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**ACQUISITION OF SECURITIES  
IN TERMS OF SECTION 48 OF THE COMPANIES ACT 71 OF 2008**

**by**

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## **ABSTRACT**

The Companies Amendment Act 37 of 1999 brought about a major change to the South African company law, the Amendment Act introduced share buyback provisions to our company law. The legislature had finally responded to numerous calls for amendments to our company law, particularly amendments that would make share buyback by a company of its own shares and share buyback by subsidiary company of shares in its holding company possible. The Amendment Act operated in a statutory scheme to which the capital maintenance doctrine was applicable, it was thus necessary that the Companies Act 61 of 1973 be overhauled and this was done through the enactment of the Companies Act 71 of 2008.

On 1<sup>st</sup> May 2011, the Companies Act 71 of 2008 finally came into effect. This study is principally about the provisions governing a company's acquisition of securities in terms of the new Companies Act. I will first give an exposition of the evolution of our Companies Act from capital maintenance to solvency and liquidity. I will then contrast the share buyback provisions of the 1973 Companies Act with the current Companies Act, I will also discuss and analyse the provision governing distributions in general and those pertaining to acquisition of securities in terms of section 48 of the Companies Act 71 of 2008.

## **KEY TERMS**

Capital maintenance; Solvency and liquidity; Distributions; Share buyback; Shares; Capital; Creditors; Shareholders; Directors; Board.

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## **CHAPTER 1**

### **1.1 Background of the study**

The advent of new ways of doing business and the rapid phase of globalization of sovereign economies has led to the evolution of company law. As a result of the evolution of company law, the Companies Act 61 of 1973 (“the old Act”) was found wanting in many respects in that it was not responsive to modern day needs of companies. The legislature had to respond to this change by enacting a new Act, the Companies Act 81 of 2008 (“the new Act”). The Companies Act of 2008 brought about sweeping changes to the then existing company law, one of the key objectives of the new Act was to be responsive to modern day needs of companies.

The change from the Companies Act 61 of 1973 to the Companies Act 71 of 2008 is a manifestation of an attempt to align the South African Companies Act with other jurisdictions whose company law legislation had been changed. Many of the countries that are our counterparts in the commonwealth have made major changes to their company law; countries like the United Kingdom, Australia, Canada and Australia have made major changes to their company law legislation in order to make it responsive to modern day needs of companies, shareholders and all other related stakeholders in commerce. It is for these reasons that the South African legislature undertook legislative reform of our company law to align it with international best practice.

The last time a comprehensive review of the South African company law was conducted was in 1963<sup>1</sup>, the review was conducted by the Van Wyk De Vries Commission<sup>2</sup>. The Van Wyk De Vries Commission was tasked with reviewing the Companies Act of 1926 which was in the main based on the English company law. The Van Wyk De Vries Commission led to a report which culminated in the enactment of the 1973 Companies Act, ten years later. Over a number of years there have been numerous amendments to the 1973 Companies Act, the most drastic one having been the Companies Amendment Act 37 of 1999<sup>3</sup> (“the amendment Act”).

Our company law has been influenced mainly by the English company law, and this includes both the English legislation and the English common law<sup>4</sup>. England has over a number of years made changes to its company law as indicated above, South Africa naturally had to follow suit and make changes to its Company law. In his foreword to the policy document which outlined the guidelines for company law reform in South Africa, the then minister of Department of Trade and Industry had this to say about our company law –

“The current framework of our company law is built on foundations, which were put in place in Victorian England in the middle of the nineteenth century. Since the introduction of the 1926 Companies Act there has only been one significant review of company law, which was initiated in 1963 and culminated in the Companies Act. 1973. Although a major review of company law in South Africa, the 1973 Act is still based on the framework and general principles of the English law. Significantly, the framework upon which our company legislation is based has been questioned in the land of its origin, England, where the review of core company law resulted in the

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<sup>1</sup> Government Gazette No.26493,23 June 2004 at Pg. 7.

<sup>2</sup> Van Der Linde KE “Aspects of the Regulation of share Capital and distribution to shareholders” (2008) at 260.

<sup>3</sup> The Companies Amendment Act 37 of 1999 introduced new concepts of Solvency and Liquidity into the South African company law.

<sup>4</sup> Van Der Linde KE “Aspects of the Regulation of Share Capital and Distribution to shareholders” (2008) at 251.

publication of the final report of the Company Law Review Steering Group in July 2002.”<sup>5</sup>

The above statement eloquently sums up the rationale behind the move to overhaul our company law, as will be discussed below, the new Act introduced a number of new concepts and in some instances existing concepts are further improved.

In 2004 the DTI released a document called *South African Company Law for the 21<sup>st</sup> Century; Guideline for Corporate Law Reform*<sup>6</sup>, this document can be described as a blue print for the process that led to the enactment of the new Act. According to the then Minister of the Department of Trade and Industry, the decision of the Department of Trade and Industry to review and modernize company law in South Africa was based on the need to bring our law in line with international trends and to reflect and accommodate the changing environment of business, both domestically and internationally.<sup>7</sup> One of the objectives of reviewing the 1973 Companies Act was to ensure that an appropriate company’s legislation is enacted to respond to the changed economic, legal and political situation in South Africa.

The objectives of the new Companies Act are amongst others, the development of the South African economy, promotion of innovation and investment in South Africa. The role of the Companies Act has been expanded and thus its role goes beyond regulating the relations between, shareholders, directors, creditors of a company. The Companies Act heralds a new way of doing things, at least in as far as company law is concerned. It is against this background that this study is conducted.

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<sup>5</sup> South African company law for the 21<sup>st</sup> century guidelines for corporate law reform. Notice 1183 of 2004 *Government Gazette* No 26493 of 23 June 2004 at 5.

<sup>6</sup> Ibid 3.

<sup>7</sup> Ibid 5.



The 1973 Companies Act, which was described in the company law reform policy document as “largely out of line with modern business practices and deficient in some critical areas, notably in the area of shareholder protection, capital rules and corporate governance generally,”<sup>8</sup> was finally repealed by the coming into operation of the Companies Act 71 of 2008 on the 1<sup>st</sup> May 2011. The new Companies Act is a culmination of work by various stakeholders under the auspices of the Department of Trade and Industry. The new Act was highly anticipated by all the stakeholders, the Jury is still out on whether the new Act lives up to its objective of transforming South African company law to be responsive to modern day commercial needs for all the relevant stakeholders<sup>9</sup>.

## 1.2 **Objectives of the study**

The objectives of this study are to critically analyze the provisions of the new Act in as far as they pertain to the regulation of an acquisition by a company of its own shares as well as the acquisition by a subsidiary company of shares in its holding company. The acquisition by a company of its own shares is governed by section 48 of the Companies Act 71 of 2008, we will thus pay particular attention to this provision and other relevant provisions that make the execution of section 48 possible.

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<sup>8</sup> South African company law for the 21<sup>st</sup> century guidelines for corporate law reform. Notice 1183 of 2004 *Government Gazette* No 26493 of 23 June 2004 at 19.

<sup>9</sup> *Ibid.*

### 1.3 **Research Question**

The research question that this paper seeks to answer is whether Section 48 of the Companies Act 71 of 2008, which makes provision for the company to acquire its own shares, is an evolution of the amended 1973 Act or is a total change. The problem with the 1973 Act was that, as a result of numerous amendments, the Act had both the capital maintenance rules as well as the solvency and liquidity test co-existing in the same legislation. We thus assess the changes that have been brought about by the new Companies Act, particularly in light of the fact that it has done away with the old capital maintenance rules in our company law.

### 1.4 **Limitations**

The study focuses primarily on the acquisition by the company of its own shares and the acquisition by the subsidiary of shares in its holding company, the study will assess the share buyback process as one of the various forms of distributions that are possible under the Companies Act. A particular bias will be on Section 48 of the Companies Act 71 of 2008.

### 1.5 **Methodology**

I will be using a comparative and critical analysis methodology in assessing both the old Act as well as the 2008 Act. The Comparison would largely be on Section 48 as well as corresponding provisions of the old Act. I will be referring to the existing body of work on the subject matter i.e. literature, contrasting views of various commentators on the subject, case law and other relevant material in this study.

## 1.6 **Chapterization**

### **Chapter 1**

The first chapter captures in essence what has been discussed above, which is the outline of the dissertation.

### **Chapter 2**

The second chapter captures the origin, development and the evolution of the capital maintenance rules in South Africa. I will interrogate the origin and rationale for the existence of the capital maintenance rules and also the reasons that led to their demise in our company law. There have been debates about the rationale for the existence of these rules in our law, many commentators have questioned their continued existence in our law prior to reformation of the South Africa company law. I am of the opinion that an in depth discussion on the capital maintenance rules is critical to understanding distributions as well as the solvency and liquidity rules under the new Companies Act.

### **Chapter 3**

This chapter will thoroughly discuss the concept of distribution as well as the two tests namely solvency and liquidity test. The twin concepts of solvency and liquidity are interwoven with capital rules as to a large degree the coming into our law of these tests has rendered capital rules obsolete. There can be no reduction of capital or distributions without the application of the solvency and liquidity test, for instance the solvency and liquidity test is a precursor test that needs to be applied before a company can embark on a share buy-back program. It is against this backdrop that I

will be discussing the concept of distribution and the solvency and liquidity test in this chapter.

#### **Chapter 4**

This chapter will deal with the buy-back of shares by a company of its own shares and the acquisition by a subsidiary company of shares in its holding company, as well as the process laid out in section 48 of the Act. A comparison will also be made between the corresponding provisions of the repealed Companies Act of 1973. The contrasting views of academics, authors and commentators will also be canvassed on this topic.

