The regulation of distributions in terms of the Companies Act 71 of 2008

by

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Abstract

Prior to 2008, South African company law was a carbon copy of English company law legislation. One of the fundamental aspects carried over from the English Law was that of Capital Maintenance. The Capital Maintenance Rule was created by the English courts in late 19th century, and became embedded in English and South African statutes. The primary aim of this rule was to protect the interests of creditors of a company by prohibiting transactions beneficial to, or expected by, the shareholders, which would result in the reduction of the company's share capital. The need for this form of protection was due to the practice of creditors to look at the shared capital of a company as a guarantee for the repayment of their debts.

South African company law deviated from sole reliance on the English company law methodology and reviewed current practices of other jurisdictions) such as the USA, New Zealand and Canada amongst others) for purposes of reforming corporate law. These other jurisdictions had shifted from the orthodox English method of capital maintenance and used the solvency and liquidity approach to balance the interest of creditors against the expectations of shareholders. The transactions, which were not specially defined in the Companies Act 61 of 1973 and Union Companies Act 41 of 1926, are now all termed "Distributions" and defined in section 1 of the Companies Act 71 of 2008. Distributions are primarily subject to the provisions of sections 46, 47 and 48 of the Companies Act 71 of 2008.

The research assesses the breadth of the definition of "distributions" and the regulations pertaining to them. Is regulation found wanting because the definition results in improper protection of the interests of creditors, even with the modern approach of applying the solvency and liquidity test? In answering this question, the South African position is assessed and the position in New Zealand researched for comparative purposes.

Declaration of originality

I, Naina Bhula, declare as follows by submitting this dissertation:

1. I understand what plagiarism is and am aware of the University's policy in this regard.
2. I declare that this mini-dissertation is my own original work. Where other people's work has been used (either from a printed source, Internet or any other source), this has been properly acknowledged and referenced in accordance with departmental requirements.
3. I have not used work previously produced by another student or any other person to hand in as my own.
4. I have not allowed, and will not allow, anyone to copy my work with the intention of passing it off as his or her own work.

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Chapter 1: Introduction and orientation

1.1 Introduction

The two primary stakeholders in corporate financing regulation are shareholders and creditors.[1] These stakeholders play a major part in the well-being of the country's economy and contribute greatly to the country's economic development.[2] Shareholders and creditors are the main sources of a company's capital[3]. Capital can be raised in two ways, either by raising funds by issuing shares or by borrowing money from creditors. However, their roles and interests differ when it comes to the company. Creditors are external investors whereas shareholders are privy to the internal management of the company. Shareholders partake in the company's affairs by voting at general meetings and appointing members of the board of directors to manage the daily operations of the company.[4] Shareholders expect returns on their investments in the company whereas creditors desire repayment of their contributions to the company's capital. Ultimately their interests' conflict in the following manner:

1. Creditors will prefer the company to hold a larger asset pool to which their claims rank above those of the shareholders, whilst shareholders will prefer minimal personal risk against creditors' claims.
2. Although shareholders welcome creditors to invest in the company by extending further loans, which will encumber the company's asset pool, there is a higher possibility of the shareholders pro-rata share in the concurrent pool being diluted on liquidation.
3. Creditors expect their claims to be paid before shareholders receive any payment from investments in the company, however shareholders expect a return when the company makes a profit.

[1] Bradstreet "Should creditors rely on the solvency and liquidity threshold for protection? A South African case study" 2015 *Journal of African Law* 121 at 124.
[2] Bradstreet above note 1 at 124.
[3] A brief discussion on how capital is raised and its purpose is discussed in Chapter 2.
[4] Bradstreet above note 1 at 125.

4. Payment of dividends is in direct conflict with the interest of creditors as it reduces the company's capital.[5]

It has always been an objective of company law, both locally and globally, to manage these conflicting interests.

1.2 Background

For well over one hundred years, South African companies were subjected to regulations laid down by the English courts and legislature. The Joint Stock Companies Limited Liabilities Act of 1861[6] of the Cape Colony, followed by the Union Companies Act of 1926,[7] thereafter the Companies Act of 1973.[8] One of the fundamental aspects carried over from the English law was that of capital maintenance. The capital maintenance rule was created by the English courts in the late 19th century, and became embedded in English and South African statutes. The primary aim of this rule was to protect the interests of creditors of a company by prohibiting transactions beneficial to, or expected by, the shareholders, which would result in the reduction of the company's share capital.[9] The need for this form of protection was due to the practice of creditors to look at the share capital of a company as a guarantee for the repayment of their claims.[10]

In 1999,[11] the South African law partially deviated from the orthodox English law principles – specifically the capital maintenance rule – in an attempt to semi-align the South African corporate law with the principles of the United States of America, New Zealand and Canada. Where some capital maintenance rules were relaxed, others remained in place.[12]

In 2004, the Department of Trade and Industry felt that there was a need for a thorough review of the existing company law. Existing practices and principles were outdated and

[5] Bradstreet above note 1 at 125-126.
[6] 23 of 1861.
[7] 46 of 1926, hereinafter referred to as the 1926 Act.
[8] 61 of 1973, hereinafter referred to as the 1973 Act.
[9] Bradstreet above note 1 at 127.
[10] Bradstreet above note 1 at 128.
[11] Companies Amendment Act 37 of 1999.
[12] See Chapter 2 for further discussion.

not in line with the current socio-economic landscape, international trends and the new constitutional dispensation which was already in place for ten years.[13]

As part of the review, the aspect of corporate finance was investigated. "Corporate finance" can be described as the part of company law which regulates the equity and debt financing of a company, including share capital, the acquisition by a company of its own shares, the provision of financial assistance to purchase these shares, share allotments and the issue of shares, debentures and restrictions on public offerings of shares for sale.[14]

The complete deviation from the orthodox English method of capital maintenance came about in 2008 when the Companies Act 71 of 2008 made provision for the solvency and liquidity test as a means of protecting the interests of creditors from the expectations of shareholders. All capital maintenance rules were relaxed. Transactions which were ring-fenced as capital reducing were regulated fragmentally in the Companies Act 61 of 1973 and Union Companies Act 41 of 1926, are clumped under the termed "Distributions" and defined in section 1 of the Companies Act 71 of 2008.[15] Distributions are primarily subject to the provisions of sections 46, 47 and 48 of the current act.

