ACQUISITION OF SECURITIES: SECTION 48 OF THE ACT 71 OF 2008

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DECLARATION

I hereby declare that this dissertation submitted for the degree of Master of Law degree in the university of Pretoria is my own work and has not been submitted to another institution for a degree and that the information contained in the dissertation is the result of my investigations

SEGALA PETER MALAHLELA

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SUMMARY

The Companies Act, 71 of 2008 repealed the Companies Act, of 61 of 1973, the former Act came into operation on the 1st May 2011. The repealing of the 1973 Act meant that a new legal dispensation was ushered in, these changes obviously affected the manner in which the law worked prior to the 1st May 2011. The repurchase of shares by the company is just but one of the many aspects which were affected by the new act. In order to understand the thought process of the legislature when enacting the current law, the history and evolution of section 48 is imperative. Section 80-90 and 46 together with 48 of the old and the new act respectively are the legislative framework behind the South African share repurchases rule.

This research investigates the genesis of share repurchases in South Africa and thereafter observes the exodus from the original principle to the status quo. Prior to 1999, share repurchases were governed through the capital maintenance rule which was imported from England and other foreign jurisdictions. In terms of the capital maintenance rule the reduction of contributed share capital in any manner was prohibited. The issued share capital of the company was perceived as a guarantee fund intended for the payment of the claims of the creditors of the company in the event that the company defaults on its payments or is liquidated.

In 1999, the Companies Amendment Act introduced sections 85 to 90 which was a paradigm shift from the out dated and superfluous share capital maintenance rule, this paradigm shift spared no sub rule within the capital maintenance rule and it is from these legal developments where we saw share repurchase rules including other sub-rules (which are beyond the scope this work) emerging. Section 48 of the new companies act read with other relevant sections the Act thereof prescribes the procedure and requirements for share repurchases, these sections further prescribe the consequences and remedies for non-compliance with the prescribed procedure and requirements.
It is against this background that section 48 effects, impact as well as the interpretation thereof are investigated. In terms of section 48, the company may purchase shares issued by it under certain circumstances provided that it complies with the requirements laid down in the Act, furthermore section 48 transactions may under certain circumstances trigger tax liability for the parties involved.
CHAPTER ONE

1. INTRODUCTION

This dissertation seeks to research the origin, evolution and development of acquisition of securities, with specific reference to section 48 of the Companies Act, 2008\(^1\), (Herein after referred to as the Act) in South Africa. The manner in which the rule manifested itself into the Act will be researched in order to understand challenges and shortcomings presented by the current legislative changes.

It is imperative to understand that the share repurchase rule is a sub-rule within the Doctrine of Capital Maintenance, the roots of which can be traced as far back as the 19th century and its footprints are visible in many European countries such as Canada, New Zealand, the United Kingdom as well as the United States of America. South Africa inherited most of its laws from the British legal system and other foreign jurisdictions. It is therefore not surprising to find some common elements with the aforementioned jurisdictions within the South African capital maintenance doctrine.

The share capital maintenance rule was designed to protect the creditors. There was a strong belief that the contributed capital was the reserve fund in which the creditors would turn to when the company was unable to pay its debts as they fall due in the ordinary course of business or when the company is liquidated. Through effluxion of time the capital maintenance rule became outdated and superfluous, the legal scholars in many jurisdictions started to see the rule as an inadequate and unrealistic protection of the creditors, it was from this angle that most countries began to shift from rigid share capital maintenance rule towards a more lenient approach.

As a result of the shift in many countries from the out-dated share capital maintenance rule, a new dispensation which permitted companies to repurchase their own shares was introduced.

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\(^1\) The Companies Act was signed into law by President Kgalema Motlanthe in 2008 and came into operation on the 1\(^{st}\) May 2011
1.1 THE DISSERTATION QUESTION AND RELEVANCE

In this dissertation the origin, evolution and the impact of section 48 in the South African corporate law fraternity will be researched, where possible an analysis of whether section 48 constitutes a sound law will be provided. The Act is still at its infancy stages and our courts are yet to provide guidance, what will be contained herein will be a personal opinion on the understanding of the Act as it is currently. In addition, the challenges and shortcomings of the old Act will be dealt with and also find out if these are properly addressed by the new section 48. The fundamental research relevance is to investigate the changes brought by the introduction of section 48 if any.

1.2 THE DISSERTATION OBJECTIVE

The main aim of this dissertation is to investigate the origin, evolution and the impact of section 48 in the South African corporate law fraternity, where possible analyse whether the section amounts to a sound law and furthermore attempt to point out as to whether the challenges and shortcomings of the old Act ² have been properly addressed.

1.3 RESEARCH METHODOLOGY

The research methodology adopted includes a comprehensive literature review of primary legal sources in the form of court cases and relevant legislation. The two aforementioned statutes will be analysed and compared with each in order to ascertain the impact and changes if any the new act has on the South African corporate law. Secondary sources in the form of textbooks and articles from academic journals have been used. The internet has also been utilised in certain instances as it provides new and updated information.

In terms of the choice of legal system, the scope of the discussion applies to the South African law however foreign jurisdictions have been looked at due to their

² The Companies Act 61 of 1973
influence on the South African jurisprudence. The most relevant foreign law for the purposes of this work is the Canadian law which is dealt with in Chapter 2.

1.4 LIMITATIONS

The scope of this research is limited to the acquisition of securities in terms of Act 71 of 2008. The other sub rules of the share capital maintenance rule fall outside the ambit of section 48, furthermore the research only addresses the share repurchases as far as they to relate to private companies however to a limited extent the regulated companies will be looked at as far as section 123 of companies is concerned.
2. BACKGROUND OF THE SHARE REPURCHASE

2.1 THE ORIGIN OF SHARE REPURCHASE

The share capital maintenance repurchase rule was developed out of the need to protect the creditors of the company. This rule was imported from the English law and other jurisdictions into the South African law. The principle espoused by the doctrine was that the paid-up capital of a company represents a reserve fund to which the creditors of the company must turn to for the satisfaction of their claims and thus must be maintained.

In terms of the capital maintenance rules at common law, every transaction between a company and a shareholder by means of which the money already paid to the company in respect of his shares was returned to him was prohibited, and hence void.\(^3\)

Important rules of the common law were that a company may not buy back its own shares, may not pay dividends out of capital and may not issue shares at a discount.\(^4\)

In terms of the capital maintenance rules at common law, every transaction between a company and a shareholder by means of which the money already paid to the company in respect of his shares were returned to him was prohibited, and hence void whether the return took place by the return of money or a distribution of assets. Furthermore, certain particular common law rules had been established, which can be enumerated as the following prohibitions:
(a) The prohibition of the purchase, by a company, of its own shares
(b) The prohibition of the payment of dividends out of share capital
(c) The prohibition of the issue of shares at a discount

\(^3\) http://www2.accaglobal.com/students/student_accountant/archive/2000/10/36856

\(^4\) Cilliers & Benade (2000) 322
Certain of these common law rules were backed up by the provisions of the Companies Act of 1973. Of particular significance in the latter category was the prohibition of the granting of financial assistance by the company for the purchase of its own shares.\(^5\)

2.2 THE LANDMARK CASE PROHIBITING THE SHARE REPURCHASE

The roots of capital maintenance rule together with its sub-rule of share repurchase can be traced as far back as 1887 in the case of *Trevor v Whitworth*.\(^6\)

In the case of *Trevor v Whitworth* (supra) a company bought back almost a quarter of its own shares. During liquidation of the company, one shareholder applied to court for the balance of amounts owed to him after the buyback.

