2) of the Companies Act, 1973. See also Cilliers et al. "Corporate Law" at 326.

other shareholders<sup>51</sup>. These shareholders were referred to as vendor shareholders by Van der Linde<sup>52</sup>.

Section 89 of the Companies Act, 1973 stated that subsidiary companies may *mutatis mutandis* in accordance with sections 85 to 88 acquire shares in their holding company to a maximum of ten percent in the aggregate of the number of issued shares of the holding company. This was to prevent the abuse of control a holding company has over a subsidiary to the detriment of shareholders. Section 39<sup>53</sup> further protected shareholders by stating that subsidiaries would not be able to vote on the shares that it acquires in its holding company. It is important to note that if a subsidiary of a company wanted to purchase shares in its holding company it had to comply with all the requirements of a company acquiring its own shares. Thus a subsidiary had to by special resolution approve the purchase and its articles needed to also authorise such a purchase<sup>54</sup>.

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<sup>51</sup> The Companies Act, 1973.

<sup>52</sup> Van der Linde "Share Repurchases and the Protection of Shareholders" at 288. See also Van der Linde "The Regulation of Distributions to Shareholders in the Companies Act, 2008".

<sup>53</sup> S 39(1)(a) of the Companies Act, 1973.

<sup>54</sup> Van der Linde "A Company's Repurchase of its Own Shares" at 70-71.



In terms of section 440A(1) of the Companies Act, 1973 if a transaction or scheme had the effect of a change in control of the company and vesting it in any person or two or more persons acting in concert, then the transaction might have been labelled as an affected transaction. This was possible in a repurchase of its shares by a company and if the transaction was so classified then Chapter XVA of the Companies Act, 1973 applied. This provided protection for shareholders where the control of a company changed and the rules of the Securities Regulation Code on Takeovers and Mergers needed to be complied with.

Shareholders of listed companies could also have argued that after the amendment of the definition of an “insider” from an “individual” in the Insider Trading Act, 1998 to a “person” in the Securities Services Act, 2004, a company acquiring its own shares could be viewed as an insider in certain circumstances and thus provided further protection to shareholders by forcing the company to provide all the non-public information to shareholders in the circular.

Section 38 of the Companies Act, 1973 prohibited a company from giving financial assistance to any person for the purchase of that company's shares. Section 38(d) introduced an exception that allowed 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. The protection for shareholders lay in the fact that the company or subsidiary had to be solvent and liquid when payment was made<sup>55</sup>.

Lastly, shareholders still had the protection of one of the last remaining capital rules when a company wanted to redeem redeemable preferent shares. Section 98 of the Companies Act, 1973 still applied on redemptions and redeemable preferent shares may have been redeemed only out of divisible profits or out of the proceeds of shares which have been specifically issued for that purpose<sup>56</sup>.

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<sup>55</sup> Cilliers et al *Corporate Law* at 336 and Van der Linde "A Company's Purchase of its Own Shares" at 71.

<sup>56</sup> Van der Linde "A Company's Purchase of its Own Shares" at 71. See also Cassim "The New Statutory Provisions on Company Share Repurchases" at 763-764.

## CHAPTER 4

### **ACQUISITION BY A COMPANY OF ITS OWN SHARES – SECTION 48 OF THE COMPANIES ACT, 2008**

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#### **1. INTRODUCTION**

This chapter deals with the acquisition by a company of its own shares and specifically the requirements of section 48 of the Companies Act, 2008. Share repurchases by a company in terms of the Companies Act, 1973, and a proper understanding thereof, are important in any discussion of the position under the current act. The Companies Act, 2008 was only enacted in May 2011 and the South African courts have thus far not been in a position to interpret much of the principles contained in the new, current act.

The solvency and liquidity test, the liability of directors and the protection of shareholders in the Companies Act, 2008 will be specifically analysed with reference to the Companies Act, 1973 where applicable.

## **2. ACQUISITION BY A COMPANY OF ITS OWN SHARES – SECTION 48 OF THE COMPANIES ACT, 2008**

Section 48(1)(a) of the Companies Act, 2008 starts with an exception, excludes the working of section 48 and stipulates that the making of a demand, tendering of shares and payment by a company to a shareholder in terms of a shareholder's appraisal rights in terms of section 164<sup>57</sup> do not constitute an acquisition of its shares by the company within the meaning of section 48. If a company gives notice to shareholders of the intention to adopt one of the resolutions of a meeting listed in sections 164(2)(a) and (b) of the Companies Act, 2008, a shareholder can give notice to the company that he objects to the resolution. This objection must be given prior to the meeting. If the resolution is passed, the company must give notice to the shareholder who objected, who can then demand that the company pay him a fair price based on the fair value of all his shares in the company.

By excluding the appraisal rights of a shareholder in terms of section 164 from the operation of section 48, the process of a company acquiring its own shares is made much easier.

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<sup>57</sup> The Companies Act, 2008.