1.3 Research statement and questions

Since capital maintenance was a globally accepted and practiced principle, and may still be effective in many jurisdictions, this move away from the principle towards a new system of solvency and liquidity, and the concomitant terminology of distribution, has caused many discussions. Although this new system has been implemented in South Africa for a decade now,[16] there has not been any reported judicial decisions on these new concepts. There has been many debates between writers on the efficacy of distributions and the restrictions around it. The question thus remains whether the current regulations placed on distributions adequately protect the interests of creditors in a similar fashion as the

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[13] Department of Trade and Industry (hereinafter DTI) “Guidelines for Corporate Law Reform” Government Gazette No 26493 Notice 1183 of 23 June 2004 at 3.
[14] Guidelines for Corporate Law Reform above note 13 at 32.
[15] Hereinafter referred to as the Current Act.
[16] The Companies Act 71 of 2008 came into effect on 1 May 2011.

previous regime of capital maintenance. An investigation into the decade old principle warrants some investigation.

The main research question that this study seeks to answer is whether distributions are regulated for the purposes of creditor protection. This question cannot be answered in isolation. The answers or investigations into the following questions will bring merit to the main research question:

1. Does the term distribution serve as an umbrella term for all those transactions that were previously identified under the capital maintenance rule as capital reducing?

2. Does the solvency and liquidity test as the prime restriction on distributions supersede the purpose of the capital maintenance rule i.e creditor protection?

3. Are the regulations for repurchase of shares too lenient?

4. What is the position in New Zealand's company law with regards to distributions and the regulation thereof?

1.4 Objective of the research

The main purpose of this research is to analyse whether the forms of capital reduction of capital reduction are enclosed under the terminology of distributions and are they regulated for the purposes of protecting the interest of creditors against the expectations of shareholders and is there any room for improvement or lessons to be learnt from those mechanisms already exhibited in New Zealand.

The starting point would be the history of the capital maintenance rule in the South African company law context. The focus will then shift to the definition of distributions in terms section 1 of the Current Act together with the requirements to carry out relevant distributions as set out in sections 46, 47 and 48 of the Current Act. Lastly, a comparative analysis will be done on how distributions are dealt with New Zealand.

1.5 Research methodology

The methodology of this research will be descriptive, analytical and comparative. The descriptive element will entail a discussion of the change of regulation against the background of creditor protection – from the principles of capital maintenance to the shift into the new paradigm. An analysis will be done on what has changed between the two regimes and whether it is an improvement or not. A comparison will be done with New Zealand statutory company law for any lessons that can be learnt or enhancements that could be made to the Current Act. New Zealand was also one of the jurisdictions that was heavily influenced by English law. It officially cut the umbilical cord from English company law in 1993 when it adopted the North American approach of solvency and liquidity. Since New Zealand was already just under twenty years ahead of South Africa in effecting this change, it is valuable to analyse how this jurisdiction regulates distributions and the reason and views for the change.

1.6 Structure of research

Chapter 1 provides an introduction and purpose of the dissertation. A short background is given on how the research question came about and it will be answered through the research to follow.

Chapter 2 provides background on the capital maintenance rule in the South African context. The chapter contains the history of how capital maintenance rule was brought about and its purpose for South African companies together with the pitfalls in the rules contained thereunder.

Chapter 3 is an in-depth analysis of the definition of distributions and the restrictions or regulations thereof. The analysis focuses on what has changed or remained the same from the time of capital maintenance rules together with any pitfalls that have been identified.

Chapter 4 contains a detailed discussion on the current definition of distributions in New Zealand Company law. The manner of regulation and the reason for the reform from capital maintenance to solvency and liquidity are discussed.

Chapter 5 is a comparative analysis of the description of distributions, its regulations and any room for enhancements for South Africa from the New Zealand context.

Chapter 2: The Principle of Capital Maintenance

2.1 Introduction

One of the core principles of company law is that of separate legal personality. A company is a legal person its own right separate from its founders.[17] Whatever a company owns does not automatically signify a right of ownership to its founders or shareholders.[18] Another core function of company law is how a company raises its capital and the manner in which that capital should be managed in the interests of all relevant stakeholders.[19] In practice, a company raises its capital primarily in two ways, either from issuing securities mostly in the form of shares in the company itself or by borrowing funds from other institutions.[20]

Any consideration paid or which is due to a company for the issuing of shares in itself is termed as 'share capital'.[21] Share capital serves three functions in a company:

1. It is a manner in which a company obtains funds for operational use.

2. It creates a safety net for creditors of the company.

3. It proportions the interests of the shareholders of the company.[22]

There are no prescribed thresholds in company law stipulating the minimum amount of share capital that a company should have as working capital. However, where a particular statute has prescribed thresholds, it is for the prevention of frivolous companies.[23] A company is free to raise its working capital from many forms other than issuing of shares.[24]

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[17] This was established in the English case of *Saloman v Saloman* [1897] AC 22 (HL).
[18] *Dadoo Ltd v Krugersdorp Municipality Council* 1920 AD 530 at 550.
[19] Van der Linde *Aspects of the regulation of share capital and distribution to shareholders* 2008 (LLD Thesis, UNISA) at 2.
[20] Cassim et al *Contemporary Company Law* (2013) 213.
[21] Van der Linde above note 19 at 2.
[22] Van der Linde above note 19 at 3.
[23] Van der Linde above note 19 at 4.
[24] Van der Linde above note 19 at 4.