Lord Watson held that paid up capital may be diminished or lost in the course of the company’s trading, that is a result which no legislation can prevent, but persons who deal with and give credit to a limited company naturally rely upon the fact that the company is trading with certain amount or capital already paid, as well as upon the responsibility of its members for the capital remaining and they are entitled to assume that no part of the capital which has been paid into the coffers of the legitimate course of business.

This case prohibited the reduction of contributed share capital and consequently the shares repurchase practices. The reasoning adopted in the case was that the contributed share capital constitutes a reserve fund to which the creditors will turn to if the company defaults on its financial obligation or when the company is liquidated.

This approach was adopted and followed in many jurisdictions which supported the share capital maintenance including South Africa.

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\(^{5}\) [http://www2.accaglobal.com/students/student_accountant/archive/2000/10/36856](http://www2.accaglobal.com/students/student_accountant/archive/2000/10/36856)

\(^{6}\) *Trevor v Whitworth* [1887] 12 APP CAS 409 (HL).
2.3 DISTINCTION BETWEEN SHARE REDEMPTIONS AND SHARE REPURCHASE

At first glance share redemption and repurchases look the same and the distinction between the two has to be done in order to eliminate the confusion which might result.

The share repurchases and redemptions both involve the return to the company of the shares the company once issued to the shareholders, in lieu the company will pay money or transfer assets to the shareholders. As far as share redemption is concerned the acquisition of shares by the company is in accordance with the provisions of a contract embodied in the memorandum of incorporation or in terms of the conditions of the issue of the shares. On the other hand the share repurchases refer to the conclusion of transactions between the company and one or more of its shareholders in terms of which it is agreed that the company will acquire its shares. Redemptions will therefore not be dealt with in detail for the purposes of this work.

2.4 THE ADVANTAGES AND DISADVANTAGES OF SHARE REPURCHASE

Every business transaction is informed by some kind of reasoning and to come to an informed business decision one has to assess the pros and cons of such a decision. Below are some of the advantages and disadvantages of share repurchases.

2.4.1 THE ADVANTAGES OF SHARE REPURCHASE

- Share repurchases are useful where a company has an employee share incentive scheme because they enable the company to repurchase employee’s shares when they leave their employment.

- Share repurchases can be usefully utilised to buy out dissident shareholders.

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7 Cassim & Cassim (2011) 272
• Share repurchases enable the company to return surplus funds to the shareholders who can then make other more profitable investments.

• Share repurchase can be used to maintain or achieve what is perceived to be a desirable debt-equity ratio. Where a company has a number of shareholders with small shareholding, the administrative overheads that this causes can be reduced by the company buying out those “odd lots” without incurring any material costs.

• Share repurchases are perceived good investments for a company whose shares are considered to be undervalued.

• Share repurchase assist companies engaging in takeovers and mergers by enabling them to take shares off the market to be reissued as a consideration in takeovers and mergers without dramatically increasing the company issued shares.

• Share repurchase can be utilised in the situation of hostile takeovers to avert the takeover.

2.4.2 THE DISADVANTAGES OF SHARE REPURCHASE

• The fact that a repurchase has been proclaimed does not necessarily mean that the transaction itself has indeed been carried out, the speculation as a result of the announcement may lead to an increase in the share price but if the shares repurchase deal fails, the impact on the share price might have already occurred.

• The share repurchase can also result in the reduction of share capital.

• In certain instances the share repurchase is abused by management to buy out inquisitive or troublesome shareholders.
CHAPTER THREE

3. SHARE REPURCHASE RULE IN CANADA

3.1 THE CANADIAN LAW AS A CHOICE FOR COMPARATIVE STUDY

Many countries shifted from the rigid capital maintenance doctrine and began to adopt more lenient approaches which enabled companies to purchase or buy back their own shares under strict conditions and the South African law makers also followed suit. The South African legislature discontinued using the British model and adopted sections 85-90 which were largely based on the Canadian model.\(^8\) It is against this background that the Canadian law is chosen as a comparative study.

3.2 THE STATUTE GOVERNING SHARE REPURCHASE IN CANADA

Share repurchases in Canada are primarily governed by sections 34, 35, 36, 45 or 190 or paragraph 241(3) (f) of Canada Business Corporations Act (R.S.C., 1985, .c. C-44)

The above sections introduced share repurchase in Canada by providing circumstances and requirements for share repurchases. For ease of reference each section is quoted followed by a brief explanation in relation to the quote.

In terms of section 34(1) and (2) of Canada Business Corporations Act a corporation may purchase shares issued by it if the articles permit and it complies with the liquidity and solvency test.

The Canadian approach is similar to the South African approach in that they both require the company to be authorised by its articles and comply with the liquidity and solvency test.

\(^8\) Cilliers & Benade (2000) 323
This section is an equivalent of section 85 of the Companies Act of 1974 and section 48 read with section 46 of the Companies Act of 2008.

Section 35 of Canada Business Corporations Act allows the company to buy back its own shares in order to settle or compromise debt or claims asserted by or against the corporation, eliminate fractional shares, fulfil the terms of a non-assignable agreement under which the corporation has an option or is obliged to purchase shares owned by a director, an officer or an employee of the corporation, satisfy the claim of a shareholder who dissents under section 190; or comply with an order under section 241, furthermore subsection 3 requires that the liquidity and solvency test to be complied with when the company undertakes the transactions outlined in section 35.

It is suffice to mention that section 36 deals with the redemption of shares which is also a common phenomenon in South African law, further, this section also lays down requirements for solvency and liquidity under which the redemption of shares may be carried out.

Section 45 of Canada Business Corporations Act deals with the situation where a loan facility is secured from the company by a shareholder of that company, the shareholder then pledges his/her shares as security in the event of default in payment. This kind of a transaction will manifest itself as a share repurchase should the shareholder indeed default. The company will in this case have to activate the lien and acquire its issued shares in the hands shareholder. This kind of a transaction must be provided for in the articles and the corporation must comply with the liquidity and solvency and amounts to a distribution. The South African law does cover these situations under distributions and strict compliance with the law is required.

Section 190 also has the effect of share repurchase, in terms of this section if a company proposes or undertakes transactions provided for in this section, a dissent shareholder has a right to be paid by the corporation the fair value of the shares in respect of which the shareholder dissents, determined as of the close of business on the day before the resolution was adopted or the order was made.
Section 241(3) (f) of Canada Business Corporations Act deals with acquisition of shares by means of a court order. The Court may order a corporation to acquire shares issued by it in the hands of a particular shareholder if it is satisfied that any of the circumstances stipulated in section 241(2) (a), (b) and (c) exist. This section is an equivalent of section 252 of the South African Companies Act of 1974 which affords a shareholder a remedy to apply to court in case of unfairly prejudicial conduct.

The court has the power inter alia to order that shares of any members of the company be purchased (a) by other members thereof or (b) by the company itself (with an accompanying order for the reduction of the company’s share capital. A company may also be authorised to purchase its own shares as part of the scheme for the reduction of its share capital.\(^9\)

### 3.3 CONTRACTS FOR THE PURCHASE OF SHARES

In Canada an agreement with a company providing for the acquisition by the company of shares issued by it is enforceable against the company. Section 40 (1) provides that a corporation shall fulfil its obligations under a contract to buy shares of the corporation, except if the corporation can prove that enforcement of the contract would put it in breach of any of sections 34 to 36, in essence the contract for the repurchase of shares must amongst other things comply with the solvency and liquidity test.