#### **Chapter 5**

In this last chapter I will evaluate, assess and conclude on the research question posed above and conclude and make recommendation on the various chapters dealt with above.

## **CHAPTER 2**

### **THE MAINTENANCE OF CAPITAL RULES DOCTRINE AND THE EVOLUTION OF SOUTH AFRICAN COMPANY LAW**

#### **2.1 Introduction**

In this chapter I will interrogate the origin and rationale for the existence of the capital maintenance rules and also explore the reasons that led to the demise of this rules in our company law. The aim of the capital maintenance doctrine at inception was to ensure the protection of creditors, this however changed over the years, as a result of this change there was a strong view calling into question the relevance of the capital maintenance doctrine. There have been debates about the relevance of the doctrine in our law, many commentators and academic authors alike questioned the continued existence of the capital maintenance doctrine in our company law.

#### **2.2 Origin of Capital Maintenance Rules**

When a company is formed, members contribute to the joint share capital by subscribing to shares in the company, that which is contributed by the members is referred to as capital. The capital maintenance doctrine is primarily concerned with the preservation of capital contributed by members of a company to the Joint capital. Gullifer and Payne aptly described legal capital rules “as a set of provisions that constrain corporate activity by reference to the shareholders’ capital investment. Broadly, these rules fall into two categories, those that regulate how capital can be raised from shareholders, and in particular how much capital shareholders must invest into a company, and those that regulate whether and how capital can be

returned to the shareholders. The primary purpose of these rules is to regulate the conflict that exists between creditors and shareholders regarding how to allocate a company's capital."<sup>10</sup> At the heart of the capital maintenance doctrine is the prohibition of the return of capital to members or shareholders of the company other than through a formal reduction of the company's issued share capital. The capital maintenance doctrine and the concept of limited liability were at one stage the fundamental pillars of our company law as we have come to know it.

The capital maintenance rules have their origin in the English company law and because of the erstwhile historical relations between England and South Africa the rules established and developed by the English courts found their way to various commonwealth jurisdictions, including South Africa. The 1926 and the 1973 Companies Act in South Africa were based on English legislation and the English common law<sup>11</sup>.

The leading case that cemented capital maintenance doctrine as cardinal to our company law is the nineteenth century case of *Trevor v Whitworth*<sup>12</sup>, a decision of the House of Lords. In this case the court held that a company could not purchase its own shares either under the Companies Act, or even if authorized by its memorandum. Capital was seen by the court as the only security for the company's creditors and must, as such, not be diminished except as authorized by law<sup>13</sup>. The court observed the following regarding share capital of a company;

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<sup>10</sup> Gullifer and Payne (2011) 115.

<sup>11</sup> Van der Linde KE(2008) "Aspects of the regulation of share capital and distributions to shareholders" at 251.

<sup>12</sup> *Trevor v Whitworth* (1887) 12 App Cas 409 (HL).

<sup>13</sup> Nwafor AO (2011) MqJBL Vol 8 pg. 2.

*“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>14</sup>*

The capital maintenance doctrine were there to place a restriction on how shareholders deal with the company share capital and to ensure the preservation of the share capital as a guaranteed fund from which creditors can look to recoup whatever money is owed to them<sup>15</sup>. The above mentioned decision of *Trevor v Whitworth* set in motion what was to become capital maintenance rules and the reach of the application of these rules went beyond the realm of just prohibiting the purchasing by a company of its own shares.

The capital maintenance doctrine initially consisted of three rules which were as follows; that a company may not acquire its own shares and also that a company may not pay dividends out of capital, lastly that a company may not issue shares at a discount.<sup>16</sup> The capital maintenance doctrine envisaged that a company with a share capital will not return the said share capital to the shareholders during the existence of the company, and that, the only time a return of capital to a shareholder would be possible, is where the return of capital is sanctioned by legislation.<sup>17</sup>

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<sup>14</sup> *Trevor v Whitworth (1887) 12 App Cas 409 (HL) 423-424.*

<sup>15</sup> FHI Cassim “The Reform of Company Law and the Capital Maintenance Concept” (2005) 122 SALJ 283 at page 285.

<sup>16</sup> Cilliers et al (2000) 322.

<sup>17</sup> Van der Linde KE (2008), “Aspects of the regulation of share capital and distributions to shareholders” at 21.

Cilliers and Benade et al are of the view that the capital maintenance rule did not develop as an independent rule, and that the rule has its origin from the extension of the *ultra vires* rule<sup>18</sup>. In addition, Cilliers and Benade et al are of the view that the capital maintenance doctrine prescribes that “the act in respect of the capital must not be ultra vires and must not prefer the shareholders above the creditors.”<sup>19</sup>

The Department of Trade and Industry policy document, South African Company Law for the 21<sup>st</sup> Century, Guideline for Corporate Law Reform outlines the South African policy view on capital maintenance as follows;

*“South Africa company law has always accepted the principle that a company’s share capital is effectively a guarantee fund for its creditors. As such the creditors have had the assurance that the capital of the company, which is initial safeguard required for the right of limited liability, will not be diminished other than in the ordinary of business or in accordance with the provisions of the Companies Act. In addition to the Companies Act, various common law principles constitute a further safeguard that companies should not, other than in limited circumstances, reduce their share capital. In this regard mention may be made of the prohibition against the purchase by a company of its own shares as being part of the foregoing common law principles<sup>20</sup>.”*

The above policy position is a reflection of the South African jurisprudential position on the capital maintenance doctrine. South African courts have been consistent in applying the capital rules as was originally applied by the English courts. There are numerous decisions where our courts had to grapple with the question of capital

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<sup>18</sup>See footnote 17 above.

<sup>19</sup>Ibid.

<sup>20</sup>“Purchase by a Company of its own shares” Department of Trade and Industry, Notice 724 of 1998, *Government Gazette* No.18868, 8 May 1998.



maintenance, in all those decisions our courts did not depart from the position as originally formulated by the House of Lords in the *Trevor v Whitworth* case. In order to illustrate this point, the reasoning of the court in the English case of *Ooregum Gold Mining Corporation of India Ltd v Roper*<sup>21</sup>, a case that dealt with the question of issuing of a company's shares at a discount, the court had this to say about the legal capital of a company; "*the capital is fixed and certain, and every creditor of the company is entitled to look to that capital as his security*"<sup>22</sup>, the reasoning of the court echoes the *Trevor v Whitworth* decision and it also informed by the fact that issuing of shares at a discount would affect the share capital of the company.

In a South African case of *Cohen No v Segal*<sup>23</sup> the court had to rule on the issue of paying dividends out of capital, and consistent with the precedent in the English case of *Ooregam* the court held that -

*"Whatever has been paid by a member cannot be returned to him and no part of the corpus of the company can be returned to a member so as to take away from the fund to which the creditors have a right to look they are to be paid. The capital may be spent or lost in carrying on the business of the company, but it cannot be reduced except in the manner and with safeguards provided by the statute"*<sup>24</sup>

The above reasoning echoes the *Ooregum* decision, it similarly echoes the *Trevor v Whitworth* decision where the Court held that "*one of the main objects contemplated by the legislature, in restricting the power of companies to reduce the amount of their capital as set forth in the memorandum, is to protect the interests of the public who*

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<sup>21</sup> *Ooregum Gold Mining Co of India Ltd vs Roper* 1892 AC 125 (HL)

<sup>22</sup> *Ibid* at 133.

<sup>23</sup> *Cohen NO v Segal* 1970 (3) SA.702 (W) at 705H.

<sup>24</sup> *Ibid*.

*may become their creditors.*<sup>25</sup> South Africa has been applying the capital maintenance doctrine consistently in addition to the common law doctrine of *ultra vires*. As would be seen below some of the aspects of the capital rules were either expressly legislated or either inferred as part of the ultra vires doctrine.

### 2.3 **Enactment of the Capital Maintenance Rules**

The common law maintenance of capital doctrine inspired the enactment of the following sections of the 1973 Companies Act: section 38 dealing with granting of financial assistance by the company for the acquisition or subscription of its own shares. According to Cilliers and Benade the prohibition on financial assistance has its origin in England, it came as a result of the common rule prohibiting companies buying their own shares being circumvented<sup>26</sup>.

Section 38 of the 1973 Companies Act prohibited financial assistance for the purchase or subscription of own shares by a company. In terms of section 38 “a company is prohibited from giving, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person or for any shares of the company, or where the company is a subsidiary company, of its holding company.”<sup>27</sup> Section 79 dealt with the payment of interest on share capital and sections 81 and 82 dealt with the issue of shares at a discount.

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<sup>25</sup> Ooregum Gold Mining Corporation of India Ltd v Roper (1887) 12 App Cas 409.

<sup>26</sup> Cilliers et al (2000) 329.

<sup>27</sup> Ibid.

There was uncertainty with regard to the acquisition of shares by a subsidiary company in its holding company, what was uncertain was whether the common law rule prohibiting the acquisition by a company of its own shares extended to the prohibition of an acquisition by a subsidiary of shares in its holding company<sup>28</sup>. Section 39 of the Companies Act 61 of 1973 extended the reach of the common law prohibition on a company acquiring its own shares by prohibiting, subject to certain exceptions, the acquisition by a subsidiary company of shares in its holding company.