As mentioned above a company may raise capital from loans taken from financial institutions, who in turn become the creditors of the company until the loan is paid up. Apart from any security held for the repayment of the loan, what comfort does a creditor have that the borrowing company will be able to pay its debts? Throughout the years, the belief was that a creditor looked at the share capital of a company as security for the repayment of its claims. However Van der Linde is of the opinion that, the idea of 'share capital' creating a safety net for creditors as repayment for company's debts is deceiving, as the share capital is a fictional amount or notional liability.[25] There is no assurance has pooled up money or assets for the repayment of creditors' claims nor is there any guarantee that the pool of assets of the company may be diminished in the ordinary course of business.[26] Share capital can protect creditors by acting as a buffer only to the extent that the company has retained the accumulated funds or has utilized it to acquire further assets.[27]

> *"A share is a fractional part of the share capital, it confers upon the holder certain rights to a proportionate part or interest in the assets of the company whether by way of dividends or distribution of assets during winding up. The capital is the property of the company and the share is the property of the shareholder."*[28]

A shareholder, by way of the shares he/she holds in a company, is entitled to certain rights or interests. Shareholders have the right to participate in general meetings of the said company. They may also share in on any returns of capital and are also vested with control of the company.[29] The constitution together with the type and number of shares held by shareholder will dictate the interest conferred upon them.[30]

2.2 The Capital Maintenance Rule

[25] Van der Linde above note 19 at 6.
[26] Van der Linde above note 19 at 6.
[27] Van der Linde above note 19 at 6.
[28] *Bradbury v English Sewing Cotton Co Ltd* [1923] AC 744 (HL) 746.
[29] Van der Linde above note 19 at 6.
[30] Van der Linde above note 19 at 7.

2.2.1 Origin

From the concept of limited liability and separate legal personality, which are privileges given to a company by the State, the view of English Law was that companies were required to be regulated in the interests of creditors and investing public.[31] In contrast, the United States of America viewed creditor protection from a company as being contractual in nature, however failed to consider involuntary creditors and creditors who could not protect themselves contractually. [32]

Based on the English Law philosophy, the House of Lords ruled in the matter of *Trevor v Whitworth*[33] that it was unlawful for a company to purchase its own shares. In his reasons for this ruling, Lord Watson's view was the following:

> "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 liability company, naturally rely on upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has subsequently been paid out except in the legitimate course of its business."[34]

From this judgment the capital maintenance rule was born. Following this judgment, by the beginning of the twentieth century, many of the English courts created extensions to capital maintenance principle:[35]

1. Shares may not be issued at a discount.[36]

2. Dividends may not be paid out of capital.[37]

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[31] Cassim "The Reform of Company Law and the Capital Maintenance Concept" 2005 South African Law Journal 283 at 284
[32] Cassim above note 31 at 284.
[33] See para 1.2 above.
[34] *Trevor v Whitworth* at 423-4.
[35] Van Der Linde above note 19 at 20.
[36] *Ooregum Gold Mining Co v Roper* [1892] AC 125 (HL).
[37] *Guinness v Land Corporation of Ireland* (1883) 22 ChD 349 CA 356.

3. A company may not repurchase or acquire its own shares.[38]

2.2.2 Capital Maintenance in South Africa

English Law had a major influence on South African Law, and the resultant effect was the adoption of the capital maintenance rules into South African company law. These rules were embedded in both the 1926 and 1973 Acts, and resident common law throughout the twentieth century.

One of the first South African courts to echo the sentiments of judgment laid down in *Trevor v Whithead* was the Western Cape High Court in the matter of *Cohen v Segal*.[39] Judge Boshoff prohibited the payment of dividends out of capital and ruled that a resolution declaring that dividends may be paid out of capital was ultra vires the company.[40] His reason for this ruling was:

> "[W]hatever has been paid by a member cannot be returned to him and no part of the corpus of the company can be returned to a member so as to take away from the fund to which the creditors have a right to look as that out of which they are to be paid. The capital may be spent or lost in carrying on the business of the company, but it cannot be reduced except in the manner and with the safeguards provided by the statute."[41]

The original 1973 Act encompassed the capital maintenance rule through sections 83 to 90. These provisions ensured that the common law rules of capital maintenance were entrenched, in effect that

1. Dividends could not be paid out of capital

2. Capital could not be reduced without the consent of creditors, a special resolution or court order.[42]

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[38] *Trevor v Whitworth* at 409.
[39] 1970 (3) SA 702 (W).
[40] 1970 (3) SA 702 (W).
[41] Cohen v Segal at 705.
[42] Sections 83 and 84.

3. A company could not acquire its own shares or shares in its holding company.[43]

4. Par value shares could not be issued at a discount except under certain stringent conditions.[44]

5. A company could not provide financial assistance for the acquisitions of its own shares or shares in its holding company.[45]

6. Payment of interest out of share capital.[46]

In essence, what both English company law and South African company law sought to do was to protect the 'guarantee fund' that a creditor relied upon against depletion for the benefit of shareholders.[47] By prohibiting those transactions that created impediments on the capital was perhaps the best possible solution at the time. According to Cassim, the original capital maintenance concept had nothing to do with a company having adequate capital to meet the claims of the creditors.[48] In fact, this concept was aimed at ensuring that issued share capital was maintained with the ideology that the company could not return its issued share capital to its shareholders unless authorized by the Companies Act.[49] Ultimately, the capital maintenance rule aimed at protecting creditors in terms of four provisions:

- Rules relating to raising of capital
- Prohibiting dividends payable out of capital
- Prohibiting a company from purchasing its own shares

[43] Section 85.
[44] Section 81.
[45] Section 38.
[46] Section 79.
[47] Van der Linde above note 19 at 21.
[48] Cassim above note 31 at 285.
[49] Cassim above note 31 at 285.

- Prohibiting a company from providing financial assistance for the purchase of or subscription for its shares.[50]

Although they have may worked at the time of creation, South African companies were for approximately thirty years subjected to these complex and inflexible rules regarding capital maintenance. Other countries such as New Zealand and Australia[51] had already shifted from this orthodox rule to the modern American approach of 'solvency and liquidity.'[52]

The inconsistencies in regulating these transactions created confusion in whether the essence of capital maintenance will be achieved. On the one hand, a special resolution was required for any form of capital reduction and on the other hand, directors of the company would be held personally liable if shares were unlawfully acquired by a company.[53] The wording of the provisions are extremely creditor- and shareholder-orientated, appearing that the company itself and the directors who are the managers of a company do not seem to have any authority to reduce the capital of a company specifically when it would result in a benefit to shareholders.

