A critical analysis of the new Capital Maintence Rules in terms of the Companies Act 71 of 2008

by

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Summary

The objective of this study is to do critical analysis if the new Companies Act, with specific reference capital maintenance rules. Furthermore, this study will compare the current Companies Act with the new Companies Act, with a specific focus on sections 44, 45 and 48 of the new Companies Act and their comparison to sections 38, 85 and 228 of the current Companies Act. The next objective is to establish what impact the new piece of legislation will have on South African companies and whether the deficiencies in the current Companies Act have been addressed by the new Companies Act. The final objective is to establish whether this new piece of legislation gives adequate protection for the shareholders of a company.

This study will focus on certain aspects of capital maintenance and excludes a comprehensive study of the capital maintenance rules, as the focus will be on certain sections in the current Companies Act\(^1\) and also the new Companies Act\(^2\). This study will focus on the comparison between the new and current Companies Act.

Furthermore, the focus will also be on the protection of the creditors of a company when analysing the different sections of the current companies act and the new companies act.

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\(^1\)The Companies Act 61 of 1973.
\(^2\)The Companies Act 71 of 2008.
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Firstly, I would like to thank my family for supporting me through my studies and throughout a very difficult year.

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CHAPTER 1

Introduction

1.1 Introduction

The Department of Trade and Industry was left with the task to create a new Companies Act \(^1\) that would promote efficiency, encourage entrepreneurship and also encourage transparency within South African companies \(^2\). However, the Companies Act \(^3\) does not currently address issues like corporate governance, the accountability of directors and minority protection properly \(^4\).

The aims of the new Companies Act is to: \(^5\)

- encourage corporate governance and transparency within companies;
- promote innovation and investment;
- promote the investment of capital in other businesses and spreading economic risk;
- balance the rights and obligations of the shareholders and also the directors of a company;
- encourage responsible management of companies in South Africa;
- ensure an effective environment for companies to be regulated in.

The new Companies Act could be seen as modern version of the current Companies Act \(^6\).

In terms of the new Companies Act, the constitutional documents of a company will be known as the Memorandum of Incorporation. The Memorandum of Incorporation may deal with any provision that the Act \(^7\) does not deal with and also allows for alterable provisions to be taken up in this document \(^8\). Also, under the new Companies Act \(^9\), better protection will be given to the minority shareholders of a company \(^10\).

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\(^1\) The Companies Act 71 of 2008.
\(^2\) Delport PA. The new Companies Act Manual p 3
\(^3\) The Companies Act 61 of 1973
\(^4\) CH Coulson Harney Advocates March 2007: New Companies Act for South Africa p 1
\(^5\) Delport PA. The new Companies Act Manual p 3
\(^6\) The Companies Act 61 of 1973
\(^7\) The Companies Act 61 of 1973
\(^9\) The Companies Act 71 of 2008
\(^10\) CH Coulson Harney Advocates March 2007: New Companies Act for South Africa p 1
The new Companies Act \textsuperscript{11} shifts away from the outdated capital maintenance by addressing the solvency and liquidity of a company.\textsuperscript{12}

The new Companies Act has been enacted but is not yet operational. The proposed implementation date of the new Companies Act is April 2011. The amendments to the new Companies Act are still to be finalised. These amendments are contained in the Companies Amendment Bill and are published for public comment. The reason for the postponement with regard to the implementation date is to give businesses enough time to prepare.\textsuperscript{13}

The new Companies Act brings significant changes to the old company law regime. It should also be noted that with any new piece of legislation, problems surface and it is up to the courts to interpret and test this new legislation.

1.2 Research Objective

As previously stated, the new Companies Act \textsuperscript{14} will come into effect in April 2011. With the new Companies Act, there are a number of changes that will be introduced in company law.

The objective of this study is to do critical analysis if the new Companies Act\textsuperscript{15}, with specific reference to capital maintenance rules. Furthermore, this study will compare the current Companies Act\textsuperscript{16} with the new Companies Act\textsuperscript{17}, with a specific focus on sections 44, 45 and 48 of the new Companies Act \textsuperscript{18} and their comparison to sections 38, 85 and 225 of the current Companies Act \textsuperscript{19}. The next objective is to establish what impact the new piece of legislation will have on South African companies and whether the deficiencies in the current Companies Act have been addressed by the new Companies Act. The final objective is to establish whether this new piece of legislation gives adequate protection for the shareholders of a company.

1.3 Research Question

How does the new Companies Act \textsuperscript{20} compare to the current Companies Act\textsuperscript{21} and does this new piece of legislation give adequate protection creditors and shareholders?

\textsuperscript{11}The Companies Act 71 of 2008
\textsuperscript{12}Delport PA The new Companies Act Manual p 2
\textsuperscript{13}www.komig.com/ZA The Companies Act 71 of 2008
\textsuperscript{14}The Companies Act 71 of 2008
\textsuperscript{15}The Companies Act 71 of 2008
\textsuperscript{16}The Companies Act 61 of 1973
\textsuperscript{17}The Companies Act 71 of 2008
\textsuperscript{18}The Companies Act 71 of 2008
\textsuperscript{19}The Companies Act 61 of 1973
\textsuperscript{20}The Companies Act 71 of 2008
\textsuperscript{21}The Companies Act 61 of 1973
1.4 Methodology

The chosen methodology for this study is comparative analysis. South African legislation and case law, as well as handbooks will be used through this study, in order to reach the objectives of this study.

1.5 Limitations of this study

This study will focus on certain aspects of capital maintenance; and excludes a comprehensive study of the capital maintenance rules, as the focus will be on certain sections in the current Companies Act\textsuperscript{22} and also the new Companies Act\textsuperscript{23} This study will focus on the comparison between the new and current Companies Act and what protection is given in terms of capital maintenance.

1.6 Proposed Structure

Chapter 2 provides a background study to the capital maintenance.

Chapter 3 provides an analysis of section 38 of the current Companies Act\textsuperscript{24} and section 44 of the new Companies Act\textsuperscript{25}.

Chapter 4 provides analysis of the financial assistance given to directors and exemptions.

Chapter 5, analysis the repurchase of shares, insider trading and tax implications repurchasing of shares.

Chapter 6 provides the conclusion of this study.

\textsuperscript{22} The Companies Act 61 of 1973.
\textsuperscript{23} The Companies Act 71 of 2008
\textsuperscript{24} The Companies Act 61 of 1973
\textsuperscript{25} The Companies Act 71 of 2008
CHAPTER 2

Background to the Capital Maintenance Rules

2.1 Introduction

The concept of capital maintenance was formulated towards the end of the 19th century in English law and formed the basis for South African company law. The capital maintenance principle was described by Lord Watson as:

Paid-up capital may be diminished or lost in the course of a company's trading: that is a fact that no legislation can prevent, but persons who deal with and give credit to a limited company, naturally rely upon the fact the company is trading with a certain amount of capital already paid, as well as upon the responsibility if its members for the capital remaining 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.

The motivation for capital maintenance is to protect the creditors of a company. In order to pay the debt of the creditors of a company, the capital of a company has to be maintained. The capital of a company is fixed and had to be maintained, due to the fact that the creditors of a company look at the capital of a company to satisfy their claims.