A contract with a corporation providing for the purchase of shares of that corporation is specifically enforceable against the corporation except to the extent that the corporation cannot perform the contract without being in breach of sections 34 or 35 dealing with the acquisition of its shares. In such a case until the corporation has fully performed the contract, the other party retains the status of a claimant entitled to be paid as soon as the corporation is lawfully able to do or on a liquidation, to be ranked subordinate to the rights of creditors but in priority to the shareholders.\(^10\)

The South African equivalent of the above section is section 88 of the Companies Act of 1974 and section 48 (4) and (5) of the Companies Act of 2008.

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\(^9\) Cilliers & Benade (2000) 327  
\(^10\) Harry Sutherland,Q.C. Company Law of Canada 164
In principle both the Canadian and South African laws provide that an agreement with a company providing for the acquisition by the company of shares issued by it is enforceable against the company.

3.4 STATUS OF THE REPURCHASED SHARES

The shares repurchased by a company must be cancelled or may be restored to the status of authorised but unissued shares of that class. Section 39(6) provides shares or fractions thereof of any class or series of shares issued by a corporation and purchased, redeemed or otherwise acquired by it shall be cancelled or, if the articles limit the number of authorized shares, may be restored to the status of authorized but unissued shares of the class.\(^\text{11}\)

Section 85(8) of the Companies Act of 1974 and Section 3(5) of the Companies Act of 2008 are an equivalent of the above section. In terms of section 85(8) Shares issued by a company and acquired under this section shall be cancelled as issued shares and restored to the status of authorized shares. Section 35 (5) provides that the repurchased shares have the same status as the shares that have been authorised but not issued. In conclusion, the laws relating to share repurchase are similar in many respects and South Africa can learn a lot and borrow from the Canadian corporate law for the purpose of interpretation when faced with a legal conundrum.

\(^{11}\) Section 39 of Canada Business Corporations Act
CHAPTER FOUR

4. ACQUISITION OF OWN SHARES UNDER THE 1973 ACT

4.1 INTRODUCTION

Prior to 1999 the company was not allowed to repurchase its own shares in South Africa. The Companies Amendment Act\(^\text{12}\) radically changed the position with regard to the share capital maintenance doctrine by introducing sections 85-90.

A company may only acquire its own shares if there is reasonable belief that the company is, or would be after the acquisition, able to pay its debts as they fall due in the ordinary course of business (liquidity test) and that the consolidated assets of the company would, after the acquisition, exceed its consolidated liabilities (solvency test). If these requirements are not met, a creditor may apply to the court for an order to compel a shareholder or a former shareholder (due to the fact that his shares were acquired by the company) to return the consideration to the company and to order the company to reissue the shares to that shareholder or any other order that the court thinks fit.\(^\text{13}\)

4.2 AUTHORITY TO PURCHASE OWN SHARES

Section 85(1) authorised the company to acquire its own issued shares by a special resolution if authorised by its articles, furthermore the company may repurchase its own shares if it complied with solvency and liquidity test doctrine.

The Companies Act now provides that a company may, if authorised in the articles, approve the acquisition of its issued shares by special resolution. The approval can be a general approval that will be valid until the next annual general meeting (unless it is revoked by a special resolution before then) or a specific approval for a particular acquisition.\(^\text{14}\)

\(^{12}\) Companies Amendment Act 37 of 1999

\(^{13}\) http://www2.accaglobal.com/students/student_accountant/archive/2000/10/36856

\(^{14}\) http://www2.accaglobal.com/students/student_accountant/archive/2000/10/36856
4.3 LIQUIDITY AND SOLVENCY TEST
Section 85(4) contains the liquidity and solvency test, in terms of this section a company shall not make any payment in whatever form to acquire any share issued by the company if there are reasonable grounds for believing that the company is, or would after the payment be, unable to pay its debts as they become due in the ordinary course of business or the consolidated assets of the company fairly valued would after the payment be less than the consolidated liabilities of the company.

4.4 STATUS OF REPURCHASED SHARES
Section 85 (8) deals with the status of the repurchased shares. In terms of this subsection shares issued by a company and acquired under this section shall be cancelled as issued shares and restored to the status of authorised shares.

4.5 CONVERTIBLE OR REDEEMABLE SHARES
Section 85(9) deals with the situation where the company acquires shares and the only remaining issued shares will be convertible or redeemable shares. This subsection prohibits the acquisition by the company of its issued shares if the acquisition will result in the only issued shares being the convertible or redeemable shares.

4.6 APPROACH OF SOUTH AFRICAN COURTS TO SHARE REPURCHASES

In Capitex Bank Ltd v Qorus Holdings Ltd and others\textsuperscript{15} the issue of share repurchase was dealt with. In this case the company had agreed to buy over 4 million of its own shares in its issued capital for R6 million. Other parties bound themselves as sureties and co-principal debtors for this obligation. When Qorus failed to honour the contract, the sureties were sued. In response they pleaded that a company is prohibited from purchasing its own shares “otherwise than in accordance with the provisions of section 87 of the Companies Act or alternatively in accordance with section 87 read with section 85 of the Act”. In rejecting this defence the Court held that section 85(1) of the Act allows a company to approve the acquisition of its own

\textsuperscript{15} Capitex Bank Ltd v Qorus Holdings Ltd and others 2003 (3) SA 302 (W)
shares subject only to two internal requirements, namely that the acquisition be authorised by the articles and that approval be given by way of special resolution. The reason for the prohibition of a company buying its own shares was based upon the common law rule that a company maintain its capital and it was considered that by purchasing its own shares a company was, effectively, reducing its capital. The Court found, following modern writers on the topic, that capital maintenance is an imperfect way to protect creditors and that modern tests relate to the solvency and liquidity of the company as requirements to protect creditors and shareholders. Thus section 85(4) still prohibits a company from making payment in whatever form to acquire shares issued by it if there are reasonable grounds for believing that the company is, or would after payment be, unable to pay its debts or that the consolidated assets of the company fairly valued would, after payment, be less than the consolidated liability of the company. Qorus, of course, had not made any payment and it was held that the mere purchase or the mere conclusion of an agreement of purchase and sale relating to the acquisition by a company of its own shares is not prima facie illegal. It is only when payment is made in contravention of section 85(4) that the illegality arises.

It clear from the above that share repurchase are no longer prohibited, Companies with the necessary authority allowed to acquire its own shares provided the satisfied the strict requirement such as the special resolution, liquidity and solvency tests etc. In a nutshell the Section 85 provides for the acquisition, under certain circumstances, by a company of shares issued by it.

4.7 LIABILITY OF DIRECTORS AND SHAREHOLDERS UNDER CERTAIN CIRCUMSTANCES

Section 86(1) provides that the directors of a company who, contrary to the provisions of section 85 (4), allow the company to acquire any share issued by it, are jointly and severally liable to restore to the company any amount so paid and not otherwise recovered by the company.
4.8 RELIEF FOR THE DIRECTORS LIABLE IN TERMS OF SECTION 86(2)
A director who is liable under subsection (1) may apply to the Court for an order compelling a shareholder or former shareholder to pay to the company any money that was paid to such shareholder contrary to section 85 (4).

4.9 RELIEF FOR CREDITORS IN TERMS OF SECTION 86(3)
In terms of section 86 (3) where the acquisition by the company of shares issued by it is in contravention of the provisions of section 85 (4), any creditor who was a creditor at the time of the acquisition, or who is a creditor by reason of a cause of debt which arose before such acquisition, or any shareholder, may apply to the Court for an order, and the Court may order a shareholder or former shareholder to pay to the company any money or return any consideration that was paid or given by the company to acquire the shares, order the company to issue an equivalent number of shares to the shareholder or former shareholder or make such other order as it thinks fit.