According to Delpont<sup>29</sup>, section 39 was intended to exclude the indirect purchase of or speculation in its own shares by the holding company and the artificial increase in dividends<sup>30</sup>. Section 39 also served to curtail abuse of control as was highlighted in the *Unicec Group and Others v Sage Holdings Ltd*<sup>31</sup>, Coetzee J eloquently captures the historical reasoning behind this prohibition as follows-

*“Since the earliest days of company law it has been firmly recognized that a company cannot buy its own shares for the reasons set forth by Lord HERSCHELL in Trevor v Whitworth (1887) 12 AC 409 (HL) at 416...the illegality and voidness of such a purchase actually came to be regarded as part of the common law and is so treated in a number of judgments and by text book writers. The prohibition against acquisition was not expressly contained in any of the company statutes until some 50 years ago. So fundamental is this principal. Our 1926 Companies Act, which followed the English Companies Act very closely, did not contain any provision expressly prohibiting such purchases and moreover contained no provisions at all relating to subsidiary or holding companies. The employment of a company’s fund in the*

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<sup>28</sup> Deeksha Bhana “The company law implications of conferring a power on a subsidiary to acquire the shares of its holding company” (2006) 232 Stell LR at 236.

<sup>29</sup> PA Delpont “Company Groups and Acquisition of shares” (2001) 13 SA Merc LJ at 124.

<sup>30</sup> Ibid.

<sup>31</sup> *Unicec Group and Others v Sage Holdings Ltd* 1986 (3) SA 259 (T).

<sup>33</sup> *The Unisec Group Limited v Sage Holdings Limited*, 1986 (3) SA 259 (T) 264-265. *Sage Holdings Ltd v The Unisec Group Ltd* 1982 (1) SA 337 (W) 347-349.

*purchase or, in loans upon security of the company's shares, was usually dealt with only in the articles but was illegal even in the absence of such a prohibiting article.*<sup>32</sup>

These provisions are but just some of the provisions which reflect the era of the capital maintenance doctrine in our company law as reflected in the companies Act 73 of 1973. The inclusion of these rules in our Companies Act merely served to complement the existing common law and in some instances served to extend the reach of the rules to bring about more certainty.

#### 2.4 **The Position of Capital Maintenance Rules Presently**

The capital maintenance rule was intended for the protection of the company's creditors as the concept of limited liability indemnified shareholders against any advances by the company creditors for the company's debt, thus the share capital was seen as a guarantee fund to protect creditors<sup>33</sup>. This reasoning was eloquently put by Bernard McCabe in his article on *The Desirability of Share Buy-Back Power*. McCabe argues as follows-

*"The capital maintenance doctrine which the Lords recognized in Trevor v Whitworth was borne out of concern for the position of creditors in the wake of the development of the concept of limited liability. Creditors were, in effect, generally prevented from having recourse to the company's shareholders in the event that the company could not pay its own debts. Creditors were forced to rely exclusively on the assets—the capital-of the company for repayment. It was thus of fundamental importance to creditors that asset base be preserved as far as possible"*<sup>34</sup>.

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<sup>33</sup> FHI Cassim "The reform of company law and the capital maintenance concept" (2005) 122 SALJ 283 at page 284.

<sup>34</sup> Bernard McCabe "The Desirability of a Share Buy-Back Power" (1991) Vol 3 Bond Law Review, Issue1, Article 6 at page 177.

The paid up capital of the company constituted the total sum that shareholders of a company were required to put at risk.

There are varying views on the accuracy of this view, some authors are of the view that the term capital maintenance is misleading, as capital could be diminished in the course of the company's trading, and the company is under no obligation to recapitalize the company once the share capital has been diminished. I agree with the view that capital maintenance was indeed a misnomer, as the old Act did not prescribe a minimum capital that the company would have to retain.<sup>35</sup>

The formation of a company brings about number of competing interests into being, there is usually a conflict between those that are tasked with managing the company and shareholders of a company, as well as the competing interest between shareholders and creditors of the company. Over the years a number of questions arose, for instance, the question of whose interests are best served by the maintenance of capital rules? Are the legal capital rules the most effective way to protect the interest of creditors of a company? In what follows, I will respond to some of these questions as well as the reasons that led to the demise of the capital maintenance doctrine in South Africa.

While there was consensus that the share capital of the company is a guaranteed fund that is available to creditors in the event that a company defaults on its obligations to creditors. The wisdom of this reasoning has come into question in

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<sup>35</sup> Delpont P "Capital Rules in South African Company Law"(1993) 26 De Jure 406 at page 408, see also Recent Developments in Corporate Law ; Acquisitions by a Company of its Own Shares (2000) 12 SA Merc LJ 5.

recent times, mainly because in reality creditors do not even look to the share capital of a company when deciding to do business with the company. Cassim is of the opinion that, the theory that creditors deal with a company on the mere make-up of its issued share capital is fictional, he is further of the view that it is in very few instances whereby a creditor would use the company's issued share capital as a measure of its creditworthiness.<sup>36</sup> Cassim's view is echoed by a number of authors<sup>37</sup> including Stein and Everingham who opine that the make-up of a Company's share capital is of no consequence to a third party who has to make a decision on whether to lend money or grant credit to a company, the only thing that can come out of that inquiry by a creditor is the capital structure of the company<sup>38</sup>.

The capital maintenance doctrine did not serve both shareholders and directors alike, furthermore its efficacy in protecting creditors was in way a fiction or very theoretic in nature and with little practical relevance<sup>39</sup>. According to Stein and Everingham<sup>40</sup>, the biggest shortcoming of the maintenance of capital rules was the fact that, while it consisted of some of the characteristics of the solvency element, it never addressed the liquidity element. South Africa thus began to sever ties with the doctrine of capital maintenance in 1999. The call for the amendment and the reform of our company law<sup>41</sup> has been there for almost three decades. In his call for reform in the Transactions of the Centre for Business Law publication, 1989, the then

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<sup>36</sup>FHI Cassim "The reform of company law and the capital maintenance concept" (2005) 122 SALJ 283 at page 285

<sup>37</sup> See also Van Der Linde KE (2008) "Aspects of the regulation of share capital and distribution to shareholders" at pages 25-27.

<sup>38</sup> Stein et al (2011) 151.

<sup>39</sup> CP Briggs "The Purchase by a company of its own Shares" (1981) *De Rebus* June at page 293.

<sup>40</sup> Stein et al (2011) 174.

<sup>41</sup> Delpont P "Capital Rules in South African Company Law" *De Jure* (1993) volume (26) 406-413.

chairperson of the Standing Advisory Committee on Company Law, Judge Goldstone had this to say-

*“The principles of capital maintenance have undergone significant changes in almost all countries and this process has been significantly influenced by developments in the United States. The modern notion of capital maintenance is that Companies may reduce capital, including the acquisition of their own shares, subject to solvency and liquidity criteria. This has the advantage of affording protection to creditors whilst at the same time giving flexibility to companies to achieve sound commercial objectives. It also noteworthy that recognition of this concept has already been accorded by South African corporate law in the close corporation Act of 1984.”<sup>42</sup>*

These calls for reform in the South African Company law only became a reality in 1999 with the promulgation of the Companies Amendment Act 37 of 1999.

After many years of existence, the capital rules were replaced by the solvency and liquidity test which was introduced by the Amendment Act of 1999<sup>43</sup>. The Companies Amendment Act brought about fundamental changes to our company law<sup>44</sup>. At the time the amendment Act was enacted, the principles of capital maintenance had undergone significant changes in almost all countries including the commonwealth. The move towards the complete abolishment of capital maintenance doctrine in our law was given further impetus by the enactment of the Corporate Amendment Act 24 of 2006. The Amendment Act of 2006 brought about a new exception to the prohibition of financial assistance by a company for the purchase or subscription of its own shares.

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<sup>42</sup> See Preface by Judge Goldstone to the Transactions of the Centre for Business Law (1989).

<sup>43</sup> Companies Amendment Act 37 of 1999.

<sup>44</sup> Kathleen Van der Linde, “Capital Maintenance is dead- long live solvency and liquidity” Juta Business Law, Vol 7 Part 4.

Section 85(1) of the Companies Amendment Act 37 of 1999 enabled a company to acquire its own shares provided the acquisition is authorised by its articles of association and that the share repurchase has been approved by a special resolution passed by the members of the company. Section 85(4)(a) and (b) of the 1973 Companies Act, prohibited any form of payment made for the acquisition of shares if it contravened the solvency and liquidity test. Section 90 of the Amendment Act also regulated payments made by the company to shareholders but excluded acquisition of shares which was regulated by section 85 and redemption of shares which was regulated by section 98.

The Companies Amendment Act 37 of 1999 set on course the changes that led to South Africa eventually abandoning the capital maintenance doctrine. The capital maintenance doctrine was embedded on the fabric of our company law in such a manner that an amendment could not eradicate all traces of the doctrine<sup>45</sup>. Van der Linde also points to the issue of having an Act that had the both solvency and liquidity test co-existing with the common law maintenance of capital rules and the kind of anomalies that arises from such a scenario<sup>46</sup>. A total overhaul of our companies was thus required to break away from any residual capital rules that remained after the introduction of the Amended Act. The Companies Act of 2008 is a manifestation of a complete move from the capital maintenance doctrine to the solvency and liquidity regime.

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<sup>45</sup> PA Delpont "Company Groups and Acquisition of shares" (2001) 13 SA Merc LJ at 121.

<sup>46</sup> Kathleen Van der Linde "Aspects of the Regulation of Share Capital and Distributions to Shareholders" at page 249., see also Kathleen Van der Linde "The Regulations of Distributions to Shareholders in the Companies Act " 2009 *Tydskrif vir die Suid-Afrikaanse Reg* 484 at 484-5 and Marc Cooke " A critical Analysis of the Regulation of Distributions by a Company's board" (2012) 24 SA Merc LJ.