The capital maintenance rules enshrined in English company law, established the following:

- that the Capital of a company is fixed and certain and every creditor is entitled to look to the capital as their security;
- that payments out of the share capital of a company is prohibited;
- that a company buying back its own shares is prohibited.

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26 www.allbusiness.com An accounting history of capital maintenance: legal precedents for managerial autonomy in the United Kingdom by Aiken Maxwell
27 Trevor v Witworth (1887) 12 App Cas 409 (HL).
28 De Jure 2010: A practical guide to the implications of the new Companies act-capital maintenance, W Makhubele and M Ratshimbilani p 63
31 The Ooregum Gold Mining Company of India Ltd v Roper and Wallroth (1892) AC 125 (HL)
32 Guinness v Land Corporation of Ireland (1883) 22 ChD 349 CA (356)
33 Trevor v Witworth (1887) 12 App Cas 409 (HL)
In her doctoral thesis, Van der Linde agreed with McGee's conclusion that capital maintenance rules are not designed in a coherent fashion, but that the following objectives can be concluded: 34

- protecting the existing shareholders of a company from depletion of their interest;
- protecting the company;
- protecting of the creditors of a company

The capital maintenance concept in South Africa is riddled with obscurities and some of the capital rules are not useful anymore 35

2.2 Development of the Capital Maintenance in South African Legislation

The current Companies Act 36, in some instances, still remains true to the 19th century concept of capital maintenance of companies 37. However, in some respects the current Act 38 moves away from this stringent concept of capital maintenance and replaces this concept with a solvency and liquidity test 39.

The Companies Amendment Act was introduced to relax the strict prohibitions of the capital maintenance rules contained in the current Companies Act. The concept of containing the capital of a company was also incorporated into the new Companies Act 40, but is primarily based on the solvency and liquidity of a company 41.

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34. K van der Linde Aspects of the regulation of share capital and distribution to shareholders p 20
36. The Companies Act 61 of 1973
37. www.bowman.co.za The Capital Maintenance concept and share repurchase in South African Law, FHI Cassim and Rehana Cassim
38. The Companies Act 61 of 1973
CHAPTER 3

Financial assistance in terms of section 38 of the current Act\(^\text{42}\) and section 44 of the new Act\(^\text{43}\)

3.1 Introduction

Capital maintenance rules seem to have caused some discomfort in the South African context.\(^\text{44}\) One of the reasons for this discomfort is the prohibition of financial assistance by company for the purchasing of shares in terms of section 38 of the Companies Act 61 of 1973.\(^\text{45}\)

In America, a new approach to the capital maintenance concept was adopted, which is based on a two way test. Firstly the test is based on liquidity of the company and the second part of the test is based on the balance sheet solvency.\(^\text{46}\)

In this chapter, section 38 of the current Companies Act\(^\text{47}\) will be analysed and then also compared to section 44 of the new Companies Act\(^\text{48}\).

3.2 The strict prohibition contained in section 38 of the Current Companies Act

Section 38 of the current Companies Act\(^\text{49}\) provides for the following:

No company may give, whether directly or indirectly, and whether by means of a loan, guarantee, provisions 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 for any shares of the company, or where the company is a subsidiary company of its holding company.

In simple terms, section 38 of the current Companies Act\(^\text{50}\) prohibits the financial assistance of the purchasing of the company’s shares. The prohibition contained in section 38\(^\text{51}\) sought protect minority shareholders and especially the creditors of a company.\(^\text{52}\)

\(^{42}\)The Companies Act 61 of 1973
\(^{43}\)The Companies Act 71 of 2008
\(^{44}\)De Rebus 2007 The new capital maintenance regime and company disposals explored:Rudloph du Plessis and Garikai Matarirano p 26
\(^{45}\)De Rebus 2007 The new capital maintenance regime and company disposals explored:Rudloph du Plessis and Garikai Matarirano p26
\(^{46}\)De Rebus 2007 The new capital maintenance regime and company disposals explored:Rudloph du Plessis and Garikai Matarirano p 27
\(^{47}\)The Companies Act 61 of 1973
\(^{48}\)The Companies Act 71 of 2008
\(^{49}\)The Companies Act 61 of 1973
When analysing section 38 \textsuperscript{53} it is clear that the capital maintenance rule, to maintain the capital of a company, is embodied in this section. The wording of this section has caused many problems in South Africa and also elsewhere, due to the strict prohibition contained in this section \textsuperscript{54}

The problem with section 38 of the current Companies Act \textsuperscript{55} is that it is set out in such broad terms, that it is difficult to establish whether a specific transaction will be subject to this section \textsuperscript{56}. The question that comes to mind, is, what were the legislator's aims for with this particular section?\textsuperscript{57} A contradiction of this section means that the transaction is void and also that the directors will be held liable for breach of their fiduciary duties \textsuperscript{58}

With the strict prohibition contained in section 38 \textsuperscript{59} there is also the argument that many BEE transactions became void due to this prohibition \textsuperscript{60}

However, it should be noted when analysing section 38 \textsuperscript{61}, that this section contains the regulation of control and also aspects of capital maintenance.\textsuperscript{62} Thus financial assistance relates to any financial assistance, whether direct or indirect, and furthermore also relates to the purpose or in connection with the purchase of shares.

Miller JA in Lipschitz v UDC Bank stated the following with regard to s88bis(2)(now section 38) and the impoverishment test:\textsuperscript{53}

\begin{quote}
The prohibition against the financial assistance is couched in very wide terms. It relates to any financial assistance, whether given directly or indirectly and it relates, moreover, to such assistance not only when it is given for the purpose of the purchase of or subscription of any shares in the company, but also in connection with such a purchase or subscription. The words 'in connection with' serve to extend (albeit not considerably, as I shall later show) the field marked out by the words 'for the purpose of'. The terms of the section have been the subject of considerable criticism not only in South Africa but also in England and
\end{quote}

\begin{thebibliography}{99}
\bibitem{50} The Companies Act 61 of 1973.
\bibitem{51} The Companies Act 61 of 1973.
\bibitem{52} Without prejudice: Will the amended S38 accelerate BEE ownership: Joubert van Wyk p 28.
\bibitem{53} The Companies Act 61 of 1973.
\bibitem{54} Howo’s South African Company law through the cases p 130.
\bibitem{55} The Companies Act 61 1973.
\bibitem{58} De Rebus 2007 The new capital maintenance regime and company disposals explored: Rudolph du Plessis and Garikai Matarirano p 27.
\bibitem{59} The Companies Act 61 of 1973.
\bibitem{60} Without prejudice: Will the amended s38 accelerate BEE ownership: Joubert van Wyk p 28.
\bibitem{61} The Companies Act 61 of 1973.
\bibitem{62} Delport PA South African Mercantile Law Journal: “Company Groups and the Acquisition of shares p 121.
\bibitem{63} Lipschitz v UDC Bank Ltd 1979(1) SA 789 (A).
\end{thebibliography}
elsewhere, where similar prohibition is contained in legislation concerning companies. In the report of the Jenkins Company Law Committee (1962) in England it was observed that the statutory prohibition had ‘proved to be an occasional embarrassment to the honest, without being a serious inconvenience to the ‘unscrupulous’ and that the fear had been expressed by some witnesses that ‘the section prohibited a number of quite innocent transactions’.