4.10 PROCEDURE OF ACQUISITION OF CERTAIN SHARES BY COMPANY IN TERMS OF SECTION 87
In terms of section 87 a company that proposes to acquire shares issued by it shall deliver or mail a copy of the written offering circular to its shareholders, lodge a copy of the offering circular with the registrar within 15 days of the delivery of the offering circular to its shareholders and notify the Registrar within 30 days of the date of the acquisition in the prescribed form of the date, number and class of shares that it has acquired. If the company proposes to acquire shares, it must distribute an offering circular, as prescribed in the Act, to all the shareholders holding shares of the class, stating that it proposes to acquire shares, and must also lodge a copy of the circular with the registrar. The circular must contain at least the prescribed information and must, in general, state the terms and reasons for the offer.16

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16 section 87(1) Act 61 of 1973
4.11 ENFORCEABILITY OF CONTRACTS FOR ACQUISITION BY COMPANY OF CERTAIN SHARES IN TERMS OF SECTION 88

A contract with a company for the acquisition of shares issued by it is enforceable against the company however such contract shall not be enforceable if company cannot execute the contract without being in breach of section 85 (4). The onus of proving that the contract is in contravention of section 85(4) lies on the company.

The shareholders who sold their shares to the company have a claim against the company until such time the company has honoured its obligations in terms of the contract.

4.12 ACQUISITION OF SHARES IN A HOLDING COMPANY BY SUBSIDIARIES IN TERMS OF SECTION 89

Subsidiary companies may acquire shares in their holding company to a maximum of 10 % in the aggregate of the number of issued shares of the holding company.

4.13 LIQUIDITY AND SOLVENCY IN TERMS OF SECTION 90

Section 90 requires the company to comply with the liquidity and solvency test. In terms of this section the company must not proceed with any payment to the shareholders if there is a reasonable believes that the company will not comply with the liquidity and solvency test. In order to avoid an order for specific performance against it the company will have to prove that payment would compromise either its solvency or its liquidity. It is clear that it is the financial position of the company at the time when it is sought to enforce the contract that is relevant. Due to the fact that section 88 merely cross- refers to section 85(4) it seems that the company has to prove only that there are 'reasonable grounds for believing' that it will not meet the solvency and liquidity criteria. It may have been preferable to require a higher degree of proof from the company in these circumstances.17

4.14 PROTECTION OF THE SHAREHOLDERS AND CREDITORS

The 1999 amendments did not just abolish the share capital maintenance without affording the creditors and holders of shares any protection. There are strict requirements build in the 1999 amendments which the company needs to comply with in order to lawfully execute a share repurchases.

4.15 PROTECTION OF THE SHAREHOLDERS

The shareholders and the registrar will be notified and in terms of section 87(1) of an intention to embark on a share repurchases. This section affords the shareholders an opportunity to take necessary action in the event they disagree with the proposed move.

4.16 PROTECTION OF THE CREDITORS

The protection of the creditors is in the form of the remedy to apply to court if the repurchase is in contravention of section 85 in term of section 85(3), liquidity and solvency requirement provided for in section 85(4), the directors’ liability in terms of section 85(6) and the breach of fiduciary duties.

4.17 TAX IMPLICATIONS TRIGGERED BY SECTION 85

The income tax effects of share buybacks are based on two aspects of the definition of a ‘dividend’ in the old Act. When a company makes a distribution to its shareholders in the course of, inter alia, a reduction of capital, any excess above the nominal value of the capital reduced is deemed to be a dividend. The company is liable for Secondary Tax on Companies (‘STC’) on this amount, which is treated as a dividend in the hands of the shareholder and is therefore exempt from normal tax. It suffice to state that under certain circumstance tax was payable when dealing with section 85.
CHAPTER FIVE

5. ANALYSIS AND COMPARISON BETWEEN SECTION 85 AND SECTION 48

5.1 INTRODUCTION

The Act contains provisions permitting the company to repurchase its own shares, such provisions are contained in section 48. Both Sections 85 and 48 of the old Act and the new Act respectively, deal with the acquisition of own shares by the company. The two sections require a company to meet certain requirements in order to lawfully undertake a transaction in terms of the two sections.

In 2011, the legislature introduced some amendments to some of the sections of the Act, these amendments are contained in the Companies Amendments Act 18. The sections discussed herein are discussed in their amended form.

As a point of departure it is important to highlight that share repurchases are viewed as a form of distribution in terms of the Act. When discussing this repurchase of shares the principles applicable to distributions *mutatis mutandis* apply.

In terms of section 1 (a) distribution means a direct or indirect transfer by a company of money or other property of the company, other than its own shares, to or for the benefit of one more holders of any of the shares of that company or of another company within the same group of companies, whether:

(iii) Is consideration for the acquisition

(aa) by the company of any of its shares, as contemplated in section 48; or

(bb) by any company within the same group of companies, of any shares of a company within that group of companies.

The distributions amongst other things consists of the repurchase of shares by the company 19

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18 Act 3 of 2011
19 Delport (2009) 34
The Act under certain circumstances allows companies to make distributions to the shareholders with strict requirements such as solvency and liquidity amongst other things. A wide range of aspects are covered by the Act as far as distributions are concerned.

5.2 SECTION 48 (1)

This section is more of an exception, it excludes certain transactions from the operation of Section 48. In terms of this section the making of a demand, tendering of shares and payment by a company to a shareholder in terms of a shareholder’s appraisal rights set out in section 164 do not constitute an acquisition of its shares by the company within the meaning of this section. This means that transactions of this nature need not comply with the requirements of section 48 read with other related sections in this Act.

5.3 SECTION 48 (2)

This section is the authority for the companies to repurchase their own shares. Section 48 (2) (a) provides that a company may acquire its own shares, if the decision to do so satisfies the requirements of section 46 and a subsidiary can purchase shares in its holding company provided that the shares held by or on behalf of the subsidiary are not in excess of 10% of the number of the issued shares of any class of shares of that company.

A company’s acquisition of its own shares qualifies as distribution in terms of section 1 of the Act and must comply with the requirements set out above. A subsidiary (or subsidiaries) can also acquire shares in the holding company, but the aggregate number of shares held by or on behalf of the subsidiary (or subsidiaries) may not exceed 10% of the number of any class of shares. As long as such subsidiaries remain subsidiaries, no voting rights attached to those shares may be exercised in respect of the shares so held. 20

Section 48 (2) is the authority for a company to acquire, it also empowers the subsidiaries to hold shares in their holding companies, set the limit on shares which

20 Delport (2009) 35
can be held by the subsidiaries and also outlines the voting rights of the shares held by the subsidiaries.

Section 85 authorises the company to acquire its issued shares by a special resolution if authorised by its articles subject to the solvency and liquidity test. This was a strict requirement and the creditors and shareholders were afforded adequate protection.

Section 48 does not stipulate as to who has the authority to authorise acquisition of security. It appears that by implication the authority is vested in the board. This is gathered from the reading of section 46 which requires the board of the company to satisfy itself that the solvency and liquidity as well as other requirements are met.

Section 48 dispensed with the requirement of a special resolution provided for in section 85 by requiring an approval. It is not clear from this section what type of approval is required for the purpose of acquisition of securities by a company in terms of section 48.