## 2.5 **Conclusion**

In conclusion the legislature has done a fairly commendable job in overhauling our company law through a revamp of the Companies Act. The transition from South Africa being a capital maintenance jurisdiction to a jurisdiction where the solvency and liquidity is the prevailing test for any form of distribution by a company has modelled our law to be in line with international best practice. The change which began with the 1999 Companies Amendment Act has been widely welcomed; it has now been given further impetus by the new Companies Act.

## **CHAPTER 3**

### **THE REGULATION OF DISTRIBUTIONS IN TERMS OF SECTION 46 AND THE SOLVENCY AND LIQUIDITY TEST IN TERMS OF SECTION 4 OF THE COMPANIES ACT 71 OF 2008**

#### **3.1 Introduction**

This chapter will thoroughly discuss the concept of distribution as well as the twin test of solvency and liquidity with reference to the provisions of section 4 and section 46 of the Companies Act 71 of 2008. The coming into our law of the solvency and liquidity test has rendered the capital maintenance rule doctrine to be obsolete in our company law.

There can be no distribution without the application of the solvency and liquidity test. The solvency and liquidity test is a precursor test that needs to be applied before a company can embark on an acquisition of its own shares, the same holds true for other forms of distributions which are mentioned in the definition of distribution in the Companies Act 71 of 2008. It is against this backdrop that I will be discussing the regulation of distribution in our law and as well as the solvency and liquidity test in this chapter.

As discussed above, the concept of capital maintenance in our law partly ceased to exist in 1999 this was as a result of the introduction of the solvency and liquidity test by the Companies Amendment Act 37 of 1999. The Companies Act 71 of 2008

abolished the concept of capital maintenance in totality as was mentioned in the previous chapter.

The new Companies Act has the following as part of its objectives; to promote the development of the South African economy; encouraging entrepreneurship and enterprise efficiency; creating flexibility and simplicity in the formation and maintenance of companies and encouraging transparency and high standards of corporate governance given the significant role of enterprises within the social and economic life of the nation<sup>47</sup>.

The legislature has, in its quest to meet the objectives mentioned above attempted to balance the rights of both creditors and shareholders of companies as stakeholders broadly in companies. The expectations of shareholders to share in the profits of the company during its existence must be balanced against the expectations of creditors to receive payment.<sup>48</sup>

The challenges of balancing the competing interest of granting adequate protection to creditors versus that of granting flexibility to companies to deal with capital as they deem fit, have been there for some time. According to Van der Linde, shareholders have an expectation, but not a right, to receive a return on the capital they contributed to the company by sharing in its profits during its existence<sup>49</sup>. They also have a residual or reversionary interest in the company's net assets upon its

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<sup>47</sup>Section 7 (b) of the Companies Act 71 of 2008

<sup>48</sup> <sup>48</sup> K Van der Linde "Aspects of the Regulation of Share Capital and Distributions to Shareholders" (2008) at 14.

<sup>49</sup> K van der Linde "The regulation of distributions to shareholders in the Companies Act 2008" (2009) 3 TSAR 484.

dissolution, but no right to repayment of their contribution during the existence of the company.<sup>50</sup>

In his article, the new legal capital regime in South Africa, James J. Hanks aptly describes the rationale for the new distribution rules as envisaged by section 46 as follows;

*“since the early days of corporations, ‘legal capital’ the rules governing contributions to capital by shareholders and distributions from capital to shareholders has played a central and often vexed role in allocations of power and economics among the corporations, shareholders, board of directors, creditors and others. Most troublesome of all is whether (and, if so, how,) corporations or company law should try to balance the legitimate main concern of shareholders –that they will be able to realise a current return on their investment –with the chief concern of creditors –that the board of directors, elected by the shareholders, will, especially if the directors see the company is in trouble, drain it of funds and other assets, through dividends, share repurchases or otherwise, leaving insufficient assets to pay creditors<sup>51</sup>.”*

The question whether the new Act adequately protects creditors will remain with us for some, particularly given the fact that capital maintenance rules have finally been done away with. In his preface to the research report submitted to the Standing Advisory Committee on Company Law (“SAC”) in 1989, the then Chairperson of the SAC, Judge RJ Goldstone, had this to say in calling for reform to our Company Law,

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“the principles of capital maintenance have undergone significant changes in almost all countries and this process has been significantly influenced by developments in the United States. The modern notion of capital maintenance is that companies may reduce capital, including the acquisition of their own shares subject to solvency and liquidity criteria. This has the advantage of affording protection to creditors whilst at the same time giving flexibility to companies to achieve sound commercial objectives. It is also noteworthy that

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<sup>50</sup> Ibid 484.

<sup>51</sup> Mongalo TH (ed)(2009) 131 to 132.

recognition of this concept has already been accorded by South African corporate in the Corporation Act o1984.”<sup>52</sup>

The question is has the new Companies Act finally responded to this call which was made almost 25 years ago? Does it afford creditors protection? Does it give flexibility to companies to achieve sound commercial objectives with their capital? In what follows I will be discussing the regulation of distribution in our company law, as well as the dual test of solvency and liquidity and how the various company stakeholders are afforded protection during distribution.

### 3.2 **Distribution**

The term distribution is in the ordinary sense used to refer to payments in cash or in kind made by a company to its shareholders, either as a return on share capital or as a return of share capital<sup>53</sup>. The question may arise as to why the need to regulate shareholder distributions.

According to Van der Linde, distributions are governed by company law, firstly to ensure that the rights of creditors are safeguarded and secondly to ensure that shareholders are not disadvantaged by disproportionate payments either within a single class of shareholders or among various classes of shareholders which may exist in a company.<sup>54</sup> Van der Linde’s opinion is somewhat shared by Jooste, who is of the view that, in light of the fact that maintenance of capital principle has been abolished from our company law, it is necessary that the gap that arises as a result

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<sup>52</sup> Anton Trichardt, Karen Organ, Jeanne Cilliers “Purchase by a Company of its own shares”(1989) Tran CBL.

<sup>53</sup> K Van Der Linde “The regulation of distribution to shareholders in the Companies Act 2008” (2009) TSAR (3) 484 at page 484.

<sup>54</sup> Ibid 484.

of the abolishment of capital rules be closed, it is for this reason that shareholder distributions have to be carefully regulated by our law in order to protect the interest of creditors and minority shareholders.<sup>55</sup> In the previous chapter the maintenance of capital rules doctrine was thoroughly canvassed, for many years the doctrine was responsible for the protection of creditors, but with the evolution of time, that ceased to be the case. There was a need for a different legal framework that will protect the interest of both members and creditors alike, the legislature saw it fit to regulate the manner in which distribution will take place in order to replace the now defunct capital maintenance rules.

The 1973 Companies Act adopted a fragmented approach to shareholder distributions<sup>56</sup>, unlike the new Companies Act there was no uniformity in regard to the approach to distribution, in instances where distributions took place there were varying application of financial restrictions, and other relevant rules. There were thus separate and specific requirements for buyback of shares, payment of dividends or redemption of shares under the 1973 Companies Act.

The new Companies Act adopts a uniform approach for all distributions that are conducted in terms of the new Act. The following types of distributions amongst others are subject to section 46 of the Act, any consideration for the acquisition by the company of any of its shares as envisaged by section 48, any capitalisation of shares as contemplated by section 47.

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<sup>55</sup> R Jooste “issues relating to the regulation of ‘Distributions’ by the 2008 Companies Act”(2009) 126 (Part 4) SALJ 627 at page 627.

<sup>56</sup> K Van Der Linde “The regulation of distribution to shareholders in the Companies Act 2008” (2009) TSAR 3 at page 484.

Section 1 of Act 71 of 2008 defines distribution as;

*“a direct or indirect – (a) transfer by a company of money or other property of the company other than its own shares, to or for the benefit of one or more holders of any of the shares, or to the holder of a beneficial interest in any such shares, of that company or of another company within the same group of companies, whether –*

- (i) in the form of a dividend*
- (ii) as a payment in lieu of capitalisation share, as contemplated in section 47;*
- (iii) as consideration for the acquisition-*
  - a. by the of any of its shares, as contemplated in section 48;or*
  - b. by any company within the same group of companies, of any shares of a company within that group of companies; or*
- (iv) otherwise in respect of any of the shares of that company or of another company within the same group of companies, subject to section 164(19);*
  - a. -*
  - b. Incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares of that company or of another company within the same group of companies; or*
  - c. Forgiveness or waiver by a company of a debt or other obligation owed to the company by one or more holders of any of the shares of that company or of another company within the same group of companies, but does not include any such action taken upon the final liquidation of the company;”*

The above definition differs extensively with the definition of payment to shareholders in the 1973 Companies Act. Section 90 of the 1973 Companies Act is the equivalent of the current section 46 of the Act, the two provisions deal with regulation of payments to shareholders. Section 90 of the old Act by way of summary defines payment to shareholders as including any direct or indirect payment or transfer of money or other property to the company's shareholders. The above definition of distributions in section 1 of the Companies Act is much more comprehensive, it captures all instances which would not be construed as distributions under the 1973 Companies Act. The above definition augurs well for

creditors of companies, the definition protects their interest against deliberate dispossessions which may occur.