In 1999 the true evolution of South African company law began where the Standing Advisory Committee convinced the DTI of the need to move towards the modern, flexible approach of solvency and liquidity which, apart from providing creditor protection, also enabled a company to achieve sound commercial objectives.[54] The first changes to the long hauled capital maintenance principle was making the solvency and liquidity test a requirement[55] for the:

1. Repurchase of shares;[56]

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[52] Cassim above note 31 at 285.
[51] As countries that were part of the Common Wealth and also subject to English Law.
[52] This concept will be discussed in detail in the following chapter.
[53] Section 86(1) and (2).
[54] DTI "Purchase by a company of its own shares" Government Gazette 188688 Notice 724 of 8 May 1998.
[55] To be discussed in Chapter 3.
[56] Sections 85 to 89 of the 1973 Act.

2. Payments to shareholders;[57]

3. Financial assistance to be provided in certain circumstances for the acquisition of shares by others, or a subsidiary company of a holding company.[58]

Although this modern approach of American company law was welcomed, it was not the end of the capital maintenance principle for South Africa. The 1999 amendments only partially abolished the capital maintenance-rule.[59] Whereas creditor, shareholder or court consent were no longer a requirement for certain capital reducing transactions, the restriction on issuing shares at a discount, the payment of interest out of share capital;[60] and the requirements in respect of redeemable preference shares[61] remained in place.[62]

Companies were permitted to acquire its own shares in certain circumstances[63] and payments to shareholders were also permitted,[64] but both transactions were now subject to the meeting of the solvency and liquidity test.[65]

The concept of allowing companies to purchase its own shares and make payments to shareholders was new to South African company law and to companies themselves. It was not entirely clear whether section 85 of the 1973 Act resulted in the complete abolishment of the rule. This question was raised by the court in *Capitex Bank Ltd v Qorus Holdings Ltd*[66] and the view of the court, supported by the authors of the seminal work on companies, *Henochsberg on the Companies Act*,[67] was that

> "s 85(1) in so many words as a general proposition allows a company to approve the acquisition of its own shares subject only to two internal requirements, viz that the acquisition be authorised by the articles and that approval be given by way of special

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[57] Section 90 of the 1973 Act.
[58] Section 89 of the 1973 Act.
[59] Pretorius et al " Hahlo's South African Company Law through the cases" 1999 at 121.
[60] Section 79.
[61] Section 98.
[62] Pretorius above note 59 at 122.
[63] Section 85.
[64] Section 90.
[65] The solvency and liquidity test will be discussed in detail in Chapter 3.
[66] 2003 (3) SA 302.
[67] Kunst et al (eds) *Henochsberg on the Companies Act 61 of 1973* ("Henochsberg") at notes on section 85 at 33.

> resolution. This effectively repeals one of the three sub-rules of the common law rule that a company maintain its capital … The general power given to all companies is inconsistent with the unexpressed rule of the common law that a company may not purchase its own shares"

and that

> "in view of the provisions of ss 85(1) and 38(2)(d), it cannot be said that the mere purchase or the mere conclusion of an agreement of purchase and sale or other transaction relating to the 'acquisition' by a company in respect of its own shares is prima facie illegal. Only payment made in contravention of s 85(4) would result in illegality."[68]

The wide – or technically absent – meaning given to the term "Payments" in section 90 was also a point of deliberation.[69] The only possible type of payment that could be made to a shareholder was in the form of a dividend.[70] From the research conducted I am yet unclear as to why the term payment was not defined and the reason for not simply referring to a dividend is S90 instead of a payment remains a mystery. It was also not clear whether these payments could be made out of capital or profits only.[71]

What remained of these enhancements was the need for shareholder approval, but no director confirmation or authorisation.

One of the first jurisdictions to establish the solvency and liquidity test was the United States of America. The solvency and liquidity test according to the the Model Business Corporation Act:

> "No distribution may be made if, after giving it effect:
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> (1) the corporation would not be able to pay its debts as they become due in the usual course of business; or

[68] *Capitec Bank v Qorus Holdings* at 308-309.
[69] Pretorius above note 59 at 122.
[70] Henochsberg above note 67 at notes on section 90 at 186(4).
[71] Henochsberg above note 67 notes on section 90 at 186(4).

(2) the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, satisfy preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving distribution."[72]

It is interesting to note that the two requirements are listed in the alternative. It did not seem necessary for a company to meet both elements of the test, neither in terms of the American company law nor South African law. Henochsberg states otherwise. He clarifies the test to mean "paired", in that if either of the circumstances in paragraph (a) or (b) of the test exist the transaction is prohibited.[73]

The true abolishment of the capital maintenance rule came about in 2008 with the enactment of the Current Act, almost a decade after its partial abolishment. The DTI did not provide much reasoning for the need to shift away from the old regime of capital maintenance to the America approach of 'solvency and liquidity' apart from the fact that the current rules in the 1973 Act are outdated and that it was time to shift to modern international standards and practices.[74]The need to reform and align with international standards included the development of the South African economy to promote local and international investments in South African companies.[75]

The solvency and liquidity test was carried over into the Current Act, however the rules relating to capital were transformed i.e the distinction between par value and no par value shares was removed.[76]The introduction of the term "Distributions",[77] conditions on distributions,[78] the distinction between par value and no par value shares was removed, shareholder approval was replaced with director approval and acknowledgment with

[72] Section 6.40(c).
[73] Henochsberg above note 67 at notes on section 90 at 186(4).
[74] DTI above note 13 at 13.
[75] DTI above note 13 at 7.
[76] DTI above note 13 at 16.
[77] Section 1.
[78] Section 46.

regards to distributions, director liability forms the cushion for non-compliance with the provisions of the Current Act.[79]

2.3 Conclusion

The capital maintenance rules were stringent and extremely creditor orientated. Creditors consent was required when dissipated capital of a company whilst directors were not provided much room to make commercial decisions. Creditor's interests were preferred over the company's investors and there was no provision to test the merit of this. By the transformation of South African company law brought South Africa on par with global company law standards. Through the introduction of the solvency and liquidity tests companies were provided with freedom to make sounder commercial decisions whilst still providing comfort to creditors on their claims.