A comprehensive definition of the words “financial assistance” in section 38 ⁶⁴ has not been given and problems do arise due to this ⁶⁵ However, the courts have formulated the so-called “impoverishment test” to work around this problem ⁶⁶ The court stated in the Lipschitz case that the words “in connection with” are in actual fact an alternative to the words “for the purpose of” ⁶⁷

JA Miller further stated in the Lipschitz case that section 38 comprises of two elements:

The first element is the giving of the financial assistance and the second element is the purpose for which it is given, and these two elements are linked to form one prohibition ⁶⁸

A contravention of section 38 ⁶⁹ means the transaction is void and also an action for damages against the directors of the company for breach of their fiduciary duties ⁷⁰ The effects of a contravention of the prohibition contained are section 38(1) ⁷¹ are dealt with in section 38(3). ⁷²

In terms of section 38(3)(c), a director has a defence if he can prove that he was not a party to the transaction.

3.3 The adoption of the Companies Amendment Act 37 of 1999

To relax the strict prohibition embodied in section 38 ⁷³, the Companies Amendment Act ⁷⁴ was introduced. ⁷⁵ The Amendment Act ⁷⁶ protects creditors through solvency and liquidity

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⁶⁴ The Companies Act 61 of 1973
⁶⁵ Hahlo’s South African Company law through the cases p 130
⁶⁶ Ibid
⁶⁷ Lipschitz v UDC Bank Ltd 1979(1) SA 789 (A)
⁶⁸ Ibid
⁶⁹ The Companies Act 61 of 1973
⁷⁰ The Companies Act 61 of 1973
⁷¹ The Companies Act 61 of 1973
⁷² The Companies Act 61 of 1973
⁷³ The Companies Act 61 of 1973
⁷⁴ The Company Amendment Act 37 of 1999
⁷⁵ De Rebus 2007 The new capital maintenance regime and company disposals explored: Rudolph du Plessis and Garikai Matarirano p 27
⁷⁶ Act 37 of 1999
requirements which the company must adhere to when financial assistance is given by a company.\textsuperscript{77}

The Amendment Act \textsuperscript{78} moves away from the capital maintenance idea (concept) in some aspects, and replaces it with the test for solvency and liquidity of the company, but clings to the concept of capital maintenance which prohibits the following:\textsuperscript{79} Section 81 \textsuperscript{80} prohibits the issuing of par value shares at a discount and the payment of interest on shares out of the share capital of a company.

\subsection*{3.4.1 Exceptions to the prohibition contained in section 38(1)}

Sections 38(2)(a)-(d)\textsuperscript{81} contain exceptions to the strict prohibition contained in section 38(1) \textsuperscript{82}. The exceptions in terms of section 38(2)(a) – (c) are listed below:

- the lending of money in the ordinary course of business by a company and where it is the business of a company to lend money;
- the provision of the company of money in terms of a scheme for the acquisition of shares by trustees for the benefit of the employees of the company;
- the making of loans to \textit{bona fide} employees, excluding directors, to enable these employees to acquire shares in the company.

However, the exception contained in section 38(2)(d)\textsuperscript{83} will be discussed at a later stage.

Section 38(2A)\textsuperscript{84} also provides a further exception to the strict prohibition contained in section 38(1).\textsuperscript{85} In terms of section 38(1)\textsuperscript{86}, a company is allowed to give financial assistance purchase the company's own shares or the company's holding company, subject thereto that

\begin{itemize}
  \item \texttt{www.bowman.co.za} The Capital Maintenance concept and share repurchase in South African Law, FHI Cassim and Rehana Cassim
  \item \texttt{Act 37 of 1999}
  \item \texttt{South African Law Journal The reform of the company law and the capital maintenance concept by FHI Cassim p 28}
  \item The Companies Act 61 of 1973
  \item The Companies Act 61 of 1963.
  \item De Jure Volume 42 1 2009 'S 38(2A): A Hidden trap for directors WJC Swart p 175.
  \item The Companies Act 61 of 1973.
  \item The Companies Act 61 of 1973.
  \item The Companies Act 61 of 1973.
\end{itemize}
the Board of the company adhere to the solvency and liquidity assessment. This is done by a special resolution adopted by the shareholders of a company.

With all the changes brought about by the Amendment Act, companies can now provide financial assistance to allow a person to buy shares in a company or its holding company.

For the exception contained in section 38(2A) to apply the following is required:

- subsequent to the transaction, the consolidated assets of the company must exceed the consolidated liabilities of the company;
- subsequent to the financial assistance and during transaction the company will be able to pay its debt;
- a special resolution by the shareholders of the company.

Upon analysing this section, it is clear that the protection given for creditors is not adequate, as there is no test for the reasonableness of the decision of the directors and that the directors have to guarantee the company will be solvent and liquid after the transaction. It will also be difficult for any company make a precise projection of the solvency of a company, especially where a company provides financial assistance over a long period of time.

Also the terminology in section 38(2A) can be confusing, because it refers to the "consolidated" assets and "consolidated" liabilities. Now the word "consolidated" refers to the assets and liabilities of companies within a group.

The principle of separate legal personality of a company, which is laid out in Salomon v Salomon Co Ltd 1897 AC 22 (HL), is ignored if the consolidated assets and liabilities of the group are taken into consideration.

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99 Act 37 of 1999
100 De Jure volume 42 1 2009:S 38(2A): A Hidden trap for directors WJC Swart p 175
103 De Rebus 2007 The new capital maintenance regime and company disposals explored: Rudolph du Plessis and Garikai Matarirano p 28
104 Act 37 of 1999
The following statement was made by Slade JL in Adams v Cape Industries Plc 1991 ALL ER 927 (ChD & CA):\textsuperscript{97}

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

3.4.2 The obscurities of Section 38(2)(d)

In terms of section 38(2)(d) of the current Companies Act\textsuperscript{98}, a company can provide financial assistance to buy its own shares by itself or for the acquisition of shares in the terms of section 85.\textsuperscript{99} Section 38(2)(d) was inserted by section 3 of the Companies Amendment Act 37 of 1999.\textsuperscript{100}

Section 38(2)(d) reads as follows:

The prohibition of financial assistance for the acquisition of shares in a company or its Subsidiary in accordance with the provisions of s85 for the acquisition of such shares.