It appears that the company can stipulate the type of a resolution which is required for the purposes of section 48 in the Memorandum of Incorporation (MOI), it is not stated anywhere in the section what form or type the approval by the board should be and therefore one presumes that the type of an approval can be dealt with in the MOI. It remains unclear and a lacuna in section 48 when it comes to the type of approval required. What can result in more confusion is when the MOI is also silent about the type of an approval required for the acquisition of securities in terms of section 48. The problem presented by the new Act is that it allows the repurchase to be carried out as long as the board has authorised the repurchase.

This means that the repurchase can be carried out in terms of an ordinary resolution which requires a threshold of a simple majority of the voting rights exercised on the resolution or a higher percentage as required in terms of Section 65 (8) or by the holder of a company’s securities.
Another problem which could arise is where the requirement of a special resolution have been lowered in terms of Section 65 (10). This in essence means that the share repurchases under section 48 could be more easier than they were under section 85 which will leave the creditors and shareholders being exposed to a greater risk than they were under section 85.

Section 48 contains a cross referencing to section 46, the cross referencing brings the compliance of distributions with the solvency and liquidity test, however this is not the case as far as section 48 (2) is concerned. Section 48 (2) requires the decision to comply with section 46, which makes no sense. Section 48 provides that, if the company is to acquire its own shares, it may only do so if the decision to do so satisfies the requirements of section 46. The cross-reference to section 46 in section 48 is ‘unnecessary and confusing’ because section 46 states the requirements for the ‘distribution’ and not for ‘decision’. The cross-reference creates an impression that a decision to make repurchase requires the company to be solvent and liquid at the time of making the decision. This does not make sense, because the decision can do no harm. It is the distribution pursuant to the decision that is potentially harmful and it is immediately after the distribution that the solvency and liquidity test should be satisfied. The reference to section 46 in section 48 should therefore be removed.21

The above view is not farfetched, because if the decision or resolution is taken but not implemented it does not fall within the ambit of Section 48, Section 48 only becomes operational upon the full implementation of the distribution. Therefore no harm can be done by the decision itself, however much harm can result from the implementation (i.e. the actual distribution).

The decision to acquire securities in terms of section 48 will do no harm, it is the acquisition itself which will cause serious harm if it does not comply with the provisions of section 46.

21 Cassim & Cassim (2011) 274
The fact that the decision is the one which must comply with section 46 as opposed to the actual acquisition makes no sense and it must be amended to the effect that the acquisition itself must comply with the requirement set out in section 46.

It can be argued further that the decision will not be recognised as distribution in terms of the definition of distribution contained in section 1 of the Act. The usage of the word acquire creates more confusion, it is impossible for the company to have rights against itself, the word acquire creates the impression that the company will acquire the share and become a shareholder in itself.

The term ‘acquisition’ is however a misnomer because it indicates that the acquiring company holds shares. This is not possible because the company cannot acquire rights against itself. In any event section 35(5) of the Act makes it clear that the shares acquired by the company no longer, on acquisition, retain the status of issued shares, but have the status as shares that have been authorised but not issued. It follows that the direct acquisition by the company of the ‘treasury’ shares is not possible, although a limited acquisition thereof is possible through the company subsidiary.22

It is not clear whether the acquisition by a company of its own shares by gift or inheritance is covered by section 48. Clearly there is no distribution as defined in section 1 of the Act, involved, and on that basis section 46 has no application. However, if such acquisition falls within the purview of the term ‘acquire’ in section 48(2) (a), then section 46 would have to be complied with. Such compliance does not make sense. In fact section 48 in its entirety seems geared towards an acquisition by a company of its own shares or shares in its group involving a distribution of some consideration, which of course, is absent in the case of an acquisition through a gift or inheritance. If an acquisition through a gift or inheritance is included for the purposes of section 48(2)(a), the shares have to be cancelled in terms of section 35(5) which refers to the acquisition contemplated in section 48. This makes no sense.23

Another situation which comes to mind is the shares left in the deceased estate and the deceased is survived by no one. In terms of the South African law an unclaimed

22 Cassim & Cassim (2011) 274
23 Ibid
first vest in the Master of the High Court in the guardian’s fund and after a period of 30 years it’s forfeited to the state. Where there are no relatives in the deceased estate and no surviving spouse, the estate goes as bona vacanctia (unclaimed estate) to the state. The above suggest that if the estate consists of securities or part is securities and such there are no relatives at all in that estate and no surviving spouse, the securities will eventually after being unclaimed for 30 years devolve to the state.

I am of the opinion that a special provision dealing with unclaimed securities must be incorporated in the companies act.

Section 48 is not a very good section as it is open to many interpretations. The legislature must intervene and address the loopholes in this section.

5.4 SECTION 48(3)

This section deals with instances where a company or subsidiary acquires its own shares and the remainder of the shares in the company is convertible or redeemable shares.

An acquisition by a company of its own shares and or an acquisition by a subsidiary of shares in the holding company resulting in the only issued shares being the shares held by one or more subsidiaries of the company, or convertible or redeemable shares is not allowed.

The company may not acquire its own shares, and a subsidiary of a company may not acquire shares of that company, if, as a result of that acquisition, the only shares of the company issued would be shares held by one or more subsidiaries of the company; or convertible or redeemable shares. The reason why convertible and redeemable shares are singled out is uncertain. It is also not clear what a “redeemable” share will be in terms of the new Act. This section serves no purpose appears to be a redundant section, and it must be repealed.

25 Delport (2009) 35
26 Delport (2009) 35 fn 24
5.5 THE ENFORCEABILITY OF AGREEMENTS FOR THE ACQUISITION OF OWN SHARES SECTION 48 (4)

The approach taken by the old Act is the same as the one in terms of s 48(4). The agreement to acquire shares with the company is enforceable against the company provided it complies with subsections (2) and (3).

An agreement with a company providing for the acquisition by the company of shares issued by it is enforceable against the company. Such enforceability is subject to the qualification that the agreement is not enforceable if the company would fall foul of the solvency and liquidity requirements or if the acquisition would result in there being no longer any shares of the company in existence other than shares held by the company subsidiaries, convertible shares or redeemable shares.

A contract with a company providing for the acquisition by the company of shares issued by it is enforceable against the company (the burden of proof lies on the company), except if the company cannot execute the contract without being in breach of section 48(2)-(3).

It is unclear whether the whole contract or only the part which is in breach of the provisions is unenforceable.

5.6 APPLICATION TO COURT AND BURDEN OF PROOF POSSIBLE ORDERS SECTION 48 (5)

In the event that the company is unable to enforce a contract because such contract contravenes section 46 or 48, the company may apply to court for the reversal of the acquisition and the burden of proof lies on the company. If the court is satisfied that the company is unable to enforce the agreement it may make an order that:

- Is just and equitable, having regard to the financial circumstances of the company; and
- Ensures that the person to whom the company is required to make a payment in terms of the agreement is paid at the earliest possible date compatible with

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27 Cassim & Cassim (2011) 279
28 Delport (2009) 35
the company satisfying its other financial obligations as they fall due and payable.

If the company acquires any securities in contravention of section 46 or 48, it may apply to court within two years for the reversal of the acquisition.

This is good since it allows for a judicial intervention in case the company alleges that it is unable to carry out the contract, the court will always consider what is just and equitable under the circumstances.

5.7 DIRECTORS LIABILITY (SECTION 48 (7))

In terms of this section, a director is liable if he or she is present at a meeting where the board approves the acquisition contemplated in section 48 or participate in the making of the decision and fails to vote against the acquisition of shares, despite knowing that the acquisition is contrary to sections 46 and 48.

If a director is present at a meeting, or participates in the making of a decision in terms of section 74 and fails to vote against the acquisition of shares, despite knowing that the acquisition is contrary to sections 46 and 48, that director is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence thereof.  