Section 48(1)(b)<sup>58</sup> further stipulates that section 48 also does not apply to the redemption by the company of any redeemable securities in accordance with the terms and conditions of those securities.

Section 48(1)(b)<sup>59</sup> specifically mentions the exclusion of redeemable securities which includes shares according to the definition of securities in the act. Section 37(5)(b)<sup>60</sup> refers to redeemable shares but specifically includes the working of sections 46 and 48. Delpont sees it as follows: *“Redemption of securities other than shares should not be covered by section 48 (see section 46) but the exclusion of redeemable shares (as species of ‘securities’) seems to be an unwarranted exclusion which is open to abuse as section 35(4) states that shares acquired by the company cease to exist. The effect on solvency and liquidity is patent.”*<sup>61</sup>

Section 48(2) of the Companies Act, 2008 regulates and gives a company authority to buy its own shares subject to

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<sup>58</sup> The Companies Act, 2008. See also Delpont “The New Companies Act Manual”.

<sup>59</sup> The Companies Act, 2008.

<sup>60</sup> The Companies Act, 2008.

<sup>61</sup> Delpont “The New Companies Act Manual” at 60, see footnote 52.

subsections (3) and (8). The decision to do so also has to satisfy the requirements of section 46 of the Companies Act, 2008 which regulates all distributions and which must be authorised by the board of directors. Section 46(1) further contains the exception that the company does not require a board decision for a distribution if the distribution is made pursuant to an existing legal obligation of the company, or a court order. All other distributions must meet the requirements of sections 46(1)(a)(ii)(b) and (c), which contain the solvency and liquidity test as set out in section 4 of the Companies Act, 1973 as well as the requirement that the board must by resolution acknowledge that it has applied the solvency and liquidity test and reasonably concluded that the company will satisfy the test immediately after the proposed distribution. The definition of distribution in the Companies Act, 2008 includes three methods by which distribution can be made namely a transfer of money or property, the incurrance of an obligation and the waiver of an obligation made directly or indirectly.<sup>62</sup>

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<sup>62</sup> S 1 of the Companies Act, 2008, definition of distribution. See also Van der Linde “The Regulation of Distributions to Shareholders in the Companies Act, 2008” at 484.

The definition of distribution in the Companies Act, 2008 further stipulates specifically that the transfer of money as consideration for the acquisition by the company of any of its shares, as contemplated in section 48, is a distribution<sup>63</sup>. Van der Linde states that the Companies Act, 2008 does not provide a definition of the term “acquisition” but reasons that: *“It stands to reason that a company cannot really acquire its shares, as it cannot hold rights against itself. Yet the term must be understood to include any instance where a shareholder relinquishes rights in respect of a share to the company.”*<sup>64</sup>

Section 48(2)(b)<sup>65</sup> authorises a subsidiary of a company, by a board decision of the subsidiary, to acquire shares of that company subject to sub sections (b)(i) and (ii) which specify that the subsidiary cannot acquire or hold more than 10% in aggregate of the number of issued shares of any class of shares of a company or for the benefit of all of the subsidiaries of that company taken together, and no voting rights attached to the shares may be exercised while the shares are held by

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<sup>63</sup> S 1 of the Companies Act, 2008, definition distribution a(iii)(aa).

<sup>64</sup> Van der Linde “The Regulations of Distributions to Shareholders in the Companies Act, 2008” at 488.

<sup>65</sup> The Companies Act, 2008.

the subsidiary and it remains a subsidiary of the company. The main reason for the regulation of shareholding by a subsidiary seems to be protection of shareholders against control exercised by the company over subsidiaries and therefore an indirect control of the company. The effect on other shareholders by the exclusion of voting rights attached to shares held by a subsidiary in the holding company can have certain unintended consequences in that, for example, where a shareholder holds 10 shares out of 100 issued shares and a subsidiary acquires 10 shares of the remaining shares, the shareholder will now have 11% of the votes instead of 10%<sup>66</sup>.

Section 48(3) of the Companies Act, 2008 further restricts the acquisition by a company of its shares if as a result of that acquisition there would no longer be any shares of the company in issue other than shares held by one or more subsidiaries of the company or convertible or redeemable shares. This exception is criticised by Delpont, who states: *“The exception of shares held by subsidiaries is superfluous,*

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<sup>66</sup> Delpont “The New Companies Act Manual” at 60, see footnote 44.



*given the general restriction that the aggregate of shares acquired by subsidiaries must not exceed 10%.”<sup>67</sup>*

Section 48(4) of the Companies Act, 2008 specifies that an agreement with a company providing for the acquisition by the company of shares issued by it is enforceable against the company, subject to subsections (2) and (3). It is unclear whether the whole contract or only the section that is in breach of subsections (2) and (3) is unenforceable<sup>68</sup>.

Section 48(5)<sup>69</sup> places the burden of proof on the company to convince the court by application that it will not be able to fulfil its obligations in terms of an agreement as per subsection (4) as a result of the operation of subsections (2) or (3). 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 a payment in terms of the agreement is paid at the earliest possible date

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<sup>67</sup> Delpont “The New Companies Act Manual” at 61, see footnote 45.