The wording of Section 38(2)(d) is not very clear, although it should be clear when applied to section 85.\textsuperscript{101} The problem with the exclusion in section 38(2)(d) is that no reference is made to section 85(4)\textsuperscript{102}, which refers to the solvency and liquidity requirements for a company, it however refers to the whole of Section 85\textsuperscript{103}, which has the effect that the company can acquire its own shares.\textsuperscript{104} In other words, the exclusion applies to the financial assistance given by the company to the company itself, which does not make sense. Section 38(2)(d) of the current Companies Act also refers to the purchase of shares in the subsidiary\textsuperscript{105}

\textsuperscript{97} The South African Law Journal Volume 122 Part 3 2005: Unravelling the Obscurities of S 38(2)(d) of the Companies Act by F H I Cassim p 493
\textsuperscript{98} Act 61 of 1973
\textsuperscript{101} South African Mercantile Law journal 2001 Volume 13 Company Groups and the acquisition of shares Delport PA p 125.
\textsuperscript{102} The Companies Act 61 of 1973.
\textsuperscript{103} The Companies Act 61 of 1973.
\textsuperscript{104} South African Mercantile Law journal 2001 Volume 13 Company Groups and the acquisition of shares Delport PA p 126.
\textsuperscript{105} South African Mercantile Law journal 2001 Volume 13 Company Groups and the acquisition of shares Delport PA p 126.
There are two possible ways to interpret the second part of the exclusion  106

Firstly, it means that a company can give financial assistance to a subsidiary, so that the subsidiary acquires shares in its holding company, which will mean that subsidiary will hold shares in its holding company  107

However, if this will be the situation it will mean that third parties are excluded and this does not comply with the idea behind the Amendment Act.  108

Secondly, it can also be said that in terms of section 38(2) (d) 109 financial assistance can be given by the subsidiary to holding company for the purchasing of shares in the holding company itself, but the subsidiary can do this in any event on terms of the provisions contained in section 37 110

With the uncertainties surrounding section 38(2)(d) it is not very useful for companies in the South African context 111

3.5.1 The adoption of the new Companies Act 71 of 2008

The new Companies Act 112 brings a mindset shift with regard to the strict principle of capital maintenance. The new Act 113 is based on solvency and liquidity requirements for a company 114 A more liberated approach is given by the new act when a company is parting with its own capital, due to the fact that a company can now acquire its own shares subject to the solvency and liquidity requirement in terms of Section 4 115

3.5.2 Interpretation of section 44 of the new Companies Act

Section 44 of the new Companies Act 116 enables a company to give financial assistance to any person to acquire shares in the company:

- section 44(1) contains an exception to financial assistance;

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106 South African Mercantile Law journal 2001 Volume 13 Company Groups and the acquisition of shares Delport PA p 126
112 The Companies Act 71 of 2008.
113 The Companies Act 71 of 2008.
• section 44(2) gives the authorisation of financial assistance;

• section 44(3) and (4) gives the requirement for financial assistance;

• section 44(5) gives the circumstances where the decision of the directors with regards to the financial assistance is void;

• section 44(6) contains the liability of the directors of the company.

Section 44(2) states that the Board may authorise the company, subject to the Memorandum of Incorporation, to provide financial assistance by ways of a loan, guarantee, the provision of security or otherwise to any person for subscription of securities in the company or a related or an interrelated company.\textsuperscript{117}

However, looking closely at wording of this section, there is an inconsistency: "... the Board may authorise the company ..."

This does not make sense, since it raises the question: how is it possible for the Board of the company to authorise the company to do something, when the Board actually acts as an agent of the Company?\textsuperscript{118}

In terms of Section 44(2), mention is given to related parties, which are defined in section 2 of the Act.\textsuperscript{119}

Section 2(c) of the Act\textsuperscript{120} reads as follows:

A juristic person is related to another juristic person if:

1) either of them directly or indirectly controls the other, the whole of or part of the business of the other;

2) either is a subsidiary of each other;

3) a person directly or indirectly controls the whole or part of the business or both of them.

The word "control", as mentioned above, is defined extensively in section 2(2) and the definition of a subsidiary is contained in section 3 of the new Companies Act.\textsuperscript{121} In short, control can be defined when one person exercises control over another person, or its

\textsuperscript{117}The Companies Act 71 of 2008
\textsuperscript{118}Delport PA The New Companies Act Manual p 31
\textsuperscript{119}The Companies Act 71 of 2008
\textsuperscript{120}The Companies Act 71 of 2008
\textsuperscript{121}The Companies Act 71 of 2008.
business. In the case of a juristic person, "control" requires for another person to be able to influence the policy of such a juristic person.

The ambit of section 44(2) is much wider than section 38(1)\textsuperscript{122} as it includes related and also interrelated parties, which is defined in section 2 of the new Companies Act.

Subject to the Memorandum of Incorporation, financial assistance may be given:\textsuperscript{123}

- pursuant to an employee scheme section 97;
- pursuant to a special resolution of the shareholders of the company, adopted within the period of two years, which approves such financial assistance;
- the board of the company has been satisfied that company will comply with solvency and liquidity test after the financial assistance have been given, and
- the financial assistance is fair and reasonable.

A company will only comply with the solvency and liquidity test, if the following requirements have been met:\textsuperscript{124}

- the assets of the company equals or exceed the liabilities of the company;
- it appears that the company will be able to pay its debt as it becomes due in the ordinary course of business for a period of twelve months after date on which the solvency and liquidity test is considered.

Furthermore, it should be taken into account that a resolution or agreement for financial assistance is void if such a resolution or agreement is in contradiction to section 44.\textsuperscript{125} In terms of section 218(1)\textsuperscript{126} a resolution or an agreement that is in contravention of section 44, or the Memorandum of Incorporation is not void until the court declares such a resolution or agreement void.\textsuperscript{127}

However, this creates a peculiar situation because a company may not trade in insolvent circumstances or carry on business recklessly.\textsuperscript{128} There is the possibility of a situation arising where nothing is void, until the court declares it void and on the other hand a company

\textsuperscript{122} The Companies Act 63 of 1973
\textsuperscript{123} S 44(3) and 44(4) gives the requirements for financial assistance
\textsuperscript{124} S 4(1) of the Companies Act 71 of 2008 and also Delport PA The new Companies Act Manual p 32
\textsuperscript{125} S 44(5) of the Companies Act 71 of 2008
\textsuperscript{126} The Companies Act 71 of 2008
\textsuperscript{127} Delport PA The new Companies Act Manual p 32
\textsuperscript{128} S 22 of the Companies Act 71 of 2008
cannot trade insolvent circumstances. This could mean that the company may trade under insolvent circumstances if the court does not declare the resolution or agreement void.129

As previously mentioned section 44(1) contains an exception to the giving of financial assistance. It provides therefore that financial assistance will not include the lending of money in the ordinary course of business by a company whose business is the lending of money.

3.5.3 A contravention of section 44

Section 44(6)130 determines that directors of a company that was present at a meeting where they failed to vote against such a resolution that is in contravention with section 44, and they will be held personally liable for loss or damage that the company may suffer it this resolution has been declared void by the court.131

Thus a director will only be held personally liable for non-compliance of section 44132 if the court declares the resolution or agreement void even though the company is trading under in solvent circumstances 133

3.6 Conclusion

The ambit of section 44 is much wider than its predecessor. Section 38 of the current Companies Act134 refers to shares, whilst section 44 refers to securities135 which include shares, bonds, debentures, etc. Section 44 allows for financial assistance in a company itself, related company or interrelated company.