According to Van der Linde, the definition of distribution above acknowledges the group context in regard to distributions, the definition is wide enough to include distributions by a company to shareholders of other companies in the group where there is a holding company involved. It is thus possible to have distributions being made by a company to the shareholders of its subsidiary.<sup>57</sup>

The definition of distributions in the Companies Act has a broader meaning than the provisions of section 90 referred to above. The definition in the Act can be summarized broadly as dealing with the following themes, the transfer of money or other property to any shareholder, the incurrance of debt or other obligation by a company for the benefit of any other shareholder as well as the forgiveness or waiver by a company of debt or other obligations owed to the company by any shareholder. This is what would broadly constitute distributions and it may manifest itself in various ways, for instance, the provision of financial assistance to directors<sup>58</sup>, payment for capitalisation shares<sup>59</sup>, payment of dividends and any consideration by the company for the acquisition of its own shares or acquisition of shares of its subsidiary company<sup>60</sup>.

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<sup>57</sup> Ibid at 490

<sup>58</sup> Section 45 of the Companies Act 71 of 2008

<sup>59</sup> Section 47 of the Companies Act 71 of 2008

<sup>60</sup> Section 48 of the Companies Act 71 of 2008



The definition of distributions has received some criticism for its exclusion from the definition of shares surrendered to a company under the appraisal remedy. Section 164(19) of the act provides that;

*“for greater certainty, the making of a demand, tendering of shares and payment by a company to a shareholder in terms of this section do not constitute a distribution by the company, or an acquisition of shares by the company within the meaning of section 48, and therefore are not subject to (a) the provisions of that section; or (b) the application by the company of the solvency and liquidity test set out in section 4.”*

The exclusion of shares surrendered to a company from the definition of distributions has the effect of putting shareholders who have surrendered their shares in terms of Section 164, in an equal footing with creditors<sup>61</sup>. Van der Linde is of the view that the situation is worsened by the fact that a shareholder relying on the appraisal remedy is not required to prove prejudice as a result of the intended corporate action by a company<sup>62</sup>. I agree with Van der Linde, it does appear as if a shareholder who has surrendered shares through the appraisal remedy is better placed as such shareholders enjoys a preference that is akin to that of a creditor.

### 3.3 **The Regulation of Distributions in terms of Section 46**

Section 46(1)(a) of the Act sets out the prescripts that would require compliance by a company before it may embark on a distribution program. In terms of section 46(1)(a) , there can only be two instances were a distribution can take place, and this

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<sup>61</sup> Van der Linde “The regulation of distribution to shareholders in the Companies Act 2008” 2009 (3) TSAR 489

<sup>62</sup> *ibid.*

is when a distribution is pursuant to an existing legal obligation of the company, or a court order alternatively a distribution may take place when the board of the company, by resolution, has authorised the distribution<sup>63</sup>.

Section 46 of the Companies Act, in requiring a board resolution, has moved somewhat from the provisions of section 90 of the Companies Act of 1973. The implication of section 46 is that it excludes shareholders from deciding the issue of distribution by making it a responsibility of the board of the company unless the memorandum of incorporation of a company provides otherwise.

In terms of section 15(2)(a)(iii) of the Memorandum of Incorporation of any company may include a provision imposing on the company a higher standard, greater restriction, longer period of time or any similarly more onerous requirement, than would otherwise apply to the company in terms of an unalterable provision of this Act<sup>64</sup>. An alterable provision is defined in terms of Section 1 of the Companies Act 71 of 2008 as “a provision of this Act in which it is expressly contemplated that its effect 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”.<sup>65</sup>

Section 15(2) (a)(iii) makes it possible for a company to set a higher threshold to what is provided for by the Act, this is however only applicable to alterable provisions, thus a memorandum of incorporation of a company, may, in addition to a board resolution authorizing a distribution require shareholder approval.

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<sup>63</sup> Section 46(1)(a) of the Companies Act 71 of 2008.

<sup>64</sup> Section 15(2)(a)(iii) of the Companies Act 71 of 2008.

<sup>65</sup> Section 1 of the Companies Act 71 of 2008.

In making distributions a prerogative of the board unless otherwise stated or provided by the Memorandum of Incorporation, Section 46 of the Act gives impetus to Section 66(1) of the Act. Section 66(1) of the Act provides that, “the business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company’s Memorandum of Incorporation provides otherwise”.<sup>66</sup> The change of dispensing with the need for shareholder approval before a distribution can be authorised has been received with some reservations, some authors<sup>67</sup> see the change as very dangerous though the reservation can easily be mitigated by the provision of section 15(2)(a)(iii) referred to above.

In terms of section 46(1)(b)<sup>68</sup> a company may 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. Section 46(1)(b) is similar to Section 90(2)<sup>69</sup> of the 1973 Companies Act.

In addition to section 46(1)(b), section 46(1)(c)<sup>70</sup> provides that a company must not make any proposed distribution unless the board of the company, by resolution, has acknowledged that it has applied the 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.

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<sup>66</sup> Section 66(1) of the Companies Act 71 of 2008.

<sup>67</sup> Stein et al( 2011) 185.

<sup>68</sup> Section 46(1)(b) of the Companies Act 71 of 2008.

<sup>69</sup> Section 90 of the Companies Act 61 of 1973.

<sup>70</sup> Section 46(1)(c) of the Companies Act 71 of 2008.

A resolution by the board as envisaged in terms of section 46(1)(c) triggers a distribution, once the resolution has been concluded by the board the relevant distribution must be carried out<sup>71</sup>. The only exception to the provision of section 46(2) is section 46 (3), section 46(3) of the Act which provides as follows –

*“(3) if the distribution contemplated in a particular board resolution, court order or existing legal obligation has not been completed within the 120 business days after the board made the acknowledgement required by subsection (1)(c), or after the fresh acknowledgment being made in terms of this subsection, as the case may be-*

- (a) the board must reconsider the solvency and liquidity test with to the remaining distribution to be made pursuant to the original resolution, order or obligation; and*
- (b) despite any law, order or agreement to the contrary, the company must not proceed with or continue with any such distribution unless the board adopts a further resolution as contemplated in subsection 1(c).”*

Though the above provision has been lauded for its certainty in the way it has improved the regulation of distributions from what they were in section 90 of the Companies Act of 1973<sup>72</sup>. The question however is whether the 120 days period referred to above, is the only time when a company is able to establish whether it still satisfies the solvency and liquidity test as per the provision of section 46(1)(a)(b). This question arises purely because once a resolution sanctioning a distribution has been adopted, such resolution has to be fully carried out, it will be interesting to see how our courts will interpret this provision.

As mentioned above there are two ways in which a distribution can take place, one is when it is pursuant to a board resolution and the other is when it is pursuant to an existing legal obligation of the company or a court order. Section 46 (5) makes

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<sup>71</sup> Section 46 (2) of the Companies Act 71 of 2008.

<sup>72</sup> Stein et al (2011) 186.

provision for the instance when a distribution is pursuant to a court order and the immediate compliance with the court order ordering a company to conduct a distribution is possible.

In terms of section 46(5)<sup>73</sup> if it is impossible for the company to comply with the court order, the company may apply to court for a variation of the court order. Upon receipt of the application for a variation of the court order, the court may, in exercising its discretion, vary its initial order and thus allow the company to make such a distribution at the earliest date that will not hamper the company satisfying its other financial obligations. It is however not guaranteed that the court will agree to the variation of its initial court order, as Van der Linde opines “it is not clear what the position would be if the court refuses to amend its order and the company complies in violation of the solvency and liquidity test”<sup>74</sup>. It will be interesting how our courts will deal with this conundrum, when an opportunity arises for the courts to interpret the provisions of this fairly new Companies Act.

Section 46 (6) with reference section 77(3)(e)(vi)<sup>75</sup> prescribes the ambit of the liability of directors in the case of a distribution that is conducted contrary to the provisions of section 46. In terms of section 77(3)(e)(vi) a director of a company would be liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having been present at a meeting, or participated in the making of a decision in terms of section 74<sup>76</sup>, and failed to vote against a resolution approving a distribution, despite knowing that the distribution was contrary to section

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<sup>73</sup> Section 46(5) of the Companies Act 71 of 2008.

<sup>74</sup> Van der Linde “The regulation of distribution to shareholders in the Companies Act 2008” 2009 (3) TSAR 488.

<sup>75</sup> Section 77(3)(e)(vi) of the Companies Act 71 of 2008.

<sup>76</sup> Section 74 of the Companies Act 71 of 2008.

46<sup>77</sup> regulating distributions by a company and section 4<sup>78</sup>, which deals with the solvency and liquidity test.

Section 77(4) limits the liability of directors that can be imposed under the provision of section 77(3)(e)(vi). In terms of section 77(4) the liability of a director in terms of section 77(3)(e)(vi) only arises if the solvency and liquidity test was not satisfied by the company, immediately after the said distribution was made by the company, furthermore, if it was objectively not reasonable for the directors to pass the resolution authorizing the distribution.

### 3.4 **The solvency and liquidity test in terms of section 4 of the Companies Act**

The solvency and liquidity test was introduced in our company law by the Companies Amendment Act No.37 of 1999. The solvency and liquidity test has been an integral part of our company law since its introduction, it is one of the tools used in the regulation of company distributions, according to Van der Linde the solvency and liquidity test can also be used as a measure of creditor protection in an array of transactions. In contrasting the difference between the solvency test and the capital maintenance doctrine Van der Linde is of the opinion that difference between the two is in the fact that, the capital maintenance doctrine requires a margin over solvency which is equal to the share capital of the company<sup>79</sup>.