<sup>68</sup> Delpont “The New Companies Act Manual”.at 61

<sup>69</sup> S 48(5)(a) and (b) of the Companies Act, 2008.

compatible with the company satisfying its other financial obligations as they fall due and payable<sup>70</sup>. Van der Linde remarks that the ranking of claims in respect of unfulfilled repurchases when a company is liquidated is not regulated and states: “*It seems that such claims will rank concurrently with the claims of other creditors.*” She points out that this differs from the position of the Companies Act, 1973 where unpaid shareholders ranked higher than non-selling shareholders of their class<sup>71</sup>.

Section 48(6) of the Companies Act, 2008 provides that where a company acquires shares contrary to sections 46 or 48, the company must not more than two years after the acquisition apply to court for an order reversing the acquisition, and the court may order the return of the consideration and the reissuing of the shares<sup>72</sup>. The reversal of the transaction can be prejudicial to a *bona fide* shareholder if he does not have the capital to pay the consideration back to the company<sup>73</sup>.

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<sup>70</sup> S 48(5)(c)(i) and (ii) of the Companies Act, 2008.

<sup>71</sup> Van der Linde “The Regulation of Distributions to Shareholders in the Companies Act, 2008” at 495.

<sup>72</sup> The Companies Act, 2008, see also Van der Linde “The Regulation of Distributions to Shareholders in the Companies Act, 2008” at 495.

<sup>73</sup> Delpont “The Companies Act Manual” at 61, see footnote 49.

### **3. THE SOLVENCY AND LIQUIDITY TEST – SECTIONS 4, 46 AND 48 OF THE COMPANIES ACT, 2008**

Section 4 of the Companies Act, 2008 sets out the requirements of the solvency and liquidity test. The test has been substantially improved to provide better protection to shareholders and more responsibility to the board of directors.

Van der Linde highlights the working of the test as follows:

*“The new Companies Act extends the field of application of the solvency and liquidity requirements even further, proving that it has potential beyond the regulation of distributions and can be used as a protection measure in a wide range of transactions affecting the rights of creditors.”<sup>74</sup>*

The test has both a solvency and liquidity element. Section 4(1)(a)<sup>75</sup> requires that the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued. This is the solvency test and must be done at a particular time and considering all reasonably foreseeable financial circumstances of the company at that time.

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<sup>74</sup> Van der Linde “The Solvency and Liquidity Approach in the Companies Act, 2008” at 225.

<sup>75</sup> The Companies Act, 2008.

The liquidity section of the test as per sections 4(b)(i) and (ii) of the Companies Act, 2008 requires that it must appear that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after the date on which the test is considered or after 12 months following the distribution.

Both the elements of the test must be satisfied for a distribution to be authorised by sections 46 and 48 of the Companies Act, 2008. The justifications of the solvency and liquidity requirements have, according to Van der Linde, two angles: "*The solvency element gives advance recognition to the ultimate priority that creditors enjoy over shareholders upon dissolution of the company*" and "*The justification for a liquidity element is that it addresses the fundamental expectation of creditors to be paid on time.*"<sup>76</sup> It is thus basically a balance sheet and cash flow test done by the directors before an acquisition is approved.

Section 4(2)(a)(i) prescribes that any financial information considered concerning the company must be based on

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<sup>76</sup> Van der Linde "The Solvency and Liquidity Approach in the Companies Act, 2008" at 226.

accounting records that satisfy the requirements of section 28<sup>77</sup>. Section 28 deals with a company's accounting records and requires a company to keep accurate and complete accounting records in one of the official languages of the Republic. Section 4(2)(a)(ii)<sup>78</sup> further specifies that financial information to be considered must also be based on financial statements that satisfy the requirements of section 29<sup>79</sup>. Section 29 sets the standard to which financial statements must adhere to if a company provides such statement to any person for any reason. This is a good example of the progressive way in which the solvency and liquidity test has been improved to protect creditors and shareholders by forcing the board of a company to base their decisions on a prescribed standard of financial information.

Section 4(2)(b)<sup>80</sup> prescribes 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

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<sup>77</sup> The Companies Act, 2008.

<sup>78</sup> The Companies Act, 2008.

<sup>79</sup> The Companies Act, 2008.

<sup>80</sup> The Companies Act, 2008.

a result of the proposed distribution, or otherwise and may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances.

Van der Linde states that the fact that reasonably foreseeable contingent assets and liabilities must be included at their fair value when the solvency and liquidity test is applied, confirms that not only financial information based on financial statements and accounting records must be included, but that: *“the application of the solvency and liquidity test involves more than looking at statements and records.”*<sup>81</sup>

Section 4(2)(c) of the Companies Act, 2008 deals with a liquidation possibility and states that unless the Memorandum of Incorporation of the company provides otherwise, when applying the test in respect of a distribution contemplated in paragraph (a) of the definition of distribution in section 1 of the act, 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 the preferential rights upon liquidation of shareholders whose preferential rights on

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<sup>81</sup> Van der Linde “The solvency and Liquidity Approach in the Companies Act, 2008” at 231.

liquidation are superior to the preferential rights upon liquidation of those receiving the distribution<sup>82</sup>.