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129Delport PA The new Companies Act Manual p 32
130The Companies Act 71 of 2006
131Ibid
132Ibid.
133Delport PA The new Companies Act Manual p 33
135Securities is defined in terms of the Securities Service Act 36 of 2004
CHAPTER 4

Financial assistance to directors

4.1 Introduction

In Terms of section 226 of the current Companies Act\textsuperscript{136}, the powerful position which directors and managers hold within a company is recognised\textsuperscript{137}Goldblatt JJ in Standard Bank SA Ltd v Neugarten and Others stated:\textsuperscript{138}

The clear purpose of S226 of the Act is to prevent directors or managers of a company Act in their own interest and against the interest of the shareholders by burdening the company with obligations which are not for its benefit, but for the benefit of another company and /or for the benefit of its directors and for managers.

Provision is made for exceptions, on the grounds that in these circumstances that there are enough safeguards established when using the assets of the company for the benefit of its directors or managers, will also be for benefit of the company and not at the expense of the company\textsuperscript{139}

When analysing section 226\textsuperscript{140} it can be divided into the following categories:\textsuperscript{141}

- prohibitions;
- exceptions;
- consequences of a contravention of Section 226.

4.2 An analysis of Section 226 of the current Companies Act

When analysing or interpreting section 226, it is important to take into consideration the approach of the court in Bevray Investments (Edms) Bpk v Boland Bank Bpk en andere 1993 (3) SA 597 (A)\textsuperscript{142}

Grosskopf JA stated:\textsuperscript{143}

\textsuperscript{136}The Companies Act 61 of 1973
\textsuperscript{138}1988 (1) SA 652 (W)
\textsuperscript{140}The Companies Act 61 of 1973
\textsuperscript{141}South African Mercantile Law Journal Volume 12 2000: Loans to directors –an Analysis of s226 of the Companies Act Richards Jooste p 272
\textsuperscript{142}South African Mercantile Law Journal Volume 12 2000: Loans to directors –an Analysis of s226 of the Companies Act Richards Jooste p 272
\textsuperscript{143}South African Mercantile Law Journal Volume 12 2000: Loans to directors –an Analysis of s226 of the Companies Act Richards Jooste p 272
Die breeoogmerk of oogmerke van die bepalings is natuurlik duidelik. Maatskappye word bestuur deur direkteure en bestuurders. Hierdie direkteure en bestuurders kan hul bevoegdheidse misbruik vir hul eie voordeel Daarbenewens kan die direkteure of bestuurders van houermaatskappye hulle self onbehoorlik bevoordeel deur hul beheer oor filiaalmaatskappy. Die wetgewer wat die moontlikheid van sulke wanpraktyke beperk. Die wetgewer het egter nie hierdie oogmerk prober vervenslik deur 'n algemene of absolute verbod te plea op alle transaksies tussen 'n bestuurder of direkteur en betrokke maatskappy waardeur die bestuurder of direkteur bevoordeel kan word nie. Klaarblyklik sou so 'n verbod op prakties wees. Daar moet nood wendig baie omstandighede wees waarin dit onbehoorlik is vir 'n direkteur of bestuurder omgelede voordele te ontvang van die maatskappy wat hy bestuur of wel deur sy maatskappy beheer word nie. Die wetgewer het hom dus beperk tot 'n verbod op sekere bepaalde transaksies wat as prima facie onaanvaarbaar beskou is, en naamlik die maak van sekere lenings en die voorsiening van sekere sekuritete. Selts hier is die verbod egter nie absoluut nie – sekere transaksies wat binne die trefwyde van die verbod val, was nogtans vir die wetgewer aanvaarbaar. Om vir sulke transaksies voorsiening te maak, bevat subartikel (2) 'n langerige lys uitsonderings op die verbodsbepalings in subartikel (1). Die wetgewer se spesifieke oogmerk met artikel 226 was dus omsekere bepaalde versins geldelik bystand te verbied, onderhewig aan bepaalde versins van geldelike bystand te verbied onderhewig van bepaalde uitsonderings. Met die een hand verbied hy Met die ander hand veroordeel hy. Daar was dus nie 'n eenvoudige of ongekwaliseerde oogmerk wat as hoeksteen by die uitleg van die Artikel gebruik kan word nie.¹⁴⁴

The ambit of section 226¹⁴⁵ is much wider and not just applicable to directors of a company.¹⁴⁶ In the first place, it is also applicable to managers and not just directors. Secondly it not only prohibits a company from giving financial assistance to its own directors and also to its managers, but also the directors and managers of the lending company's holding company or companies that are subsidiaries of the holding company.¹⁴⁷ An officer is defined in section 1 as a managing director, manager or a secretary.¹⁴⁸

Section 226(3)¹⁴⁹ determines that for the purpose of liability contained in subsection 4, a director or officer of a company which is a subsidiary, will also include a director or manager of the holding company. The reason for the extension is to prevent abuse of power that the holding company will have over the subsidiary company.¹⁵⁰ The shortfall in terms of section 226 is that if a holding company has two subsidiary companies, and a loan is made by one

¹⁴³ Bevray Investments (Edms) Bpk v Boland Bank Bpk en andere 1993 (3) SA 597 (A)

¹⁴⁵ The Companies Act 61 of 2008
¹⁴⁸ The Companies Act 61 of 1973
¹⁴⁹ The Companies Act 61 of 1973
subsidiary company to a director or a manager of the other subsidiary, this is will not be prohibited in terms of section 226 151

The abovementioned situation, where a director or manager receives a loan from a subsidiary company, opens the way for possible abuse of power. Furthermore, if a company makes a loan to trust, of which director is a beneficiary, this will also not be prohibited in terms of section 226 152

4.3 Regulation by other than section 226

It must be noted that directors' interest in contracts is also regulated by section 234-241 153 and the common law. 154 So if a transaction escapes the working of section 226 it does not mean it will be unregulated.

4.4 The exceptions to the prohibition of section 226

A few possible exceptions to the prohibition contained in section 226 are discussed below.

With regard to section 226 Stegman J stated the following: 155

The purpose behind S 226 is to establish a general prohibition against the use of a company's assets in certain proscribed ways for the benefit of the directors or managers or any company controlled by them, and then to provide a framework of exceptions according to which the use of a company's assets in the otherwise proscribed ways for the benefit of its directors or managers, or companies controlled by them, is to be regulated

The court in the abovementioned case recognised the purpose of section 226 and also the exceptions contained in this section.

4.4.1 Exception in terms of Section 226(1B)

The first exception is contained in section 226(1B), which is demonstrated in the following example:

If a company B makes a loan or provide security on behalf of company B's holding company or to a subsidiary of company B's holding company, this will fall within the prohibition of section 226(1)(b) of the current Companies Act, due to the fact that the holding company or

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152 The Companies Act and also South African Mercantile Law Journal Volume 12 2000: Loans to directors—an Analysis of s 226 of the Companies Act Richards Jooste p 274
153 The Companies Act 61 of 1973
154 The Companies Act and also South African Mercantile Law Journal Volume 12 2000: Loans to directors—an Analysis of s226 of the Companies Act Richards Jooste p 271
155 S v Pourolis and others 1993 (4) SA 575 (W)
subsidiary is controlled by directors of company B, the holding company of company B, or a subsidiary of the holding company of company B. In the case where a director of company B’s holding company (company A) held more than 50 per cent of the equity share capital of the company A, a loan by company B to company A would be exempted by Section 226(1B). Section 226(1B) has the effect that it brings Section 226 in line with section 37 of the Current Companies Act, which regulates the provision of security and loans within a group of companies.