In terms of section 48(7) director of a company is liable to the extent set out in Section 77 (3) (e) (vii) if the director was present at the meeting when the board approved an acquisition of shares contemplated in this section 48, or participated in the making of such a decision in terms of section 74, failed to vote against the acquisition of shared, despite knowing that the acquisition was contrary to this section or section 46.

The director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director being party to the acquisition by the company of its own shares despite knowing that the acquisition was contrary to section 48 or section 46.

29 Delport (2009) 36
The liability arises if the director was present at the meeting when the board approved the acquisition and failed to vote against the acquisition knowing that the acquisition was contrary to section 48 or section 46.

As an acquisition by a company of its own shares involves distribution, that can give rise to liability on the part of a director in terms of section 48(7) read with section 77 (3) (e) (vi) and also section 46(6) read with section 77(3) (e) (vii). It appears that the two liabilities are the same, with two exceptions:

In the case of distribution, the liability is wider in that the director is not only liable if the distribution does not meet the solvency and liquidity requirements, but also if the acquisition results in the requirements in section 48(3) not being met (i.e. the acquisition leaves the company with only shares held by its subsidiaries or only convertible or redeemable shares), and

In the case of an acquisition, the limit in section 77(4) (b) does not apply, whereas it does in the case of a distribution.\textsuperscript{30}

Cassim et al is further of the view that where a company acquires shares in its holding company unlawfully or makes a distribution pursuant to such an acquisition unlawfully, directors of the acquiring company incur liability in terms of section 48(7) or section 46(6) respectively. The liability is for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director being a party to the distribution or acquisition despite knowing that the acquisition or distribution was unlawful. The liability arises if the director was a party to the resolution approving the acquisition or distribution and failed to vote against it knowing that the acquisition or distribution was unlawful.

The limit on the liability in terms of section 77 (4) applies. It is the difference between the amount by which the value of the distribution exceeded the amount that could have been distributed without causing the company to fail the solvency and liquidity test and the amount, if any, recovered by the company from persons to whom the distribution was made.\textsuperscript{31}

\textsuperscript{30} Cassim & Cassim (2011) 280
\textsuperscript{31} Cassim & Cassim (2011)284
5.8 STATUS OF REPURCHASED SHARES (SECTION 35 (5))

The status of the repurchased shares under the new dispensation is that the shares are authorised but not issued. As far as the shares acquired by the subsidiary are concerned the voting rights attached to those shares cannot be exercised for as long as the subsidiary remain the subsidiary.

A subsidiary (or subsidiaries) can also acquire shares in the holding company, but the aggregate number of the shares held by the subsidiary or on behalf of the subsidiary (or subsidiaries) may not exceed 10% of any class of shares as long as such subsidiaries remain subsidiaries, no voting rights attached to those shares may be exercised in respect of the shares so held.\(^{32}\)

Section 35(5)(a) and (b) states that the 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, have the same status as shares that have been authorised but not issued.\(^{33}\)

The position under the Act as far as the status of the shares is concerned is the same as the one under the old Act, even though the new section does not mention the fact that the shares must be cancelled. The shares under both regimes have the status of authorised but not issues shares.

5.9 CONFLICT BETWEEN THE MEMORANDUM OF INCORPORATION AND THE ACQUISITION

Each provision of the Memorandum of Incorporation must be consistent with the Act and is void to the extent that it contravenes, or is inconsistent with the Act. This suggests that if there is a conflict between an acquisition which complies with the Act and a memorandum of incorporation the acquisition will supersede.

In the event of a conflict between the Memorandum of Incorporation and the acquisition, the acquisition will supersede the Memorandum of Incorporation, rendering the provision in memorandum of incorporation ineffective and inoperative. It appears, although this is by no means clear, that an acquisition which complies with the relevant requirement requirements of section 46 and section 48, as the case

\(^{32}\) Delport (2009) 35

\(^{33}\) See section 35(a) and (b) of Companies Act 61 of 2008
maybe, is valid even if it conflicts with the Memorandum of Incorporation. Thus provisions in the Memorandum of Incorporation that prohibit acquisition partially or altogether or permit them only if certain conditions are met are ineffective. This is borne by a reading of section 15 (2(a) (ii) of the act and the definition of an ‘alterable provision’ in section 15 (2) (a) (ii) provides that the Memorandum of Incorporation of any company may include any provision altering the effect of any alterable provision of this Act. 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.

An examination of section 48 shows that it is not an alterable provision. There is nothing in section 48 that expressly contemplates that the effect of section 48 may be negated, restricted, limited, qualified, extended, or otherwise altered in substance or effect by a company’s Memorandum of Incorporation.

It is doubtful whether the legislature intended the Memorandum of Incorporation to be nullified in this way. Why should a company not, for example, in its Memorandum, prohibit repurchase or add to the requirements of section 48 in some way? A clarifying amendment is called for.

5.10 PROTECTION OF THE CREDITORS UNDER SECTION 48

The requirement that a company must satisfy the solvency and liquidity test is a protection of the creditors. In terms of section 48 a company may acquire its own shares provided it complies with section 46.

As a means to safeguard creditors and minority shareholders of a company, the company’s board must not make any proposed distribution unless it has applied the solvency and liquidity test, and it has acknowledged, by resolution, that it has reasonably concluded that the company will satisfy the test immediately after completion of the proposed distribution.

The requirements must be met whether the distribution is pursuant to a board resolution, an existing obligation or a court order.

When more than 120 business days have passed since the board’s acknowledgement that it has applied the solvency and liquidity test and it has

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34 Cassim Cassim (2011) 275
reasonably concluded that the company will satisfy the test, and the company has not yet completed the distribution, the board is required to reconsider the solvency and liquidity test with respect to the remaining distribution to be made. The company may not proceed with or continue a distribution unless the board adopts a further resolution acknowledging that it has applied the solvency and liquidity test and has reasonably concluded that the company will satisfy it. Once an acknowledgement is made (whether an initial or a subsequent one) the company is required to proceed with the distribution. As Van der Linde says, this means a company may have to proceed with and complete a distribution on the basis of the directors’ acknowledgement even when it appears within the 120 day period that the company no longer satisfies the test. It is strange that the company is obliged to proceed with what is in effect an unlawful distribution, merely based on the board’s formal acknowledgement.\textsuperscript{35}

The requirement that the acquisition must be authorised by the board does afford the creditors some protection to some extent, the challenge with the current section 48 is that it removed the special resolution requirement and replaced it with the board’s approval, this approval seem to be on a simple majority. This requirement is too low and exposes creditors and those conducting business with the company to a greater risk.

The directors liability contained in section 48 (7) provide some protection to the creditors. In terms of section 48(7) of section 48(7) director of a company is liable to the extent set out in Section 77 (3) (e) (vii) if the director was present at the meeting when the board approved an acquisition of shares contemplated in this section 48, or participated in the making of such a decision in terms of section 74; failed to vote against the acquisition of shared, despite knowing that the acquisition was contrary to this section or section 46.

\footnote{Cassim & Cassim (2011) 247}
5.11 MANDATORY OFFERS

Under certain circumstances transactions acquisitions of securities by the company in terms of section 48 have a potential of attracting the provisions of section 123 of the Companies Act.

Section 123 deals with mandatory offers which a company or a person has to comply with if the prescribed threshold is reached when an acquisition of securities in terms of section 48 is done.