Paragraph (a) deals with a distribution in the form of a transfer of money or property. Van der Linde remarks: *“Although the provision refers to the application of the solvency and liquidity test, it is clear that the preferential liquidation rights of preference shareholders are relevant for the solvency element and not the liquidity element.”*<sup>83</sup>

It is clear from section 4 that the test is in essence a test based on recorded financial information as well as reasonably foreseeable financial circumstances. It appears that the test for solvency is an objective one and for liquidity a subjective test as it requires a test by taking circumstances in the following twelve months into account before reaching a conclusion<sup>84</sup>.

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<sup>82</sup> Van der Linde “The Solvency and Liquidity Approach in the Companies Act, 2008” at 231.

<sup>83</sup> Van der Linde “The Solvency and Liquidity Approach in the Companies Act, 2008” at 232.

<sup>84</sup> Delport “The New Companies Act Manual” at 54. See also Van der Linde “The Solvency and Liquidity Approach in the Companies Act, 2008” at 235.

Although the extended role of the solvency and liquidity test in the new Companies Act is welcome, there are several areas in which it still can be improved to provide better and more extensive protection for creditors and shareholders.

#### **4. LIABILITY OF DIRECTORS – SECTION 48 OF THE COMPANIES ACT, 2008**

Sections 48(7)(a) and (b) of the Companies Act, 2008 prescribes that a director of a company is liable to the extent set out in section 77(3)(e)(vii) of the act if the director was present at the meeting when the board approved an acquisition of shares contemplated in section 48 or participated in the making of such a decision in terms of section 74 of the act and failed to vote against the acquisition of shares despite knowing that the acquisition was contrary to sections 46 or 48.

Section 46(6) of the Companies Act, 2008 read with section 77(3)(e)(vi) places liability on directors for unlawful distributions. It is clear that directors in approving the acquisition of shares in terms of section 48 can be held liable in terms of section 46 and/or section 48. Section 77 of the act



provides for a wider meaning of director which includes prescribed officer but Van der Linde is of the opinion that the narrow description should be followed. *“However, when regard is had to the specific provisions on liability for distributions and repurchases, it seems that only a director in the narrow sense can be held liable, because the director must have participated in the board resolution authorising the distribution.”*<sup>85</sup>

A director is also jointly and severally liable with other directors<sup>86</sup>.

Liability for directors in terms of section 77(3)(e)(vi) of the Companies Act, 2008 only arises after it is clear that immediately after making all of the distributions contemplated in a resolution in terms of section 46, the company does not satisfy the solvency and liquidity test and it was unreasonable at the time of the decision to conclude that the company would satisfy the solvency and liquidity test after making the relevant distribution.

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<sup>85</sup> Van der Linde “The Regulations of Distributions to Shareholders in the Companies Act” at 495.

<sup>86</sup> S 77(4)(b) of the Companies Act, 2008.

It is clear that liability is only triggered if the above two requirements are met.

The liability of directors in terms of sections 77(3)(e)(vi) and (vii) is further limited to the difference between the amount by which the value of the distribution exceeded the amount that could have been distributed without causing failure by the company to satisfy the solvency and liquidity test. The liquidity is further minimised by the amount recovered from the persons who received the distribution<sup>87</sup>.

As with the Companies Act, 1973 the director's liability is towards the company only and shareholders and creditors are not allowed to institute action against the directors for an unlawful distribution in terms of sections 48 and 46 of The Companies Act, 2008.<sup>88</sup>

A further possibility will be if the regulation of repurchases is included in the Memorandum of Incorporation of the company.

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<sup>87</sup> S 77(4)(b)(i) and (ii) of the Companies Act, 2008. See also Delpont "The New Companies Act Manual" at 61.

<sup>88</sup> Delpont "The New Companies Act Manual" at 59 and 61. See also Van der Linde "The Regulation of Distributions to Shareholders in the Companies Act, 2008" at 496 and 498.

Van der Linde states that it is obvious that directors are obliged to comply with the provisions of the Memorandum and remarks: “*The directors will be liable to the company if the company suffers loss or damage as a result of the non compliance with the Memorandum.*” She further states: “*A director will also be liable to a shareholder who suffers damage as a result of such non compliance.*”<sup>89</sup> This view is not shared by some writers as section 48 is not an alterable provision and I tend to agree with this view<sup>90</sup>.

Any further liabilities of directors will be determined in accordance with the general liability principles in sections 75 to 77 of the Companies Act, 2008. The duties of directors in the Companies Act, 2008 are in essence a codification of the common law duties and further development of the duties might take place in future by the courts in relation to share repurchases.