4.4.2 Exception in terms of section 226(2)(a)

In terms of section 226(2)(a) of the current Companies Act, the prohibition will not be applicable if a company makes a loan to, or provides security on behalf of a director or manager without prior consent in terms of a special resolution of the shareholders of the company. The exception contained in section 226(1)(a) will also be applicable where a director or manager, to whom the loan is given, is a director or manager of the lending company’s holding company.

4.4.3 Exception in terms of section 226(2)(b)

When looking at section 226(2)(b) of the current Companies Act, the following must be noted:

- anything done to provide a director or manager of a company with funds to meet expenses incurred;
- the director or manager must be allowed to perform his/her duties properly.

The question is now if the exceptions mentioned above will be available if a director or a manager of the lending company is also a director or manager of the lending company’s holding company? In Bevray Investments (Edms) Bpk v Boland Bank Bpk, the court

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156 The Companies Act 61 of 1973
158 The Companies Act 61 of 1973
164 1993(3) SA 597 (A)
answered this question by confirming that the exception will be available to the director or manager.\textsuperscript{165}

4.4.4 Exception in terms of section 226(2)(d)

Section 226(2)(d) of the current Companies Act gives an exemption to the provisions contained in section 38(2)(b) and section 38(2)(c).\textsuperscript{166} This would mean that if a company makes a loan to one of its managers to enable them to buy shares in the company of its holding company, this transaction would be exempted.

4.4.5 Exception in terms of section 226(2)(e)

In terms of section 226(2)(e), a company can assist a director or manager with their housing needs. The approval for such financial assistance is given by ways of an ordinary resolution adopted at the general meeting. The question is, however, whether this approval can be given after the loan is made. The answer would be that because there is no mention of ratification, that prior approval is needed.\textsuperscript{167}

4.4.6 Exception in terms of section 226(2)(f)

Section 226(2)(f) provides that when a company provides security on behalf of a director, manager or subsidiary it would be exempted, subject to the condition that the director or manager must not be a director or manager of the company itself, and this seems flawed.\textsuperscript{168}

The exemption is illustrated with the following example:

When company D and E are subsidiaries of company F the holding company, and if company X is a subsidiary of D and when director A is a director of company X and the holding company, company F, and in the case where a loan is made to director A by company D, this transaction will be exempted.

In Bevray Investments (Edms) Bpk v Boland Bank Bpk\textsuperscript{169}, it was stated that the exception in section 226(2)(a) applied even if the director to whom the loan is made is also a director of the lending company’s holding company or a subsidiary.\textsuperscript{170}

\textsuperscript{166} South African Mercantile Law Journal Volume 12 2000: Loans to directors – an Analysis of s226 of the Companies Act Richards Jooste p 286
\textsuperscript{169} 1993(3) SA 597 (A)
4.5 A contravention of the prohibition

Any contravention of the prohibition will have the effect that the loan or security that was provided will be void.\(^{171}\) In terms of section 226(4), any director or officer who authorises or is a party to such a loan or the providing of security and such a security or loan is in contradiction to section 226, and will be liable to indemnify the company or any other bona fide person against any loss suffered due to such a transaction.

4.6 Loans to directors in terms of section 45 of the new Companies Act

In terms of section 45, a company may give direct or indirect financial assistance to a director of company or a related company or interrelated company, subject to the Memorandum of incorporation and the solvency and liquidity test.\(^{172}\)

The Board of a company, before giving financial assistance, must satisfy themselves of the following:\(^{173}\)

- immediate compliance with the solvency and liquidity requirement;
- fair and reasonable financial assistance.

It must again be noted that financial assistance in contradiction with section 45 will not be void until the court declares it void.\(^{174}\) Yet again a peculiar situation is created, because a company cannot trade under insolvent circumstances and this can now mean that the company can actually trade under insolvent circumstances if the court does not declare this transaction void.\(^{175}\)

In terms of section 45(6) a director will be held liable under section 77(3)(e)(v) for breach of his fiduciary duties, only if the court declares the transaction void in terms of section 218(1).

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\(^{172}\) S 4 of Act 71 of 2008 contains the solvency and liquidity test

\(^{173}\) Delport PA, The new Companies Act Manual p 66

\(^{174}\) S 218 of Act 71 of 2008

\(^{175}\) S 22 of Act 71 of 2008.
4.7 Conclusion

Section 226 of the current Companies Act\textsuperscript{176} prohibits the giving of financial assistance to directors, but exceptions are given subject to the fact that there must enough safeguards.

However section 45\textsuperscript{177} of the new Companies Act allows for financial assistance to directors, conditional to the fact that the board of the company must be satisfied that the requirements for the solvency and liquidity test have been met.

\textsuperscript{176} The Companies Act 61 of 1973
\textsuperscript{177} The Companies Act 71 of 2008
CHAPTER 5

Repurchasing of shares by a company

5.1 Introduction

Important common law rules formed the cornerstone for certain aspect in the current Companies Act\textsuperscript{176}, and which strengthen the concept of capital maintenance \textsuperscript{179}Before the adoption of the Companies Amendment Act\textsuperscript{180}, it was prohibited for a company to buy back its own shares, or pay dividends out of share capital.\textsuperscript{181}Section 9-13 of the Companies Amendment Act\textsuperscript{182} substituted section 85-90 of the current Companies Act\textsuperscript{183}The Companies Amendment Act drastically changed the concept of capital maintenance and also the protecting of creditors of a company\textsuperscript{184}

This change caused that companies can now buy back their own shares. In terms of section 85-89 of the current Companies Act\textsuperscript{185} a company can acquire its own shares.\textsuperscript{186}

- in terms of section 85 a company can acquire its own shares under certain circumstances;

- in terms of section 86 liability is imposed on directors and shareholders who is selling their shares;\textsuperscript{187}

- in terms of section 87 the procedure for buy back by a company is contained in this section;

- in terms of section 89 a subsidiary can acquire shares in its holding company;

- in terms of section 90 payments to shareholders are regulated

\textsuperscript{176} Act 61 of 1973
\textsuperscript{177} Cilliers and Benade p 322
\textsuperscript{178} Act 37 of 1999
\textsuperscript{179} Cilliers and Benade p 322
\textsuperscript{180} Act 37 of 1999.
\textsuperscript{181} Act 61 of 1973
\textsuperscript{182} Cilliers and Benade p 322
\textsuperscript{183} Act 61 of 1973
\textsuperscript{185} The South African Law Journal: The reform of Company Law and the Capital Maintenance Concept FHI Cassim p 286
In Capitex Bank Ltd v Qurus Holdings Ltd\textsuperscript{183} the court ruled that a company may purchase its own shares and section 85-89 repealed the common law rule\textsuperscript{184}. As previously mentioned section 85 allows for a company to buy its own shares, subject to certain requirements.\textsuperscript{185} Section 85-90 of the current Companies Act brings forth relaxation of the strict capital maintenance rule.\textsuperscript{186} In terms of the New Companies Act\textsuperscript{192}, distributions are regulated by section 46 and acquisition by a company of its own shares is regulated by section 48.