If a company acquires its own voting securities under section 48, or a person has acquired a beneficial interest in the voting securities of a regulated company and before that acquisition was able to exercise less than the prescribed percentage of all the voting rights attached to the securities of that company, and as a result of the acquisition, together with any other securities of that company already held, is able to exercise at least the prescribed percentage of all the voting rights attached to the securities of that company, that person must give notice in the prescribed manner to the holders of the remaining securities that he/she is in a position to exercise at least the prescribed percentage of all the voting rights attached to the securities of that regulated company and offer to acquire any remaining such securities.\(^{36}\)

Within one month after giving this notice, the person or persons must, in compliance with the Take-over Regulations, deliver to the holders of the remaining securities of that company a written offer to acquire those securities on the terms determined in accordance with the Act and the Take-over Regulations.\(^{37}\)

When faced with an acquisition of securities of a regulated company in terms of section 48 it is pivotal to observe the provisions of section 123.

In terms of section 123 when securities of a regulated company are acquired under section 48 the position prior to the acquisition and after the acquisition must be taken into consideration. If prior to the acquisition the company or any person held the securities below the prescribed percentage and as a result of the acquisition, together with any other securities of the company already held, is in a position to

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\(^{36}\) Delport (2009) 92

\(^{37}\) Id
exercise at least the prescribed percentage of the voting rights attached to the securities of that regulated company he/she must notify the holders of the remaining securities of the fact that he has reached the threshold and offer to acquire to acquire the remaining securities.

Once the company or person has given notice in the prescribed manner, a written offer to acquire the remaining securities on the terms in accordance with the Act and the Take-over Regulations.

5.12 TREASURY SHARES

Treasury shares are shares acquired by the company by means of repurchase, surrender, donation, inheritance or similar methods which instead of being cancelled on their reacquisition are held by the company until reissue or resale.

The Act does not recognise the concept of treasury shares. It also does not cover instances where a company acquires shares by means of surrender, donation and, inheritance. If section 35 is applied the shares might have to be cancelled which is not such a good thing.

The company cannot acquire rights against itself. In any event section 35(5) of the Act makes it clear that the shares acquired by the company no longer, on acquisition, retain the status of issued shares, but have the status as shares that have been authorised but not issued. It follows that the direct acquisition by the company of the ‘treasury’ shares is not possible, although a limited acquisition thereof is possible through the company subsidiary.38

It is not clear whether the acquisition by a company of its own shares by gift or inheritance is covered by section 48. Clearly there is no distribution as defined, involved, and on that basis section 46 has no application. However, if such acquisition falls within the purview of the term ‘acquire’ in section 48(2) (a), then section 46 would have to be complied with. Such compliance does not make sense.

in fact section 48 in its entirety seems geared towards an acquisition by a company

38 Cassim & Cassim (2011) 274
of its own shares or shares in its group involving a distribution of some consideration, which of course, is absent in the case of an acquisition through a gift or inheritance. If an acquisition through a gift or inheritance is included for the purposes of section 48(2)(a), the shares have to be cancelled in terms of section 35(5) which refers to the acquisition contemplated in section 48. This makes no sense.\textsuperscript{39} \textsuperscript{39}Ibid
CHAPTER SIX
6. THE MEANING OF SOLVENCY AND LIQUIDITY TEST

6.1 INTRODUCTION

The Act makes provision for the acquisition of own shares by the company provided if complies with the solvency and liquidity. A full understanding of the test is crucial on the part of any person dealing and implementing sections 46 and 48.

6.2 THE TEST

The regulation of distributions is contained in section 46. Section 46 has the elements of the solvency and liquidity test and also requires one to observe the provisions of section 4. The cross reference in section 46 to section for means that section 4 must be complied with.

When dealing with sections 46 and 48 section 4 immediately comes into picture since it’s the actual test. It must be noted that section 46 is the regulatory framework for distribution and since section 48 qualifies as a distribution section 46 must be complied with. Section 46 (1) (b) and(c) provides that:

(b) It reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution; and

(c) A company must not make any 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.40

In terms of section 48 the acquisition of securities must comply with section 46. Sections 46 stipulate the following requirements for a distribution:

The distribution must be pursuant to an existing legal obligation of the company, or a court order; or the board of the company by a resolution, has authorised the distribution.

It must reasonably appear that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution and the board of the company, by resolution, has acknowledged that it has applied the solvency and

40 Section 46 (b) and (c) Act 71 of 2008
liquidity test as set out in section 4, and reasonably concluded that the company will satisfy the solvency and liquidity test after completing the proposed distribution.

I will now turn to deal with the intricate aspects of the solvency and liquidity test. The test of solvency and liquidity is a two legged test and both legs must be satisfied in order to comply with section 48 of the new Act.

Non-compliance with either one of the two legs will result in the transgression of sections 46 and 48 and consequently result in the liability clause of the act invoked. The test must be met whether the distribution is pursuant to a board resolution, an existing obligation or a court order.

If the distribution contemplated in a particular board resolution, court order or existing legal obligation has not been completed within 120 business days after the board made the acknowledgement required by subsection (1) (c) or after a fresh acknowledgment being made in terms of this subsection as the case may be, the board must reconsider the solvency and liquidity test with respect to the remaining distribution to be made pursuant to the original resolution, court order or obligation.

Despite any law, order or agreement to the contrary, the company must not proceed or continue with any such distribution unless the board adopts a further resolution as contemplated in subsection (1) (c).

The acquisition must be carried out within the prescribed 120 days, otherwise the approval becomes void. In the event the time frame expires solvency and liquidity test must be reconsidered.

For any purpose 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 or, in the case of a holding company, the consolidated assets of the company, as fairly valued, equal or exceed the liabilities of the company or, in the case of a holding company, the consolidated 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 case of a distribution contemplated in paragraph (a) of the definition of distribution' in section 1, 12 months following that distribution.\textsuperscript{41}

The above section requires the company to be solvent and liquid for a period of 12 months subsequent to the implementation of a transaction in terms of section 48.

The board or any other person applying the solvency and liquidity test to a company must consider a fair valuation of the company’s assets and liabilities, including any reasonably foreseeable contingent assets and liabilities, irrespective of whether or not arising as a result of the proposed distribution, or otherwise and may consider any other valuation of the company’s assets and liabilities that is reasonable in the circumstances and unless the Memorandum of Incorporation of the company provides otherwise.

In conclusion solvency and liquidity test is a process when it comes to the acquisition of securities in terms of section 48.

The point of departure is section 48 itself which makes reference to section 46.first and foremost the requirements found in section 48 must be observed, from there one must go and comply with the requirements of section 46.
In complying with the requirements of section 46 the provisions of section 4 are of utmost importance as they will also play a significant role in ensuring that the solvency and liquidity test are fully complied with

\textbf{6.3 CONSEQUENCES OF NON – COMPLIANCE}

Non - compliance with the provisions of section 48 will result in the contract being Unenforceable. The company however must prove that it is unable to comply with the terms and conditions of the contract due to non-compliance with provisions of section 48 and 46.

In terms of section 48(4) the agreement to acquire shares with the company is enforceable against the company provided it complies with subsections (2) and (3).

\textsuperscript{41} http://www.vdma.co.za/index.php?option=com_content&view=article&id=id=86:qsolvency-...
An agreement with a company providing for the acquisition by the company of shares issued by it is enforceable against the company. Such enforceability is subject to the qualification that the agreement is not enforceable if the company would fall foul of the solvency and liquidity requirements or if the acquisition would result in there being no longer any shares of the company in existence other than shares held by the company subsidiaries or convertible shares or redeemable shares.