It is important to take note of section 77(9) of the Companies Act, 2008 confirming that in any proceedings against a

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<sup>89</sup> Van der Linde “Share Repurchases and the Protection of Shareholders” at 303. See also S 20(6) of the Companies Act, 2008.

<sup>90</sup> Cassim et al “Contemporary Company Law” at 275.

director, other than for wilful misconduct or wilful breach of trust the court may relieve directors, either wholly or partially, from any liability set out in section 77, on any terms the court considers just if it appears to the court that the director is or may be liable, but has acted honestly and reasonably, or having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director<sup>91</sup>.

Finally, the liability of directors is basically the same in terms of section 46 (a distribution) and section 48 (an acquisition) of the Companies Act, 2008 because an acquisition involves a distribution. There are two exceptions. Firstly the liability is wider in an acquisition in that the director is liable if the distribution does not meet the solvency and liquidity test, but also if the requirements of section 48(3) of the Companies Act, 2008 are not met. Secondly, the limit in section 77(4)(b)<sup>92</sup> does not apply in the case of an acquisition, whereas it does in the case of a distribution<sup>93</sup>.

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<sup>91</sup> McLennan “Directors Fiduciary Duties and the 2008 Companies Bill” at 188.

<sup>92</sup> The Companies Act, 2008.

<sup>93</sup> Cassim et al “Contemporary Company Law” at 280.

It is clear that directors in respect of non-compliance with sections 46(6) and 48(7) of the Companies Act, 2008 can only incur liability in strict accordance with the prescriptions in these sections.

## **5. PROTECTION OF SHAREHOLDERS – SECTION 48 OF THE COMPANIES ACT, 2008**

In terms of the Companies Act, 1973 the main mechanisms of protection for shareholders were the fact that all repurchases of shares by the company had to be approved by a shareholder resolution which had to be preceded by enough information to enable the shareholder to make an informed decision. The company also had to follow a formal process to make sure that all shareholders were treated equally and had to acquire shares proportionately from shareholders<sup>94</sup>.

Shareholders of listed companies received additional protection in that the Companies Act, 1973 prescribed that additional requirements for the repurchase of listed shares may be included by the Johannesburg Stock Exchange. If a transaction was classified as an affected transaction in terms

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<sup>94</sup> S 85 to 87 of the Companies Act, 1973.

of section 440A, further protection was granted to shareholders and a company had to adhere to requirements of the Securities Regulation Code on Takeovers and Mergers<sup>95</sup>.

The solvency and liquidity test in the Companies Act, 1973 went a long way in improving the protection of shareholders, but the wording of section 85(4)(a) with specific reference to the liquidity test, specifically the wording “*there are reasonable grounds for believing that*” was in a sense too wide and didn’t require any proof from the directors that they had applied their minds to the test.

Lastly the Companies Act, 1973 also required authorisation in the company’s Articles of Association to approve an acquisition by a company of its shares.

The Companies Act, 2008 provides protection to shareholders in terms of sections 46 and 48. Van der Linde described it as follows: “*The new Companies Act dispenses with authorisation in the company’s constitution and shareholder*

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<sup>95</sup> Cilliers et al. “Corporate Law” at 325 – 326.

*approval by resolution.*<sup>96</sup> The decision by a company to repurchase its shares now lies with the board of directors. It seems that the process to be followed will be that the company will make an offer to the shareholders which offer the shareholders can accept or reject. Delport highlights the fact that there are no requirements that a specific process had to be followed as was the case in the Companies Act, 1973 and described his view as follows: *“There is no requirement that the offer must be made to all the shareholders or that pro rata offers and/or acceptances, based on existing interests in the company, must be made. The possibility for abuse is therefore clear.”*<sup>97</sup>

Further protection is provided in that the directors have to comply with section 48 by applying the solvency and liquidity test as set out in sections 4 and 46 of the act<sup>98</sup>. The solvency and liquidity test as discussed earlier in this chapter requires the directors to apply an objective and a subjective test based on financial statements and records and all reasonable foreseeable financial circumstances. Section 4(2)(a) of The

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<sup>96</sup> Van der Linde “Share Repurchases and the Protection of Shareholders” at 302.

<sup>97</sup> Delport “The New Companies Act Manual” at 61.

<sup>98</sup> The Companies Act, 2008.

Companies Act, 2008 further requires the directors to make sure that the financial statements and accounting records adhere to the standards of sections 28 and 29 of the act respectively, which places more responsibilities on directors to consider all relevant and up to date financial information before acquiring the shares of the company<sup>99</sup>. The board may rely on reports, opinions and statements prepared by others in exercising their judgment unless they have knowledge or ought to have known that the information supplied is suspicious<sup>100</sup>.

The directors also have to consider a fair valuation or any other valuation that is reasonable in the circumstances, of the company's assets and liabilities when applying the solvency and liquidity test. Section 46(1)(c) of the Companies Act, 2008 specifically requires the board of a company to by resolution acknowledge that it has applied the solvency and liquidity test as set out in section 4 of the act. This requirement places a positive duty on directors to formally by resolution acknowledge that they have applied their minds and are thus more likely to prevent unlawful distributions which

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<sup>99</sup> S 4(2)(a)(i) and (ii) of the Companies Act, 2008.