The Companies Act of 1973 did make mention of the words solvency and liquidity, the solvency and liquidity test was however provided for by section 85(4) of the

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<sup>77</sup> Section 46 of the Companies Act 71 of 2008.

<sup>78</sup> Section 4 of the Companies Act 71 of 2008.

<sup>79</sup> Kathleen Van der Linde "The solvency and liquidity approach in the Companies Act 2008" 2009 TSAR at 226.

Companies Act 61 of 1973. The solvency and liquidity test consist of two legs which have different theoretical justifications<sup>80</sup>, a company will meet the test only if the two legs of the test are satisfied. Stein and Everingham are of the view that the solvency element of the test serves to ensure that a creditor is not prejudiced by the company stripping itself of assets and incurring excessive debts<sup>81</sup>, Van der Linde is of the view that the solvency element gives recognition to the priority that creditors enjoy over shareholders at the time when a company is being dissolved<sup>82</sup>. Van der Linde is further of the view that the liquidity element of the test addresses the expectation of creditors to be paid timeously, this view is also shared by Stein and Everingham<sup>83</sup>.

The Companies Act of 2008 is a total departure from the 1973 Act in that the solvency and liquidity test is a standalone provision in the Act<sup>84</sup>, the test is not just referred to in the process of share buyback<sup>85</sup>, process of payments to shareholders<sup>86</sup> or transaction of a similar nature.

The solvency and liquidity test had a very narrow application in the previous Companies Act as it applied only in the following instances; when it came to payments to shareholders<sup>87</sup>, in instances of financial assistance by a company for acquisition of own shares<sup>88</sup> as well share buy backs by the company<sup>89</sup>.

In the current Companies Act the solvency and liquidity test now finds a wider application, the test is applicable in the following instances: all forms of distributions

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<sup>80</sup> Ibid at 226.

<sup>81</sup> Stein et al (2011) 174.

<sup>82</sup> Kathleen Van der Linde "The solvency and liquidity approach in the Companies Act 2008" (2009) TSAR at 226.

<sup>83</sup> Ibid 69.

<sup>84</sup> Section 4 of the Companies Act 71 of 2008.

<sup>85</sup> Section 85(4) of the Companies Act 61 of 1973.

<sup>86</sup> Section 90 of the Companies Act 61 of 1973.

<sup>87</sup> Ibid.

<sup>88</sup> Section 38 of the Companies Act 61 of 1973.

<sup>89</sup> Ibid.

under section 46 as discussed above, share buy-backs in terms of section 48, in instances of financial assistance to directors in terms of section 45.<sup>90</sup>

Section 4(1) of the companies act provides that –

*“For any purposes of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time*

*(a) the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and*

*(b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of –*

*(i) 12 months after the date on which the test is considered; or*

*(ii) in the case of distribution contemplated in paragraph (a) of the definition of ‘distribution’ in section 1, 12 months following that distribution.”*

The solvency element of the test is aimed at establishing whether a company’s assets exceed its liabilities and this involves an inspection of its books including the balance sheet. The liquidity element of the test has to do with establishing whether a company is able to meet its obligations, this includes debts as they become due and payable. Section 4(2) of the Companies Act, unlike the Companies Act of 1973 sets out exactly what needs to be considered by the company when conducting the solvency and liquidity test including the assets and liabilities that should be considered when applying the test.

Section 4(2)(a)(i) and (ii) of the Act provides that, for the purposes contemplated in subsection (1) any financial information to be considered concerning the company must be based on –(i) accounting records that satisfy the requirements of section 28; and (ii) financial statements that satisfy the requirements of section 29. Van der

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<sup>90</sup> See further the following provisions of the Companies Act 71 of 2008 wherein the solvency and liquidity test finds application, sections 113, 13(6) and 47.



Linde is of the view that it may be difficult to rely solely on financial records when applying the liquidity test, this is because the test involves a prediction of the company's cash flow situation over the ensuing period of 12 months<sup>91</sup>. Van der Linde is further of the view that over and above the financial records of the company, the liquidity aspect of the test should take into consideration the foreseeable circumstances that may inhibit the company's ability to pay its debt, and that the solvency test must be based on a fair evaluation of the company's asset and liabilities<sup>92</sup>. Section 4 thus provides directors with more certainty in applying the solvency and liquidity test.

Section 4 also introduces a timeline for the liquidity test, by stating that it must be apparent to the company whether it 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, the 12 months period in section 4 mirrors the requirements of the listing requirements of the Johannesburg Securities Exchange<sup>93</sup>.

There have been mixed reactions to the introduction of the 12 months' time period, Bradstreet is of the view that the 12 month period limits creditor protection to the extent to which directors are able to predict the future and that "expecting long-term predictions to be accurate is unrealistic as seeking to secure protection for creditors by means of such forecasting".<sup>94</sup> Van der Linde opines that, the imposition of the time limit for the liquidity test is undesirable, and that the deciding factor in determining the liquidity of a particular company is the ordinary course of each

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<sup>91</sup> Kathleen Van der Linde "The solvency and liquidity approach in the Companies Act 2008" (2009) TSAR at 230.

<sup>92</sup> Ibid at 230-23.

<sup>93</sup> Listing Requirements of the JSE Limited Para 5.69(C).

<sup>94</sup> Richard Bradstreet "Regulating Legal Capital Reduction: A comparison of Creditor Protection in South Africa and the State of Delaware. (2012) 129 the South Africa Law Journal, at page 750.

business.<sup>95</sup> Van der Linde proposes an alternative way of protecting creditors whom section 4(1)(b)(i) seeks to protect by proposing a creation of a presumption in terms of which it will be presumed that a company did not meet the liquidity test if its liquidated in a said period after conducting the test.<sup>96</sup> Stein and Everingham have welcomed the imposition of the time limit in section 4(1)(b) of the Act as they believe it offers protection to creditors, according to Stein and Everingham the absence of a time limit in sections 38(2A), 85(4) and 90(2) of the Companies Act of 1973 was vague and imprecise thus leading to uncertainties in the application of the solvency and liquidity test under the 1973 Companies Act<sup>97</sup>.

### **Conclusion**

The Companies Act of 2008 has greatly improved the way in which distribution takes place in our company law, the idea of having a single provision which regulates a number of distributions is one that has been widely welcomed for certainty. Certainty as the hallmark of distributions is manifested in this new dispensation of company distributions. The solvency and liquidity test has also been greatly improved by the Companies Act of 2008, the fact that section 4 of the Act properly sets out the methodology of how the test is to be conducted, as well as the considerations that have to be factored in when conducting the test has cured the imprecise and vague nature of the 1973 Companies Act. The test in its current form has thus been lauded for its precision.

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<sup>95</sup> Kathleen Van der Linde “The solvency and liquidity approach in the Companies Act 2008” 2009 TSAR at 229.

<sup>95</sup> Ibid.

<sup>96</sup> Stein et al (2011) 176.

## **CHAPTER 4**

### **ACQUISITION BY A COMPANY OF ITS OWN SHARES AND THE ACQUISITION OF SHARES BY A SUBSIDIARY OF SHARES IN ITS HOLDING COMPANY IN TERMS OF SECTION 48 OF THE COMPANIES ACT 71 OF 2008**

#### **4.1 Introduction**

The Companies Amendment Act 37 of 1999 ushered in a new era in the South African Company law, the changes that were brought about by the Amendment Act set in motion the revamping of our company law legislation which culminated in the enactment of the current Companies Act. As was mentioned in Chapter 1 above, the Companies Amendment Act of 1999 heralded the beginning of the end for the capital maintenance doctrine in South Africa.

In this chapter I will look principally at the provisions regulating share buyback by companies and assessing what improvements have been made by the current Companies Act. A share buyback is an example of a distribution by a company to which the provisions of sections 4 and 46 of the Companies Act which were discussed in the previous chapter are applicable. Sections 85 and 86 of the Companies Act were provisions governing share buyback in the 1973 Companies Act. Share buy backs are regulated in the main by the provisions of section 48 of the Companies Act and also in some instances share buyback may take place in terms of the provision of section 114 of the Companies Act.

What is a share buyback? A share buyback occurs when a company acquires its own shares from its shareholders, a share repurchase has various ramifications for

companies the most critical of them being that it changes the structure of the company's share capital and also the allocation of rights amongst shareholders<sup>98</sup>. As mentioned in the preceding chapters above, the practice of share buyback was as a matter of principle, a forbidden practice, and the principle was first laid out in the *Trevor v Whitworth*<sup>99</sup> decision. The prohibition of a company acquiring or buying back its own shares notwithstanding the fact that it has been bestowed with those powers by its own memorandum of incorporation, has its roots in the capital maintenance doctrine which was discussed in chapter 2 of above. The dominant view at that time was that, the company would be impoverished by the diversion of company assets to shareholders if share buybacks were permitted<sup>100</sup>.

The prohibition of buy-back of shares had more to do with protecting the interest of creditors of companies; the legislature thus came to the realization that, there were better ways of protecting the interest of creditors other than insisting on the capital maintenance doctrine. The advent of the solvency and liquidity test heralded a new thinking which made the capital maintenance doctrine obsolete. In one of the first cases that our courts had to deal with after the Companies Amendment Act of 1999 came into effect, the case of *Capitex Bank Ltd v Qorus Holdings Ltd*<sup>101</sup> dealing with share buyback provisions of the Companies Act of 1973, the court held that, an agreement pertaining to the acquisition by a company of its own shares is no longer illegal in itself, however, payment that is made in contravention of the solvency and liquidity test would result in the illegality of the share repurchase agreement.