[79] Section 77.

Chapter 3: The new concept of "Distributions"

3.1 Introduction

Holding shares in a company not only brings about certain rights and obligations upon a shareholder but also some expectation – this expectation primarily entails some form of return on the capital that the shareholder contributed, such as sharing in the profits during the company's existence.[80] Van der Linde confirms that a return on any investment made into a company is not a right but merely an expectation.[81] The capital of a company remains the asset of the company and a share/s in the company is the asset of the shareholder. Van der Linde cautions that the expectation of a shareholder to receive profits in a company must be weighed against the expectation of a creditor to be paid.[82]

The term "distribution" is broad. It Includes all transactions which result in returns on share capital and return of share capital.[83] Any form of distribution has an impact on the shared capital of the company and must be regulated in order to protect the interests of creditors and minority shareholders.[84] The most common way of protecting the interests of creditors and minority shareholders is by way of imposing financial restrictions on distributions.[85]

Under the capital maintenance rule, a company was conferred with the power to declare dividends out of profits.[86] Any other form of distribution required approval from shareholders coupled with a court order and creditors consent where applicable.[87] In the 1973 Act the term distribution was not defined, however the different transactions were identified as impediments to capital reduction and/or creditor protection. These

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[80] Van der Linde "The Regulation of Distributions to Shareholders in the Companies Act 2008" 2009 *Tydskrif vir die Suid-Afrikaanse Reg* 2009 484 at 484.
[81] Van der Linde above note 80 at 484.
[82] Van der Linde above note 19 at 16.
[83] Van der Linde above note 19 at 14.
[84] Van der Linde above note 19 at 15.
[85] Van der Linde above note 19 at 15.
[86] Section 25 of the Joint Stock Companies Act 7 & 8 Vict. C 110 & 111 of 1844.
[87] Section 83 of the 1973 Act required a company to obtain creditors' consent above shareholder approval for the reduction of its share capital.

transactions were regulated fragmentally in the 1973 Act.[88] In 1999, the solvency test was introduced as a (financial) restriction on some of these transactions – in particular, where the guaranteed result would be capital reduction. Repurchase of shares and payments to shareholders were subject to the solvency and liquidity test, whereas payment of interest out of capital was excluded from any financial restriction, as the payment had no impact on the share capital.[89]

In 2008, the concept of distributions was formalised in the Current Act and can now be described as an umbrella term for the above listed transactions, and more. The solvency and liquidity test was retained as a restriction of, and coupled with many other new conditions for, the regulation of distributions. The intent remained the same: protection of creditors and minority shareholders.[90] Jooste confirms that, for this intent to be realised, it is important that distributions be regulated.[91]

From the comments provided by the DTI to the many discussions by various writers I am of the view that South Africa has aligned itself to most of the Western countries' approach to *regulate* capital reduction, instead of *avoiding* capital reduction. This chapter will consider the definition of distributions and the manner in which these transactions are regulated in the interest of protecting creditors.

3.2 Analysis of the term "Distribution"

A distribution in terms of the Current Act may occur – directly or indirectly – as follows:

1. A transfer of money or property;[92]

2. An incurrence by the company of an obligation;[93]

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[88] Bradstreet "Regulating Legal Capital Reduction: A comparison of creditor protection in South Africa and the State of Delaware" 2012 *South African Law Journal* 736 at 741.
[89] Section 79 of the 1973 Act.
[90] Jooste "Issues Relating to the Regulation of Distribution by the 2008 Companies Act" 2009 *South African Law Journal* 627 at 628.
[91] Jooste above note 90 at 627.
[92] Section 1(1)(a).
[93] Section 1(1)(b).

3. A waiver or forgiveness of an obligation.[94]

Any of the above forms of distributions may take place in a company or between companies in the same group.

According to Van der Linde, the Current Act has listed a few examples of what typically would entail a distribution, however the generality of the last example[95] indicates that this is an exhaustive list by which a distribution will be carried out upon transfer of property of money.[96] The Current Act has listed the following examples under the definition of Distributions:

"

1. Dividends;
2. Payments in connection of capitalization shares;
3. Consideration for the acquisition by a company of its own shares;
4. Consideration for the acquisition by a company in a group of shares of another company in the same group;
5. Transfers by a company in respect of any of the shares of that company or of another company within the same group."[97]

According to Bradstreet, the definition of a distribution makes no direct reference to capital but regulates behavior that may be considered as depleting capital, and is broad enough to cover a range of potential problematic transactions.[98]

3.2.1 Dividends

Under the capital maintenance rule dividends were prohibited from being paid out of capital.[99] With the Companies Amendment Act,[100] payments to shareholders were

[94] Section 1(1)(c).
[95] Paragraph (a) (iv) from section 1 of the definition of a distribution.
[96] Van der Linde above note 80 at 486.
[97] Section 1 under 'distribution' para (a)(i)-(iv).
[98] Bradstreet above note 88 at 749.
[99] Chapter 2 above.
[100] 37 of 1999, hereinafter referred to as the 1999 Amendment Act.

permitted subject to approval in the company's articles of Incorporation,[101] and satisfying the requirements of the solvency and liquidity test.[102] The term "payment" was qualified in section 90(3) of the 1999 Amendment Act.[103] "Dividends" were not included in this description however as the payment related to a shareholder's shareholding and from the exclusions provided, it was deemed that the term "payments" included payments made out of the profits of the company and that these payments would then include dividends.[104]

The inclusion of dividends in the definition of a distribution is welcomed although its statutory meaning for the purposes of company law is still unclear. If one applies the ordinary meaning of a dividend, a share in the profits of a company.[105] The Memorandum of Incorporation will, in most cases, stipulate the manner and method in which dividends will be declared and paid. Unless the Memorandum of Incorporation of the company includes a specific description of a dividend, it would entail any payment in the form of money or property to a shareholder based purely on his/her shareholding, and as long as it does not fall into any of the other categories set out in the statutory definition of a distribution.[106]