<sup>100</sup> Cassim et al "Contemporary Company Law" at 251.



may compromise the position of creditors and shareholders. Further protection is extended to shareholders in that if the distribution has not been completed within 120 business days after the formal acknowledgement of the board, the board must reconsider the solvency and liquidity test and the company must not proceed with any such distribution unless the board adopts a further resolution<sup>101</sup>.

Sections 48(2)(b)(i) and (ii) of the Companies Act, 2008 extend the protection to shareholders by regulating shareholding by a subsidiary or subsidiaries to not more than 10% in aggregate of the shares in the holding company and to strip the shares of their voting rights for as long as it's held by the subsidiary. Together with sections 48(3)(a) and (b), section 48(2) protects shareholders from abuse of control over the company by the company or a subsidiary<sup>102</sup>. The reason that shareholders need protection against a subsidiary acquiring shares in its holding company is that the holding company does not gain any economic benefit from shareholding in it by its subsidiary. Coetzee J said in *The*

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<sup>101</sup> S 46(3)(a) and (b) of the Companies Act, 2008. See also Delport "The New Companies Act Manual" at 59, see footnote 34.

<sup>102</sup> The Companies Act, 2008.

Unisec Group Ltd v Sage Holdings Ltd<sup>103</sup> with regard to interrelated companies: *“In addition, the true financial state of the holding company can be effectively masked from the eyes of its shareholders.”* Oppression of the minority shareholders of the subsidiary can also take place when funds of their company are used to pay out shareholders of its holding company<sup>104</sup>.

Section 48(8)(a) of the Companies Act, 2008 requires approval from shareholders by a special resolution 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<sup>105</sup>. This is to make sure that the shareholders approve a board resolution to acquire a director or prescribed officer’s shares and are thus informed of the detail of the transaction and is aimed at preventing directors from abusing their positions to benefit themselves<sup>106</sup>.

Section 48(8)(b) of the Companies Act, 2008 protects shareholders by requiring that if the acquisition of shares by

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<sup>103</sup> The Unisec Group Ltd v Sage Holdings Ltd 1986(3) SA 259 (T).

<sup>104</sup> Cassim et al “Contemporary Company Law” at 287.

<sup>105</sup> The Companies Act, 2008.

<sup>106</sup> Cassim et al “Contemporary Company Law” at 277.

the company alone or together with other transactions in an integrated series of transactions has the effect that more than 5% of the issued shares of any class of the company's shares is acquired, the repurchase must be done by way of section 114 (scheme of arrangement) and section 115 (fundamental transaction)<sup>107</sup>. In terms of section 114(2) of The Companies Act, 2008 an independent expert must compile a report which contains all the information to enable shareholders to give approval of a transaction for the company acquiring its own shares<sup>108</sup>. Section 115 of the Companies Act, 2008 prescribes the process to be followed by the company to get the approval of shareholders and requires a special resolution by shareholders<sup>109</sup>. Sections 114(2)(a) and (b) prescribe the qualifications of the expert and further elaborate about the requirements of the independence of the expert in relation to the company.

Some writers are of the opinion that the thinking behind section 48(8) of the Companies Act, 2008 is to reconcile the requirements of sections 48(8) and 114 of the act. The

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<sup>107</sup> Delpont "The New Companies Act Manual" at 60.

<sup>108</sup> S 114(1)(e) and 114(4) of the Companies Act, 2008.

<sup>109</sup> S 115(2)(a) and (b) of the Companies Act, 2008.

distinction is that section 48 is to deal with once of decisions to acquire shares while section 114 is to address fundamental changes to the company's capital structure<sup>110</sup>.

Section 37(1) of the Companies Act, 2008 provides protection to shareholders in a broader sense and stipulates that all of the shares of any particular class authorised by a company have preferences, limitations and other terms that are identical to those of other shares of the same class. Van der Linde<sup>111</sup> suggests that this implies that all shares of a class must be treated equally unless the Memorandum provides otherwise.

Van der Linde states further: *“Depending on one’s interpretation of the quoted phrase, one could argue that this provision rules out selective repurchases within a class. This would protect shareholders against selective repurchases unless the Memorandum expressly allowed discrimination, in which case shareholders would have been alerted in advance to the possibility of unequal treatment.”*<sup>112</sup>

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<sup>110</sup> Cassim et al “Contemporary Company Law” at 277.

<sup>111</sup> Van der Linde “The Regulation of Distributions to Shareholders in the Companies Act 2008” at 486. See also S 36(1)(b)(ii), 37(2)(b) and 37(4) of the Companies Act, 2008.

<sup>112</sup> Van der Linde “Share Repurchases and the Protection of Shareholders” at 303.