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<sup>98</sup> Van Der Linde K "Share repurchases and the protection of shareholders"(2010) 288 TSAR 2.

<sup>99</sup> *Trevor v Whitworth* (1887)12 App Cas 409 (HL), Also see *Sage Holdings Limited v The Unisec Group Ltd and Others* 1982(1)347-349.

<sup>100</sup> Davies et al (2008) 316.

<sup>101</sup> *Capitex Bank Ltd v Qorus Holdings Ltd* 2003(3) SA 302(W) at 3081-309A.

The frustration with the rule prohibiting capital maintenance was aptly captured by Cassim when he submitted that "...It is unduly narrow, rigid and restrictive to prohibit a company from purchasing its own shares, even in a case where this may have been done in good faith, and with the consent of its shareholders and even though there is no fraud on the creditors".<sup>102</sup> In 1999 the South African legislature finally responded to the call for the abolition of the rule prohibiting buyback by a company of its own shares, from 1999 it was possible for a company to acquire or buy its own shares.

Before I discuss the mechanics of how a share buyback is regulated by the Companies Act, it's important to first establish why a share buyback is required or necessary. There may be a myriad of reasons as to why a company would want to acquire or buy its own shares. The reasons why a company would embark on a share buyback program include amongst others the following: to increase earnings per share of a company<sup>103</sup>, a buyback could also be used as anti-takeover mechanism as defense against takeovers usually hostile takeovers<sup>104</sup>, tax consideration which in some instances result in a share buyback being more favourable to shareholders than a declaration of dividends. A share buyback scheme may also facilitate the employee shareholder scheme by enabling the company to acquire shares that are held by an employee who is leaving the company in which the share are held.

Share buybacks are therefore an important tool used by companies to facilitate a whole lot of corporate transactions, there have been a number of share buyback

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<sup>102</sup> FHI Cassim- "The right of a company to purchase its own shares", 1985 (48) THRHR at page 321.

<sup>103</sup> See Henochsberg on the Companies Act, 71 of 2008 Vol (1) at page 201.

<sup>104</sup> Lamba A and Ramsay I "Share buy-backs an empirical investigation"(2000) at 3.

transactions since 1999 and the trend has continued with even greater number of transactions of this nature taking place in South Africa.

#### 4.2 **Share Buyback vs Share Redemption**

Even though there appears to be no distinction between share buyback and share redemptions, there is a huge difference between the two processes. Section 48 1(b) of the Companies Act provides that, section 48 is not applicable to the redemption by the company of any redeemable securities. There are similarities between redemption of shares and share buybacks, both entail a return of shares to a company that initially issued them to shareholders. Redemption of shares is usually governed by way of a contractual arrangement that is found in the company's memorandum of incorporation. A share buyback involves an agreement between the company and one or more of its shareholders wherein it is agreed that the company will buy back the shares it initially issued to the shareholders.<sup>105</sup>

#### 4.3 **Acquisition by a Company of its own shares**

The Companies Act of 2008 is similar to the 1973 Companies Act it makes provision for two forms of buy-backs, an acquisition by a company of its own shares as well as the acquisition by a subsidiary of shares in its holding company.

Section 85(1) of the Companies Act of 1973, provided that "subject to the provisions of this section and any other applicable law, a company may by special resolution of the company, if authorized thereto by its articles, approve the acquisition of shares

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<sup>105</sup> Farouk HI Cassim (ed) 2011,272.

issued by the company”<sup>106</sup>. Section 48(2) of the Companies Act 71 of 2008 unlike section 85 merely provides that “subject to subsections (3) and (8), and if the decision to do so satisfies the requirements of Section 46- (a) the board of the company may determine that the company will acquire a number of its own shares”, this is a departure from the 1973 Companies Act which required shareholder approval for a decision of this nature.

Shareholder approval for a buy-back of shares is not required in the current Companies Act, similarly authority to buy-back shares is not required by the Act that it be included in the company’s Memorandum of Incorporation.

The statutory provision bestowing the power to make decisions on share buybacks the sole prerogative of the board of directors has been received with some criticism from various authors. Wainer is of the view that exclusion of the requirement of special resolution for a decision on share buyback, in the Companies Act of 2008 could not have been intentional, he is also of the view that it was surprising that Section 48 empowers a company to buy its own shares without any involvement by the shareholders.<sup>107</sup> In the absence of making it a requirement for the board to also obtain shareholder approval for buyback of own shares, there is no other way to inform the shareholders about the merits or demerits to acquire their shares,<sup>108</sup> the current companies has done away with the elaborate process provided for in section 87 of the Companies Act of 1973.

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<sup>106</sup> Section 85 (1) of the Companies 61 of 1973.

<sup>107</sup> Wainer HE “The new Companies Act: Peculiarities and Anomalies”(2009) 4 SALJ at 820.

<sup>108</sup> Farouk HI Cassim (ed) 2011, 276.

A share buy-back is considered as a distribution under section 46 of the Companies Act, thus the provision of section 48(2)(a) are similar to the provisions of section 46(1)(a), in far as they relate to the authority of the board to authorise a distribution. In the case of section 48(2)(a) the authority of the board to authorise a buyback of own shares, both this provisions do not require the authority of the shareholders.

Cassim takes the view that a share buy-back scheme cannot be equated to a distribution, Cassim submits that–

*“...a share repurchase entails a change in the ownership of the company’s shares and, unlike a dividend payment, may thus be used to change control of a company or, for that matter, to prevent a change of control. It may also be used to manipulate the market price of the company’s shares. Share repurchases clearly have a greater 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<sup>109</sup>.”*

This argument also holds true in questioning the exclusion of shareholders from being the final arbiters of whether a company should embark on a share buy-back scheme. It is my view that share buy- back schemes should at the very least be solely the preserve and prerogative of the shareholders.

While it is concerning that the current Companies Act excludes shareholders from authorizing share repurchases, this is however not the end. Section 48 of the Act is

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<sup>109</sup> FHI Cassim “The Reform of Company Law and the Capital Maintenance Concept” 2005 (SALJ) 287-288.



an unalterable provision, the Memorandum of Incorporation of a company can however be modified in terms of section 15(2)(a)(iii) to indicate that, for every share buy-back scheme that the company embarks upon a special resolution would be required.

Section 48(2) provides that the decision of the company or subsidiary company to acquire the company's shares has to satisfy the requirements of section 46; this provision could be construed as an equivalent of section 85(4) and section 90 (2) of the Companies Act of 1973. The only criticism I have about the reference to section 46 in section 48(2), is the fact that, reference to section 46 in section 48 is of no consequence; once we conclude that a share buyback is a distribution it follows that the provisions of section 46 which I have discussed above are applicable.<sup>110</sup> Cassim et al are of the view that the "cross-reference to section 46 creates an impression that the decision to make such an acquisition requires the company to be solvent and liquid at the time of making the decision"<sup>111</sup> to buy –back shares. The approach in section 48(2)<sup>112</sup> is similar to the approach under section 85<sup>113</sup>, section 85(4) had the same provisions as section 90(2)<sup>114</sup> of the Companies Act of 1973 the difference in the current Companies Act is that section 46 is now a provision of the Act that regulates all kinds of distributions.

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<sup>110</sup> Also Richard Jooste "Issues Relating to the Regulation of Distributions By the 2008 Companies Act" 2009 (SALJ) Vol 12 at page 638.

<sup>111</sup> Farouk HI Cassim (ed) 2011, 283.

<sup>112</sup> Section 48(2) of the Companies Act 71 of 2008.

<sup>113</sup> Section 85 of the Companies Act 71 of 2008.

<sup>114</sup> Section 90 (2) of the Companies Act 61 of 1973.

#### 4.4 **Acquisition by a subsidiary Company of shares in its holding Company**

Section 48 (2)(b)(i) provides “that the board of a subsidiary company may determine that it will acquire shares of its holding company, but- (i) not more than 10%, in aggregate, of the number of issued shares of a company may be held by, or for the benefit of, all of the subsidiaries of that company, taken together”. Section 48(2) (b) mirrors section 89 of the Companies Act of 1973, as discussed above, acquisitions of this nature were not possible until Companies Amendment Act of 1999 was enacted.

In terms of section 48(2)(b)(ii), once the subsidiary has acquired shares in its holding company it may not be able to exercise the voting rights attaching to those shares, this remains the case for the duration that it holds the shares in the holding company and that it is still a subsidiary company of the company in which the shares are held. The Act is however silent on the issue of dividends in regard to these shares, perhaps it’s implicit in the makeup of section 48 that there would no dividends which may accrue to those shares once they are acquired.

While section 48 of the companies makes it possible for the company to acquire its own shares and for the subsidiary to acquire shares in its holding company, there are limits on the extent of this possibility. In terms of section 48(3) a company may not be able to acquire its own shares, and similarly a subsidiary company may not be able to acquire shares in its holding company if as a result of the said acquisitions 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 redeemable shares.

In terms of section 48(4) of the Act which is similar to section 88 of the old Act, an agreement to acquire shares by a company is enforceable against the company, in the event that a company cannot comply with the agreement it has concluded with shareholders in terms of which it undertook to acquire shares from them, the company must then make an application to court. The court if it satisfied by the reasons furnished by the company for non-compliance, the court may make an order that is just and equitable.<sup>115</sup> Similarly a company has to apply to a court in the instance where it has acquired shares in contravention of section 46 or section 48 of the Companies Act. The company must, not more than a period of two years after the said acquisition, make an application to court for an order reversing the acquisition.<sup>116</sup>

In the preceding paragraphs of this chapter, I lamented the fact that the provisions of section 48 have excluded the critical role of shareholders in authorising share buy-backs, I viewed this exclusion as a concern, especially when I compare the provisions of section 48 to those of section 85 of the companies Act of 1973. There is however within section 48, instances where a special resolution is required. Section 48(8)(a) provides that in a situation where shares are from a director or a prescribed officer of the company, or a person or persons related to a director or prescribed officer of the company then a special resolution is required.