There is also no indication of whether dividends can be paid out of capital or only profits.[107] In *Hill v Permanent Trustee Co of New South Wales Ltd*[108] the court's view was that, irrespective of whether a payment is called a dividend or bonus, it must still remain a payment on division of profits. Henochsburg supports this view and notes that the wording of section 90[109] regarding "any other payment made by it by means of which it

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[101] Section 90(1).
[102] Section 90(2).
[103] Pretorius above note 59 at 122, "payment includes any direct or indirect payment or transfer of money or other property to a shareholder of the company by virtue of the shareholder's shareholding in the company, but excludes an acquisition of shares in terms of section 85, a redemption of redeemable preference shares in terms of section 98, any acquisition of shares in terms of an order of Court and the issue of capitalisation shares in the company".
[104] Henochsberg above note 67 at notes on section 90 at 186(4).
[105] Pretorius above note 59 at 138.
[106] Delport *Henochsberg on the Companies Act 71 of 2008* at notes on section 1 at 24.
[107] Van der Linde above note 80 at 487.
[108] [1930] AC 720 (PC) at 731.
[109] The 1973 Act.

parts with moneys to its shareholders must and can only be made by way of dividing profits" confirms that dividends can only be paid out of profits.[110]

3.2.2 Capitalisation shares

The board of directors may opt to capitalize profits and issue capitalisation shares to shareholders instead of declaring large dividends. When these shares are issued, no payments are made to shareholders and the issuing of these shares merely increased the shareholders' respective share portfolios in the company.[111] Van der Linde reasons that the inclusion of this example is because the capitalisation shares are in themselves not distributions, but the board of directors may offer (if the Memorandum of incorporation permits it) cash payments as an alternative to the capitalization shares.[112] This cash payment will entail a distribution. Payments in terms of capitalization shares must then comply with section 47 of the Current Act.

3.2.3 Acquisition of shares by a company or subsidiary

Share buybacks, or acquisition by a company of its own shares or by a subsidiary company in its holding company, was prohibited under the capital maintenance rule. The 1999 Amendment Act made it permissible for a company to acquire its own shares[113] or for a subsidiary to acquire shares in its holding company.[114] The Current Act includes the repurchase of its own shares, or shares by a subsidiary in its holding company, in the definition of a distribution and applies the requirements for distributions to these transactions under section 48. Van der Linde has pointed out that acquisitions of shares of companies within a group is regarded as a distributary act but that the requirements under section 48 need only be met if a subsidiary company acquires shares in its holding company and not in any other company in the group.[115]

[110] Henochsberg above note 67 at notes on section 90 at 186(4).
[111] Henochsberg above note 106 at notes on section 1 at para (a)(ii) at 27.
[112] Van der Linde above note 80 at 487.
[113] Section 85.
[114] Section 89.
[115] Van der Linde above note 80 at 487.

3.2.4 Incurrence of debt

Henochsberg raised the question whether the inclusion of an incurrence of debt on behalf of a shareholder is linked to the examples provided in paragraphs (a) of the definition.[116] The author explains the nexus between paragraphs (a) and (b) by way of an example.[117] If a company incurs debt or an obligation for the repayment of a shareholders loan, that debt will ordinarily not be regarded as a distribution.[118] However, if the debt incurred is for the acquisition of shares in the company, then the acquisition will be subject to the requirements for a valid distribution and not relate only to the actual financing of the transaction.[119]

3.2.5 Forgiveness and waiver of debt or obligation

The rationale for the inclusion of forgiveness and waiver of a debt or obligation of a shareholder by the company is unclear. It seems that the same nexus applicable to debt is to apply in these situations – in effect, the forgiveness or waiver must be incidental to any of the scenarios listed in paragraph (a) relating to distributions.[120]

3.3 Requirements for the authorisation of distributions

3.3.1 Authorisation

Unlike with the capital maintenance rule, the Current Act provides for a distribution to arise from an existing legal obligation,[121] court order,[122] or board of directors resolution.[123] With the capital maintenance rule, all distributions were to be authorised by court and in some instances a special resolution was also required.

The requirement of shareholder approval has been removed but the Memorandum of Incorporation may still include this as a condition.[124] Including shareholders' approval as

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[116] Henochsberg above note 106 at notes on section 1 at para (b) at 29.
[117] Henochsberg above note 106 at notes on section 1 at para (b) at 29
[118] Henochsberg above note 106 at notes on section 1 at para (b) at 29.
[119] Henochsberg above note 106 at notes on section 1 at para (b) at 29.
[120] Henochsberg above note 106 at notes on section 1 at para (c) at 30.
[121] Section 46(1)(a)(i).
[122] Section 46(1)(a)(i).
[123] Section 46(1)(b)(ii).
[124] Henochsberg above note 106 at notes on section 46 at 198(1).

a condition will not negate the need for director authorisation, it will be regarded as an additional requirement for authorisation. As such, a higher standard, greater restriction and more onerous requirements over and above the norm will apply in respect of that particular company.[125] An exception to the (non-)requirement of shareholder approval by special resolution is stipulated in section 48(8).[126]

The board's involvement in authorizing distributions is two-fold. Firstly, the board must authorise the distribution before any form of payment or transfer takes place, and secondly, confirming application and passing of the solvency and liquidity test.[127] The board must acknowledge that it is has applied the test and that they are satisfied that upon completion of the distribution the company will pass the solvency and liquidity requirements. My interpretation of this requirement is that he former is an approval and the latter is an affirmation.