Shareholders have different remedies at their disposal to protect their interests in the company and enforce their rights against the company and directors.

Any distribution by a company prohibited by section 46 of the Companies Act, 2008 is not void, unless declared void by a court. Any acquisition by a company of its shares is enforceable unless the company is in breach of sections 48(2) and (3). The company can apply to court to reverse the acquisitions and order any shareholder to repay the amount received from the company<sup>113</sup>.

The company can also act against the directors who did not comply with section 46 read with section 77(3)(c)(vi) of the Companies Act, 2008. The meaning of director is an extended one as in section 77(1) of the act and liability follows without the transaction having to be declared void<sup>114</sup>. The company can further act against a director in terms of section 48 read with section 77(3)(c)(vii). In both cases the directors are liable for any loss, damages or costs sustained by the company as a direct or indirect consequence thereof.

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<sup>113</sup> Delpont "The new Companies Act Manual" at 59 and 61.

<sup>114</sup> Delpont "The New Companies Act Manual" at 60, see footnote 49.

Shareholders can firstly, through section 165(2)(a) of the Companies Act, 2008 serve a demand on the company to take action against a director or any other person to protect the legal interests of the company. Shareholders can thus make sure that the company takes action if a director is liable under sections 46 or 48 of the act.

If a shareholder can convince the court that he was subjected to oppressive or prejudicial conduct in the process of a company acquiring its shares then that shareholder can obtain an order to protect his interest in the company in terms of section 163 of the Companies Act, 2008. The court in this instance has wide-ranging powers in terms of section 163(2) (a) to (l) of the Companies Act, 2008. Van der Linde sees it as follows: *“This is evident from the availability of the oppression remedy to a shareholder on the basis that the exercise by a director of her power is oppressive or unfairly prejudiced to or ‘unfairly disregards’ the interests of that shareholder.”*<sup>115</sup>

Section 163(1)(c) of the Companies Act, 2008 may provide further possible protection according to Van der Linde in that

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<sup>115</sup> Van der Linde “Share Repurchases and the Protection of Shareholders” at 304.

the conduct of a person related to the company may also provide protection to a shareholder. She explains that this could be possible in the case of a shareholder where alone or together with persons who are in turn related to the shareholder they can control the majority of the voting rights of a company and a minority shareholder can then argue that the majority shareholder should take the interests of other shareholders into account. I support this view.

Section 218(2) of the Companies Act, 2008 provides a shareholder with the right, by way of a civil action, to claim any loss or damage suffered by him from any person as a result of a contravention of any provision of the Companies Act, 2008. It is clear from this section that a director can be liable to a shareholder if in the process of a company acquiring its shares one or more of the provisions of the Companies Act, 2008 are not adhered to. Section 218 clearly confirms that subject to any provision in this act specifically declaring void an agreement, nothing in the act renders void any agreement, resolution or provision of an agreement unless a court has made a declaration to that effect regarding the agreement<sup>116</sup>.

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<sup>116</sup> S 218(1) of the Companies Act, 2008.

Section 218(3) of the Companies Act, 2008 further stipulates that the provisions of this section do not affect the right to any remedy that a person may otherwise have.

It is important for shareholders to take note of section 77(7) of the Companies Act, 2008 in that any proceedings against a director to recover loss, damages or costs may not be commenced more than three years after the act or omission that gave rise to that liability. A contradiction between sections 218(1) and 77(7) of the Companies Act, 2008 may give rise to confusion in that a court must declare an agreement void which indicates that prescription starts running from that date whereas section 77(7) refers to the date of the act or the omission<sup>117</sup>.

Lastly, although a shareholder has different options to choose from in protecting his interest in the company, the most effective mechanism seems to be to focus on the duties of directors. Van der Linde highlights this. “*Directors in South Africa are expressly required to exercise their powers for a proper purpose.*” I agree with her in this regard and she

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<sup>117</sup> Cassim et al “Contemporary Company Law” at 262.



elaborates that: *“Although directors have to act in the best interest of the company, they have to take into account the interest of different shareholders.”*<sup>118</sup>

Shareholders with preferent shares do not receive additional protection through the working of the solvency and liquidity test unless so required by the company’s Memorandum of Incorporation. The only exclusion is that section 48 of The Companies Act, 2008 does not apply to the redemption by the company of any redeemable securities in accordance with the terms and conditions of these securities. Due to the working of section 37(5) of the Companies Act, 2008 redeemable shares will still be subject to section 48 of the act<sup>119</sup>.

The tax implications to the company is that in terms of the new definition of "dividend" in the Income Tax Act 58 of 1962 the company will be exempted from paying tax if:

- The acquisition was by a listed company in accordance with the Johannesburg Stock Exchange requirements  
or

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<sup>118</sup> Van der Linde “Share Repurchases and the Protection of Shareholders” at 304.

<sup>119</sup> Delpont “The Companies Act Manual” at 60, see footnote 52.

- In the event of a non listed company buying back its own shares, the amount paid for the acquisition of the relevant shares to the extent that it results in a reduction of its contributed tax capital.