A special resolutions is also required in section 48(8)(b) in an instance where a share buy-back is subject to the requirements of sections 114 and 155, if considered alone, or together with other transactions in an integrated series of transactions, it

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<sup>115</sup> Section 48 (5) of Act 71 of 2008.

<sup>116</sup> Section 48(6) of Act 71 of 2008.

involves the acquisition by the company of more than 5% of the issued shares of any particular class of the company's shares. It is important to note that section 48(8) is not applicable to the acquisition by a subsidiary of shares in its holding company.

A share buy-back can take place through a scheme of arrangement in terms of section 114(1) (e) read together with section 48 of the Act, section is incorporated in section 114 (4) of the Act. The provisions of section 114 are applicable where there is a scheme of arrangement and a buyback of shares involves more than 5% of the issued shares of any particular class of shares.

#### 4.5 **Treatment of Shares once acquired by the Company**

Section 35(5)<sup>117</sup> of the Companies Act provides that “shares of a company that have been issued and subsequently acquired by that company, as contemplated in section 48 or surrendered to that company in the exercise of appraisal rights in terms of section 164<sup>118</sup> have the same status as shares that have been authorised but not issued”. Section 35(5) of the Act is the erstwhile section 85(8) of the Companies Act of 1973, section 35 (5) has not changed much from what was provided under section 85(8)<sup>119</sup> of the Act. Section 85(8) provided that, “shares issued by a company and acquired under this section shall be cancelled as issued shares and restored to the status of authorised shares forthwith”. Some of authors have questioned the absence of treasury shares in our company law, particularly in regard to the advantages treasury shares have for companies<sup>120</sup>.

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<sup>117</sup> Section 35(5) of the Companies Act 71 of 2008.

<sup>118</sup> Section 164 of the Companies Act 71 of 2008.

<sup>119</sup> Section 85(8) of the Companies Act 61 of 1973.

<sup>120</sup> Mongalo TH (ed)(2009) 151 to 152.

What are treasury shares? Cassim defines treasury shares as follows-

*“treasury shares are shares issued by a company and thereafter reacquired by the company by way of share repurchase, but neither cancelled nor restored to the status of unissued shares on their reacquisition. Instead, the repurchased shares are held by the company in its treasury or are dormant until their reissue or resale at the discretion of the company for what they will fetch on the market.”*<sup>121</sup>

Treasury shares have certain advantages for companies, they offer flexibility to companies to manage their capital structure and they enable companies to reduce the cost of raising new capital and lastly that they are useful for employee share schemes.<sup>122</sup> Cassim acknowledges that treasury shares carry a potential for abuse with them, he however also recognizes that treasury have important advantages and safeguards can be put in place to guard against the dangers of abuse.<sup>123</sup>

Cassim is of the opinion that given the objective of the Companies Act as stated in section 7 of the act, the absence of treasury shares is incongruent with the objectives of the Companies Act particularly the objectives of flexibility and simplicity which are themes underpinning our current company law<sup>124</sup>. It is perhaps prudent that the legislature should review the possibility of amending the provisions of section 35(5) to bring it in line with international trends.

#### 4.6 **The Liability of Directors under Section 48 of the Act.**

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<sup>121</sup> Ibid.

<sup>122</sup> Ibid.

<sup>123</sup> Cassim FHI “The repurchase by a company of its own shares: the concept of treasury shares”(2003) 120-1 SALJ at 151.

<sup>124</sup> Mongalo TH (ed)(2009) 163.

The liability for directors in terms of section 48 is set out in section 48(7) of the Companies Act. Section 48(7) provides with a cross reference to section 77(3)(e) (vii) that a “director of company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having been present at a meeting, or participated in the making of a decision in terms of section 74, and failed to vote against the acquisition by the company of any of its shares, or the shares of its holding company, despite knowing that the acquisition is contrary to section 46 or 48.” In terms of section 77(6) liability is joint and several with any other who is or may be held liable for the same contravening act.

The approach in the current Companies Act is similar to the provisions of section 86 of the Companies Act of 1973, which provides that directors who act contrary to section 85(4) in allowing the company to acquire its own shares, are jointly and severally liable to restore to the company any amount so paid and which has not been recovered by the company.<sup>125</sup>

Section 48(7)<sup>126</sup> has greatly improved the shortcoming of section 86(1) of the 1973 Companies Act. In contrast to the provisions of section 86(1), in order for a director to be liable, section 48(7) requires the director to have been present alternatively the director must have participated in the making of a decision and failed to vote against the acquisition of shares notwithstanding the knowledge that the acquisition would be contrary to section 46. The legislature has with section 48(7) responded positively to calls made by various authors for an amendment to section 86(1), section 48(7)

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<sup>125</sup> Section 86(1) of the Companies Act 61 of 1973.

<sup>126</sup> Section 48(7) of the Companies Act 71 of 2008.

now ensures that, only those directors who had voted for or assented to the wrongful share repurchase would incur personal liability to the company.<sup>127</sup>

#### 4.7 **Conclusion**

In conclusion, although there have been some changes and improvements to how share buy-backs are regulated in the current Companies Act, there are some good improvements but there are also not so good changes. The main question is should creditors and shareholders feel comforted and adequately protected by the measures that are in place to protect their interest in the current regime of share buy-backs? My view is that the process laid out in section 87 of the Companies Act of 1973 provided more protection and information to shareholders thus enabling shareholders to make informed decisions, the provisions of the current new Act do not do well in this respect. Cassim had this to say about the provisions governing share repurchase in the companies act of 1973,-

*"The safeguards provided by our Companies Act are not only inadequate; they are clearly rudimentary, and require further thought and analysis. The provisions of the Act relating to selective share repurchases leave too much scope for mischief. Specific statutory safeguards must be provided to guard against the very real danger of abuse here. It is not a sufficient safeguard that at common law the directors have a fiduciary duty to act bona fide in the best interests of the company, or that it may not be a proper exercise of their powers for directors to repurchase shares of the company with the primary motive of perpetuating themselves in office."*<sup>128</sup>

I believe Cassim's opinion still holds truth in relation to the provisions of the current Companies Act that govern share repurchases. Seligson SC's view of the current

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<sup>127</sup> Cassim FHI "The reform of company law and the capital maintenance concept"( 2005) 11 SALJ at 289.

<sup>128</sup> FHI Cassim "The New Statutory Provisions on Company Share Repurchases: A Critical Analysis" (1999) 116 SALJ 776.

share buy-back provisions of the companies act is that- “It seems a pity that the workable, tightly-woven fabric of the current Act relating to share buy-backs, already familiar to company administrators and lawyers alike, has been replaced with a patchwork of loosely-knit, over-simplified provisions that seem destined to create a less equitable and efficient legislative framework—something that was never envisaged by the lawgiver.”<sup>129</sup> I concur with Seligson SC that the provisions of section 48 appear to be too simplified and as such some of the protection afforded in the previous act has been sacrificed, I am of the view that the legislature should revisit the question of shareholder approval in share buybacks to the point where it should be made peremptory.

Overall I believe the legislature has done a balancing act in regard to share repurchases, the essence of what governed share repurchases in the companies act of 1973 has been retained but a good part of that has made way for new provisions.

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<sup>129</sup> Milton Seligson SC “Share Buy-backs under the Companies Acts, The Devil is in the detail” (2011) Business Tax and Company Law Quarterly, Volume 2, Issue 1 at page 15.



## **CHAPTER 5**

### **5.1 Conclusion**

In conclusion, the current Companies Act is fairly new and most of its provisions have yet to be tested by the courts. The Act presents new concepts as well as new ways of doing things. In answering the research question that this paper seeks to answer, I am of the view that the provisions of section 48 appear to be too simplified and as such some of the protection afforded in the previous Act has been sacrificed. I believe the legislature has done a balancing act in regard to share repurchases, the essence of what governed share repurchases in the companies act of 1973 has been retained but a good part of that has made way simplicity.

I am also of the view that the legislature has done a fairly commendable job in overhauling our company law through a revamp of the Companies Act. The transition from South Africa being a capital maintenance jurisdiction to a jurisdiction where the solvency and liquidity test is the acid test for any form of distribution by a company has modelled our law to be in line with international best practice.

The Act has greatly improved the way in which distribution takes place in our company law, the idea of having a single provision which regulates a number of distribution is one that has been widely welcomed for the main reasons that certainty is the hallmark of distribution is characterized in this new dispensation of the new Companies Act. The solvency and liquidity test has also been greatly improved by the new Companies Act. The fact that section 4 of the Act properly sets out the methodology of the how the test is to be conducted and what considerations are to

be factored in when conducting the test has cured the imprecise and vague nature of the 1973 Companies Act. The test in its current form has thus been lauded for its precision by many. It remains to be seen how some of these new provisions would be interpreted by our courts. I concur with Cooke in his view that while some of the problematic provisions of the Act may be cured by judicial intervention, there seems to be too much reliance on our courts alone and that some provisions may require intervention through the legislature.<sup>130</sup>

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<sup>130</sup> Marc Cooke “A critical Analysis of the Regulation of Distributions by a Company’s Board”(2012) 24 SA Merc LJ at 384.

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