Although the approval and acknowledgement onus placed on the board sounds relaxed at first glance, the board is still bound by its fiduciary duties and must make decisions in good faith and in the best interests of the company.[128]

3.3.2 Solvency and Liquidity Test

The solvency and liquidity test was introduced in the United States of America and thereafter adopted by many other jurisdictions such Australia, New Zealand, and Canada in respect of the regulation of distributions. This method was later incorporated into South African company law as an attempt to protect creditors and minority shareholders from misappropriation of the company's capital.[129]

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[125] Henochsberg above note 106 at notes on section 46 at 199.
[126] S48(8) states that " A decision by the board of a company contemplated in subsection (2) (a)
(a) must be approved by a special resolution of the shareholders of the company if any shares are to be acquired by the company from a director or prescribed officer of the company, or a person related to a director or prescribed officer of the company; and
(b) is subject to the requirements of sections 114 and 115 if, considered alone, or together with other transactions in an integrated series of transactions, it involves the acquisition by the company of more than 5% of the issued shares of any particular class of the company's shares."
[127] Section 46(1)(c).
[128] *Bester NO v Wright; Bester NO v Mouton; Bester NO v Van Greunen* [2011] 2 All SA 75 (WCC).
[129] Cassim et al above note 20 at 270.

The solvency and liquidity test is the cornerstone of regulatory intervention to restrict distributions and certain forms of transactions that affect the shareholding and capital of a company.[130] The test enables a company to assess whether it would be in a financial position to carry out a distribution in the form of money or property[131] – placing the onus on a company through its board of directors to decide whether it would be in the interest of creditors and relevant stakeholders to carry on with the distribution. This is contrary to the position under the original capital maintenance rule, where the interests of creditors were protected by prohibiting transactions or distributions that would affect the capital of a company negatively or where the consent of creditors[132] or court sanctioning was required.[133]

The test is two-fold, one part focuses on solvency and the other part on liquidity.

From a solvency perspective, at their fair value, the assets of the company must be equal to or exceed the liabilities of the company.[134] This element of the test is purely based on a balance sheet analysis conducted at a particular point in time and due regard for all reasonably foreseeable financial circumstances.[135] Not only is it required to look at the existing portfolio of assets and liabilities but at contingent assets and liabilities too.[136] The issue that has been raised by Bidie[137] is that the Current Act has not prescribed *which* assets and liabilities nor the method to be used for the assessment. His comparison with the United Kingdom's Companies Act of 2006 has not yielded much as the United Kingdom's legislation refers to the term "net assets", which is neither of assistance to determine meaning nor of method in respect of the assessment.[138]

[130] The solvency and liquidity test is applicable to S44, S45 and affected transactions in Chapter 5 of the Current Act.
[131] Bidie "The Nature and Extent of the Obligation Imposed on the Board of Directors of a Company in respect of the Solvency and Liquidity Test under S4 of the Companies Act 71 of 2008" 2019 *Journal of Corporate and Commerical Law and Practice* 59 at 63.
[132] Section 83 of the 1973 Act.
[133] Section 84 of the 1973 Act.
[134] Section 4(1)(a).
[135] Henochsberg above note 106 at notes on section 4 at 35.
[136] Section 4(2)(b)(i).
[137] Bidie above note 131 at 76.
[138] Bidie above note 131 at 77.

The Current Act is not prescriptive in this regard, the suggestion provided for in section 4(2)(a) and (b) when determining the use of accounting records and financial statements that are compliant with standards prescribed in the Current Act.[139]. The question though which years financial records or statements must be used? Shouldn't the Current Act provide clarity in this regard? In my view if it's left up to the directors to decide, there may be room for fraud and manipulation which will result in the inefficiency of the test.

On the liquidity side, a company must be able to pay its debts in the ordinary course of business as they become due from twelve months of application the test[140] or for twelve months after the distribution has been completed.[141] This is a cash flow analysis of the company's inflows, outflow, income and financial activity demonstrating the ability to meet future obligations.[142] In comparison to section 90 of the 1973 Act, where no time frame was imposed, the Current Act requires the company to demonstrate its ability to meet its business debts as they become due for one year after the distribution. Van der Linde states that, whilst the time frame provided will provide certainty for directors, it may not be in the best interests of creditors who have long term arrangements which need to be met after twelve months.[143] Her recommendation is to rather create a presumption that should the company be liquidated within a specified time, it is deemed that the company did not satisfy the liquidity element of the test.[144] There has not been much debate from other commentators on the time frame and perhaps the twelve month period does not create an impediment for creditor protection, because it may arguably provide short-term comfort for most creditors in that their rights are secured until the next financial cycle.

The difference between the capital maintenance test and the solvency and liquidity test is that with the capital maintenance test is a margin over solvency which is equal to the capital of the company.[145] Van der Linde explains that compliance with the capital

[139] Sections 28 and 29.
[140] Section 4(1)(b)(i) – in any other case.
[141] Section 4(1)(b)(ii) – in the examples set out in paragraph (a) of the definition of distribution.
[143] Henochsberg above note 103 at notes on section 4 at 35.
[143] Van der Linde "Solvency and Liquidity approach in Companies Act 2008" 2009 *Tydskrif vir die Suid-Afrikaanse Reg* 224 at 229.
[144] Van der Linde above note 143 at 229.
[145] Van der Linde above note 143 at 226.

maintenance test meant complying (comparably) with the solvency test only.[146] There was no requirement for determining whether a company would be able to satisfy its debts in the ordinary course of business as they became due.[147]

It is noteworthy that, in order to carry out a distribution, both components of this test must be answered in the positive, and a company may not rely on a strong balance sheet if it has very weak or null cash flow prospects.

Before 2011, the solvency and liquidity test required that the consolidated assets must equal or exceed the consolidated liabilities if the company was part of a group.[148] Jooste's view was that the use of the term "aggregate" was unnecessary.[149] It would be logical that if a company was not part of a group, then a group assessment would not be possible but a group view would be essential if an inter-group distribution took place.[150] Another loophole created by the group assessment would be the potential for misrepresentation where the company wanting to carry out the distribution does not meet requirements of the test, but relies on the strength of the group structure, which does meet the requirements.[151] This would only lead to the test falling short of its purpose to protect the creditors of the company itself. With the Companies Amendment Act 3 of 2011, the wording of section 4 was reconstructed to provide for a singular company view.