The standard exemption of dividends received by a shareholder in terms of section (10)(1)(k)(i) of the Income Tax Act, 1962 still applies unless the shares bought back were held as trading stock<sup>120</sup>

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<sup>120</sup> Kruger " Share Buy Backs".

## CHAPTER 5

### **CONCLUSION – SECTION 48 OF THE COMPANIES ACT, 2008**

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The main aim of capital rules was to protect shareholders and creditors of the company against dilution of their interests in the company. As mentioned in chapter 1 of the dissertation, these rules were complex and fell short of their main aim to protect shareholders and creditors.

The introduction of the solvency and liquidity test into South African company law provided more effective protection to interested parties. Sections 85 - 87 of the Companies Act, 1973 prescribed rules and procedures to be followed and included shareholder participation requiring a special resolution, and authorisation in its Articles of Association before a company could acquire its own shares.

Section 48 of the Companies Act, 2008 introduced a process where directors of the company can decide on repurchases. Companies thus have the authority to decide, subject to the extended application of the solvency and liquidity test, to purchase their own shares. The

solvency and liquidity test in the Companies Act, 2008<sup>121</sup> provides improved protection for all interested parties in comparison with the Companies Act, 1973.

Although the provisions in sections 85 to 89 of the Companies Act, 1973 has not been taken up in the Companies Act, 2008 the extended solvency and liquidity test provides improved protection by placing a bigger responsibility on directors to consider all relevant financial information before deciding on a repurchase of shares.

There are, however, a few areas in which I propose that the solvency and liquidity test can be improved. Firstly as Van der Linde points out: *“I think the subtle differences in the way in which the solvency and liquidity test must be applied in different circumstances cause unnecessary complexity, for example what is the difference between being satisfied, reasonably believing and concluding? Is there a difference between considering and applying the test?”*<sup>122</sup> I agree with her that all the provisions where the solvency and liquidity test are used should be harmonised.

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<sup>121</sup> S 4 of the Companies Act, 2008.

<sup>122</sup> Van der Linde “The Solvency and Liquidity Approach in the Companies Act, 2008” at 237.

Secondly, although the protection given to interested parties by section 46(2) of the Companies Act, 2008 in that if a distribution is not completed within a 120 day period the directors have to reconsider the solvency and liquidity test and adopt a further resolution before the company may proceed, the question remains what happens if within the 120 days the board realises that the company will not pass the test anymore but the act states that the company will be obliged to proceed<sup>123</sup>.

I agree with Van der Linde's recommendation that a company should be prohibited from proceeding with a distribution if the directors are no longer satisfied that the company does not or cannot comply with the solvency and liquidity test<sup>124</sup>.

The inclusion of Section 48(8)(a) in the Companies Act, 2008 provided improved and more adequate protection for shareholders in that a special resolution by shareholders is required when a company acquires its shares from a director or prescribed officer, or related person to a director or prescribed officer. This clearly delayed the fears of directors abusing their powers to buy shares at inflated

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<sup>123</sup> S 46(2) of the Companies Act, 2008.

<sup>124</sup> Van der Linde "The Solvency and Liquidity Approach in the Companies Act, 2008" at 239.

prices. Section 48(8)(b) also improved protection by giving shareholders more information and requiring a specific process to be followed in terms of sections 114 and 115 of the Companies Act, 2008.

There are, however, a few areas in which section 48 of the Companies Act, 2008 (read with section 46) could have provided additional protection according to Van der Linde<sup>125</sup> and I agree with her on the following issues:

- Coercive purchases remain possible under the new act.
- The Memorandum of Incorporation should authorise repurchases.
- No protection for shareholders with preferential rights through the application of the solvency and liquidity test.

Section 48 of the Companies Act, 2008 created a new, relaxed process and is less prescriptive on the steps that should be followed. In the light of the above it is vital that the directors satisfy themselves that they have applied the solvency and liquidity test before acquiring the company's shares. It is in this area that Van der Linde sees the

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<sup>125</sup> Van der Linde "Share Repurchases and the Protection of Shareholders" at 302 – 304.

development of directors' liability towards shareholders will take place. *“Shareholders will have to resort to general principles to protect themselves against unfair repurchases. Although reliance on fiduciary duties of directors and in particular on the proper purpose principle is possible, it may take time for the courts to develop its application in the context of repurchases.”*<sup>126</sup>

In this regard, section 5(2) of the Companies Act, 2008 allows for consideration of foreign company law to interpret and apply the act.

Finally, a call for the development of fiduciary duties of controlling shareholders owed to minority shareholders, into South African company law cannot be supported. I am of the opinion that the protection of shareholders and specifically minority shareholders are adequately catered for in the Companies Act, 2008 and that the basis of our company law, namely fiduciary duties by directors to the company and to the majority of shareholders as a group, should prevail.

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<sup>126</sup> Van der Linde “Share Repurchases and Protection of Shareholders” at 307.

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