5.2 Provisions with regard to repurchase

5.2.1 The solvency requirement

In terms of section 85, a company is allowed to buy back its own shares, but subject to certain requirements\textsuperscript{193}. Section 85(4) states there must be reasonable grounds for believing that after the repurchase the company will pass the solvency and liquidity test.\textsuperscript{194}

A company shall not make any payments in whatever form to acquire any shares issued by the company if there are reasonable grounds believing that:

(a) 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

(b) The consolidated assets of the company fairly valued would after the payment be less that the consolidated liabilities of the company.

The test contained in section 85(4) is a three-part objective test\textsuperscript{195}:

- the director must have reasonable grounds to believe the company is and will after repurchase be liquid and solvent;

- the company must be able to pay its debt in the ordinary course of business;

- the consolidated assets must exceed the consolidated liabilities.

\textsuperscript{183} 2003(3) SA 302 (W)
\textsuperscript{184} FHI Cassim The South African Law Journal: The reform of Company Law and the Capital Maintenance p 288
\textsuperscript{185} FHI Cassim The South African Law Journal: The reform of Company Law and the Capital Maintenance p 288
\textsuperscript{186} FHI Cassim The South African Law Journal: The reform of Company Law and the Capital Maintenance p 288
\textsuperscript{191} Act 71 of 2008
\textsuperscript{192} Delport PA South African Law Journal 2001 13 SA Company Groups and the acquisition of shares p 123.
\textsuperscript{193} VWJC Swart De Jure Volume 42 1 2009: S 38(2A): A Hidden trap for directors p 28
In the case where the first part of the test is answered positively the latter part of the test will not come into operation.\textsuperscript{196}

Upon further investigation of section 85(4), the wording refers to the consolidated assets and also the consolidated liabilities. It is important to take into consideration that consolidated financial statements, move from the holding company downwards, because section 289\textsuperscript{197} requires financial statements of the holding company and subsidiary, which means that subsidiary cannot have consolidated financial statements.\textsuperscript{198}

This will mean that if a subsidiary acquires shares, the consolidated assets and consolidated liabilities will not be taken into consideration.\textsuperscript{199} This means, in turn, that group solvency will not be bare any weight for the creditors of the holding company.\textsuperscript{200}

In terms of section 85(4) of the current Companies Act\textsuperscript{201} it is only required that the directors have reasonable grounds to believe that the company will be solvent and liquid before the transaction, and thus there will no need to actually proof that the company is solvent and liquid.\textsuperscript{202}

Lastly, section 85(4) does not say anything about the period after the repurchase of shares by the company.\textsuperscript{203}

5.2.2 Authorisation for the acquisition of shares

In terms of section 85(1) of the current Companies Act\textsuperscript{204}, as amended by the Companies Amendment Act\textsuperscript{205}, it is possible for a company to acquire its own shares, subject articles of association and the approval of such an acquisition by ways of a special resolution that was passed by the shareholders of the company.\textsuperscript{205} This approval can be a general approval or

\textsuperscript{196} South African Mercantile Law Journal 2001 13 SA Company Groups and the acquisition of shares Delport PA p 123

\textsuperscript{197} The Companies Act 61 of 1973

\textsuperscript{198} South African Mercantile Law Journal 2001 13 SA Company Groups and the acquisition of shares Delport PA p 123

\textsuperscript{199} South African Mercantile Law Journal 2001 13 SA Company Groups and the acquisition of shares Delport PA p 123

\textsuperscript{200} South African Mercantile Law Journal 2001 13 SA Company Groups and the acquisition of shares Delport PA p 124

\textsuperscript{201} Act 61 of 1973

\textsuperscript{202} The South African Law Journal: The reform of Company Law and the Capital Maintenance Concept FHI Cassim p 285 and p 288

\textsuperscript{203} The South African Law Journal: The reform of Company Law and the Capital Maintenance Concept FHI Cassim p 285 and p 288

\textsuperscript{204} Act 61 of 1973.

\textsuperscript{205} Act 37 of 1999.

\textsuperscript{206} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim
specific approval for a certain acquisition, for example the latter will facilitate repurchase in connection with an employee share scheme.\textsuperscript{207}

5.2.3 The procedure with repurchasing of shares

Section 87(1) provides for two types of procedures when it comes to repurchase:\textsuperscript{208}

- an offer to all existing shareholders;

- an offer on the open market.

These procedures are very important to prevent abuse of power and discrimination against shareholders of the company.\textsuperscript{209} In the case of non-compliance with the requirements in the above mentioned section, it will constitute a criminal offence.\textsuperscript{210} The procedure prescribed in section 87(1) will not apply with the repurchase of listed shares on the JSE and repurchase of shares in terms of a specific approval.

5.3 Insider Trading

A disappointing fact is that the statutory provisions in terms of the current Act\textsuperscript{211}, with regard to repurchasing of a company’s shares by the company itself, is not viewed as an instance of insider trading, in terms of the Insider Trading Act 135 of 1998\textsuperscript{212}. However, insider trading is now regulated by the Securities Service Act.\textsuperscript{213}

In New Zealand, Australia and Canada, a company that acquires its own shares is viewed as the “ultimate insider”.\textsuperscript{214} This must however pressurise companies only to repurchase its own shares of which information have been made public.\textsuperscript{215} In terms of the Securities Service Act any person who, \textit{inter alia}, includes a company, can be an insider for purposes of insider trading. Before the Securities Service Act took effect, it was not possible for a company to be viewed as an insider.

\textsuperscript{207} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim

\textsuperscript{208} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim

\textsuperscript{209} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim

\textsuperscript{210} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim

\textsuperscript{211} Act 61 of 1973

\textsuperscript{212} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim

\textsuperscript{213} S 72 of Act 36 of 2004

\textsuperscript{214} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim

\textsuperscript{215} www.bowman.co.za The Capital Maintenance Concept and share repurchase in South African Law FHI Cassim and Rehana Cassim
It is therefore postulated that the Securities Service Act has not been aligned with Section 85 of the current Companies Act\textsuperscript{216}, with regard to insiders.

5.4 Interpretation of section 46 of the new Companies Act

The requirements for a distribution in contained section 46 of the new Companies Act\textsuperscript{217} Section 1 gives the definition of a distribution, as being either direct or indirect:

- Transfer by a company of money, or other property, other than its own shares, to shareholders of that company:
  
  1) in a form of dividends;
  
  2) payment in terms of section 47;
  
  3) as consideration of the acquisition of any of its shares in term of section 48 or by any company within the group of companies of any shares of a company within that group

- It is also the incurrence or forgiveness of a debt by a company to or for the benefit of shareholders or of another company within the group

In simple terms a distribution will be seen as the following:\textsuperscript{218}

- dividends;
- capitalisation shares;
- repurchase of shares;
- debt “forgiveness”.