A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having inter alia acquiesced in the operations of the company's business despite knowing that it was being conducted in a manner prohibited by section 22 (1) or been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose. The agreement entered into with a third party is voidable and can be declared void by a court of law. Financiers of companies must consider updating credit policies to obtain a solvency and liquidity declaration from all companies in all circumstances.42

**6.4 SECTION 48 AND INSIDER TRADING**

The insider trading only applies to the regulated companies which excludes the private companies as discussed in this work are not applicable. The share buy backs of companies not listed at the stock exchange are not covered under the insider trading concept. In essence the security services act will not find application in this regard.

CHAPTER SEVEN

7. TAX IMPLICATIONS OF SHARE REPURCHASES

7.1 INTRODUCTION

The acquisition of securities in terms of section 48 can under certain circumstances result in tax liability. It is possible for corporate law and tax law to fuse when dealing with or implementing share repurchases. It is therefore prudent when faced with the implementation of share repurchase to ascertain if the transaction raises tax matters. The tax liability is likely to affect the new Act in almost in the same manner affected it did with the old Act.

7.2 TAX IMPLICATIONS

Whether Secondary Tax on Companies (STC) is payable or not depends on whether a share buy-back amounts as a reduction of share capital, or the purchase of shares.

An investigation of the tax implications pertaining to share buy-backs require the detailed consideration of various provisions of the Income Tax Act No. 58 of 1962 including the capital gains tax ("CGT") provisions that may apply in the event of a company acquiring its own shares.

The reduction of share capital attracts tax, due to definition of dividend contained in terms of the Income Tax Act. If a share buy-back constitute a dividend, then STC will be payable. Generally, any profits distributed by a company to its shareholders will be a dividend for tax purposes. Paragraph (c) of the dividend definition specifically includes the excess over the amount by which the par value of shares is reduced in terms of a partial reduction or redemption of a company’s capital. The effect of the new Section 85 therefore appears to be a partial reduction or redemption of capital. Any amount paid to shareholders in excess of par value will therefore be a dividend subject to STC.

In terms of the new Companies Act, No 71 of 2008, share buy-backs are governed by section 46 thereof, which sets out the circumstances in which a company’s board
of directors may authorise a distribution by such company. The most noteworthy
requirement is contained in section 46(1) (b) which provides that a distribution may
not be made unless the company will satisfy the solvency and liquidity test
immediately following such distribution.
Section 48 of the Companies Act contains further pertinent requirements relating to
share buy-backs, mainly that the acquisition of its own shares by a company, or the
acquisition by a subsidiary of that company's shares is prohibited if, as a result of
that acquisition, there would no longer be shares of the company in issue other than
shares held by subsidiaries of the company or convertible or redeemable shares.
A new definition of dividend is effective as of the 1 January 2011 for tax purposes,
“Dividend” is now defined as any amount transferred or applied by a company for the
benefit of any shareholder in relation to that company by virtue of any share held by
that shareholder in that company, whether by distribution or as consideration for the
acquisition of any share in that company. Specifically excluded from the definition of
“dividend” is, inter alia, an amount transferred or applied by the company to the
extent that the amount so transferred or applied constitutes an acquisition by a
company of its own shares by a company listed on the JSE Ltd in accordance with
the JSE Listings Requirements.\(^{43}\)
For the purposes of this discussion it is suffice to say that the acquisition of securities
in terms of section 48 has tax implications under certain circumstances and tax laws
must be given consideration when implementing a section 48 transaction.

CHAPTER EIGHT

8. CONCLUSION

8.1 INTRODUCTION

The companies Act, 2008 came into operation on the 1st May 2011. This piece of legislation is still in its infancy stages. There is no judicial interpretation or guidance by our courts on how to approach any legal conundrum around this legislation at this stage and in particular section 48 of this Act. The inferences drawn on the Act will serve as individual opinion of the writer and remain untested. Given the fact that no court has pronounced as yet when it comes to the correct interpretation of section 48 one will not be deterred from erring on the side of caution in trying to interpret the approach which may be adopted by our courts in future.

8.2 CONCLUSION ON SECTION 48 OF THE COMPANIES ACT 2008

Section 48 poses so many challenges and it is prone to abuse. The conspicuous feature of this section is its lack of control mechanism. The transactions carried out in terms of section 48 must be authorised by the board, it appears that this authorisation is by way of a simple majority. One cannot understand why the legislature moved away from the requirement of a special resolution which was a real control mechanism that guarded against the abuse of power by those who are controlling the company.

The special resolution in the old Act could only be passed, on a show of hands, by not less than three fourths of the number of members of the company entitled to vote on a show of hands at the meeting who are present in person or by proxy or, where a poll has been demanded, by not less than three-fourths of the total votes to which the members present in person or by proxy are entitled. It was not easy to enter into unauthorised share repurchase transactions due to the high percentage required to get the special resolution.
Cassim et al is of the view that a distribution by a company must be authorized by the company’s board of directors. Unless the distribution is pursuant to an existing obligation of the company or a court order, no shareholder approval of any kind is required for a distribution. It also appears that the Memorandum of Incorporation cannot validly impose any prohibitions, conditions or requirements relating to distributions. This means provisions in the Memorandum of Incorporation that prohibit certain distributions or acquisitions altogether or permit them only if certain conditions are met, are ineffective. This is borne out by a reading of section 15(2) (a) (ii) which provides that the memorandum of Incorporation of any company may include any provision altering the effect of any alterable provision of this Act. An alterable provision means that 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.

An examination of section 46 shows that this section is not an alterable provision. There is nothing in this section that expressly contemplates that the effect of section 46 may be negated, restricted, limited, qualified, extended, or otherwise altered in substance or effect by a company’s Memorandum of Incorporation.

It is doubtful whether the legislature intended the Memorandum of Incorporation to be nullified in this way. Why should a company or not, for example, in its Memorandum of Incorporation, prohibit the paying of dividends out of anything other than profits? A clarifying amendment is called for.44

The other aspect that is not covered by the section is how to deal with the inherited and donated shares, these shares cannot just be cancelled and at the same time the company cannot have rights against itself. I am of the opinion that such shares must be held in trust for the benefit of the company. Furthermore another aspect which is unclear is how to treat the shares which are bona vacantia. These shares are the shares which are unclaimed either from the deceased estate or the owner thereof cannot be found.

44Cassim & Cassim 246
The paradigm shift in the share repurchase is a progressive one and adapts with the modern way of conducting business. The fears expressed by some legal commentators that the creditors are exposed to a greater risk by this practice are misplaced. The creditors are not concerned with an intact share capital but they are more interested in their claims being paid. The protection of creditors is maintained through solvency and liquidity test, and at the core of these tests is the fact that the company must be able to pay its debts as they become due in the ordinary course of business.

Under section 48 directors are liable for transactions in contravention of section 48 and 46. It is also possible for the directors to be held liable in terms of other laws. This affords the creditors and shareholders’ further protection. This aspect makes it possible to sue the directors for breach of fiduciary duties.

With some few amendments section 48 can become a very good framework, the main change which is required is to bring back the special resolution requirement to give the shareholders more say in the execution of such important decisions. Another aspect which needs to be taken care of is the inclusions of the approval in section 48 itself and bring back the requirement of special resolution for the purpose of acquisition of securities in terms of section 48, furthermore the requirement of special resolutions must not be an alterable provision of section 48 otherwise it will defeat the purpose as it might still be lowered if it is made an alterable provision.

In principle the section is welcomed as the world has evolved towards the acquisition of securities by the companies, however the shareholders and creditors need to be protected when engaging in these types of business transactions.

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