In terms of section 46, a distribution is not allowed unless:

- the distribution is pursuant to an existing legal obligation of the company, or a court order or the board has authorised the distribution\textsuperscript{219};
- it reasonably appears that the company will satisfy the solvency and liquidity requirement after the distribution;

\textsuperscript{216} Act 63 of 1973
\textsuperscript{217} Act 71 of 2008
\textsuperscript{218} Delport PA, The new Companies Act Manual p 34
\textsuperscript{219} Authorisation is given by ways of a special resolution
- the board acknowledge that it has applied the solvency and liquidity requirement contained in S4 220 and reasonably concluded it will satisfy the solvency and liquidity requirement after the distribution.

Before making a distribution the Board must satisfy themselves that the company will comply with solvency and liquidity test in terms of Section 4. 221

The requirements contained in section 4 are as follows:

A company satisfies the solvency and liquidity requirement in a certain time, considering all reasonable foreseeable financial circumstance of the company at that time:

- The company’s aggregated assets equal or exceed its aggregated liabilities

- It appears that the company will be able to pay its debts as it becomes due in the ordinary course of business;

  I) 12 months after date of consideration

  II) A distribution in terms of section 48, 12 months following such a distribution

When it comes to the validity of the distribution, the provision contained in section 218(1) 222 must be taken into consideration. If the distribution falls within the ambit of section 218(1) and it is in contradiction of section 46, it will not void until the court declares it void 223

A director will be held liable in terms of section 77(3)(e)(vi) if such a director failed to vote against such a resolution. 224 Where a company acquires its own shares, it is viewed as a distribution and must comply with the requirements in terms of section 46

Thus, under the new Companies Act 225 repurchasing is allowed, however it must comply with the solvency and liquidity test in terms of section 4

The solvency and liquidity requirement contained in section 4 is much clearer and also refers to the period after the consideration date and distribution date, which the current Act 226 remains silent on

5.5 Interpretation of section 48 of the new Companies Act

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220 The Companies Act 71 of 2008
221 The Companies Act 71 of 2008
222 If an action falls within the ambit of S 218(1) it will not be void until the court declares it void
223 Delport PA The New Companies Act Manual p 34
224 Delport PA The New Companies Act Manual p 34
225 Act 71 of 2008
226 Act 81 of 1973
In terms of section 48(2)(a) of the new Companies Act\textsuperscript{227} a company may acquire its own shares subject to the requirements in terms of section 46 of the new Companies Act.\textsuperscript{228}

Shares in a holding company can also be acquired by the subsidiary company, however the total number of shares held by the subsidiary may not exceed 10\% of the number of issued shares of any class of shares.\textsuperscript{229}

It must also be noted that in terms of section 48(3) a company may not acquire its own shares, or subsidiary the shares in the holding company as a result that only the issued shares held would be shares held by subsidiaries or redeemable shares.\textsuperscript{230}

Reference is made to an agreement, for the repurchase in terms of section 48(4), and it is not clear from the rest of the section whether the company has to make an offer or if shareholder’s approval is required.\textsuperscript{231} The appraisal remedy will be available if a scheme of arrangement is purpose to repurchase shares by a company itself.\textsuperscript{232} The agreement referred to in section 48(4) is not enforceable if it is in breach of section 48(2)-(3)\textsuperscript{233}

Unlike the current Companies Act\textsuperscript{234} which requires that requires approval in the articles of association, the new Companies Act\textsuperscript{235} does not require that the memorandum of incorporation should authorise such a repurchase of shares by a company\textsuperscript{236} There is no provision in the new Act\textsuperscript{237} which states that a repurchase must comply with the Memorandum of Incorporation, however a repurchase in contravention of the Memorandum of Incorporation will probably be attacked by shareholders of the company\textsuperscript{238}

When a company acquires shares in contradiction of section 46 and section 48 of the new companies act it may apply to the court for an order to the reverse such a repurchase.\textsuperscript{239}

5.6 Tax implications of repurchasing

\textsuperscript{227} Act 71 of 2008
\textsuperscript{228} Act 71 of 2008
\textsuperscript{229} Delport PA The New Companies Act Manual p 34
\textsuperscript{230} Delport PA The New Companies Act Manual p 34
\textsuperscript{231} TSAR 2010-2 K van der Linde Share repurchase and the protection of shareholders p 302.
\textsuperscript{232} TSAR 2010-2 K van der Linde Share repurchase and the protection of shareholders p 302-303 and also s 164(2)(b) together with s 114
\textsuperscript{233} Delport PA The new Companies Act Manual p 35
\textsuperscript{234} Act 63 of 1971
\textsuperscript{235} Act 71 of 2008
\textsuperscript{236} TSAR 2010-2 K van der Linde Share repurchase and the protection of shareholders p 299 and p 302.
\textsuperscript{237} The Companies Act 71 of 2008.
\textsuperscript{238} S 15(2) The Memorandum of Incorporation is a contract between the company,directors and the shareholders
\textsuperscript{239} Delport PA The new Companies Act Manual p 35
In the case where a company repurchase its own shares, it will be viewed as a dividend in terms of the Income Tax Act 58 of 1962. The company will be liable for Secondary Taxation on Companies for the amount that was used to buy back the shares. From the shareholders’ side, it will be possibly viewed as taxable income, if shares are kept in a trading account, or capital gains tax in case where the shares are kept in a capital account.

5.7 Conclusion

The words in section 85(4)(a) of the current Act read "in the ordinary course of business.", while, in section 4 of the new Act the word "ordinary" has been removed. From this it can be concluded that as long as the debt is due and related to the business of the company it must be taken into consideration. The requirement in section 4 is formulated differently to section 85(4)(a).

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240 S 64B and 64C, read together with s 1 that defines a dividend
241 www.deneysreitz.co.za Share Buy Backs, October 1, 2002
242 The Companies Act 61 of 1973
243 The Companies Act 71 of 2008
CHAPTER 6

6.1 Conclusion

The new Companies Act, which will come into effect April 2011, has addressed some of the difficulties in the current Companies Act. The provisions contained in the new Companies Act with regard to the period after the date that the solvency and liquidity test have been complied with, is much clearer than its predecessor.

Section 44 gives adequate protection to shareholders and creditors of the company, however there is an inconsistency with regard to the wording of section 44, because a board can not authorise the company, it must be the other way around. It is a much better approach for the Board of the company to approve financial assistance due to the fact that they are more involved with the day to day running of the business and are more in touch with the financial position of the company.

In terms of the new Companies Act, the Memorandum of Incorporation is a contract between the directors, the shareholders and the company which gives more protection to third parties (creditors) and also the minority shareholders.

Section 226 contains a general provision against financial assistance to directors except for a few exceptions. In terms of section 45, the Board may authorise financial assistance to directors, but the board must satisfy themselves they had complied with the solvency and liquidity requirement.

Provisions in the current Companies Act, with regard to share repurchase, are in some ways inadequate. In terms of section 48 of the new Companies Act, a company is now allowed to repurchase its own shares, subject to section 46. Section 48 provides adequate protection for shareholders and creditors.

The new Companies Act brings a major shift by moving away from the outdated concept of capital maintenance. New concepts are introduced by the new Companies Act, however this still needs to be tested by the courts. It seems with the new Company Act brings South African company law in line with other international jurisdictions.
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Word Count

10 813, footnotes included