Many authors have raised the issue whether the solvency and liquidity test is an objective or subjective one. According to Bradstreet, depending on how the test is viewed and what information the director relied on at the time will result in either the implication or exoneration of director liability.[152]Cassim explains the 2 scenarios concisely. A subjective test will take into account the directors level knowledge, skill and experience when

[146] Van der Linde above note 143 at 226.
[147] Van der Linde above note 143 at 226.
[148] S4 of the Companies act 71 of 2008 before the 2011 amendments: "[T]he assets of the company or, if the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, the aggregate liabilities of the company, as fairly valued"
[149] Jooste above note 90 at 641.
[150] Jooste above note 90 at 641.
[151] Jooste above note 90 at 641.
[152] Bradstreet above note 1 at 137.

applying the test, whilst the objective test has no consideration on any of these factors.[153] Van der Linde views the test as an objective one: "*this paragraph does not state to whom this should be reasonable apparent, so it can assumed that the test must be applied from the perspective of an objective bystander.*"[154] Cassim is in agreement with this view.[155]

There has been no case law to date to test the success or flaws of the adapted solvency test and therefore, apart from commentators' debates, it is unclear how the courts would approach the need for any improvements. As such, the comparative study undertaken in chapter 4 is of cardinal importance.

3.3.3 Timing

Once the board of directors have acknowledged the application of the solvency and liquidity test and are satisfied that the company will satisfy the test after the distribution is carried out, the company may proceed to effect the relevant distribution.[156]

However if 120 days have lapsed since the resolution was adopted and the distribution has not been carried out, the board must reconsider the solvency and liquidity test.[157] The company is prohibited from carrying out the relevant distribution without satisfying the solvency and liquidity test again.[158]

3.3.4 Additional requirements relating to the repurchase of shares

One of the critical reasons for the development of the capital maintenance rule was the ultra vires act by a company of repurchasing its own shares.[159] From 1999, it was possible for a company to purchase its own shares.[160] This was carried into in the Current Act.[161]

[153] Cassim above note 20 at 273.
[154] Van der Linde above note 144 at 235.
[155] Cassim above note 20 at 273.
[156] Section 46(2).
[157] Section 46(3)(a).
[158] Section 46(3)(b).
[159] *Trevor v Whithead at* 432.
[160] Section 85 of the 1973 Act.
[161] Section 1(1)(a).

Apart from satisfying the general requirements of distributions in section 46, any distribution payable for the repurchase of shares must also satisfy the requirements of section 48.

The power is placed in the hands of the board to authorise the repurchase of shares, which is unlike the 1973 Act, where authorisation in the Memorandum of Incorporation coupled with shareholder approval was required. As in the case of any other distribution, nothing prevents a company from including specific rules regarding the repurchase of shares in its Memorandum of incorporation as long as the provisions are not contrary to those of the Current Act.[162]

Before 1999, a subsidiary company was prohibited from acquiring shares in its holding company. The position has changed as the board of the subsidiary may now authorise the acquisition of shares in its holding company.[163] However, a subsidiary is limited to acquiring no more than 10% in aggregate of the number of issued shares of any class of shares in the holding company and no voting rights will be attached to the acquired shares.[164]

Another condition for the repurchase of shares is that a company may not acquire its own shares or a subsidiary may not acquire shares in its holding company where the resultant effect would be that the company no longer holds any shares except the shares held by the subsidiary, or convertible or redeemable shares.[165] Henochsberg without providing any explanation, is of the view that the objective of this condition is clear but there is nothing in the Current Act that prohibits a company from repurchasing its ordinary shares and thereafter converting these shares into redeemable shares.[166]

In the instance where there is a proposal to the company to acquire shares from a director or prescribed officer of the company or a person related to them, the approval by special

[162] Van der Linde "Share Repurchases and the Protection of Shareholders" 2010 *Tydskrif vir die Suid-Afrikaanse Reg* 208 at 303.
[163] Section 48(b).
[164] Section 48(b)(i) and (ii).
[165] Section 48(3)(a) and (b).
[166] Henochsberg above note 106 at notes on section 48(3) at 207.

resolution of shareholders is required.[167] The purpose of this requirement is to pre-empt the abuse of power by a director or a prescribed person.[168] Unlike the 1973 Act, the Current Act does not prescribe what the offer or proposal to repurchase of shares should entail and whether notice of such proposal or offer must be circulated to all shareholders.[169] Section 87 of the 1973 Act also distinguished between general and selective offers.[170] Cassim et al opine that, other than this exception, there are no other special safeguards for shareholders when it comes to repurchase of shares in the Current Act.[171]

Where the repurchase, if considered alone or together with other transactions in an integrated series of transactions, involves the repurchase of more than 5% of the shares of the company, then there must be compliance with the requirements of section 114 and section 115.[172] Sections 114 and 115 of the Current Act relate to schemes of arrangements and the requirements thereof. The approval of the shareholders is required due to the impact that a possible scheme of arrangement may have on a company.[173]

3.4 Non-compliance and director's liability

According to Bidie, one of the main purposes of distributions rules is to ensure that the company is managed judicially.[174] Under the 1973 Act, the liability of directors was quite simple. The only provision relating to liability for a distribution was in relation to the unlawful repurchase of shares in terms of section 86. A director incurred no liability for any payments made to shareholders contrary to section 90. It is unclear why a director could not be held liable for payments made in terms of section 90 and Jooste highlights this discrepancy.[175] It was also difficult to hold a director liable if he or she was not party

[167] Section 48(8)(a).
[168] Henochsberg above note 106 at notes on section 48(8) at 209.
[169] Section 87, a prescribed form had to be circulated among all shareholders.
[170] See Chapter 4 for the position in New Zealand and Chapter 5 for the possible resolution.
[171] Cassim et al above note 20 at 303.
[172] Section 48(8)(b).
[173] Schemes of arrangement is when a company arranges with its shareholders to acquire their shares and requires at least 75% approval of the shareholders.
[174] Bidie "Director's Duty to Act for a Proper Purpose in the Context of Distribution under the Companies Act 71 of 2008" 2019 *Potchefstroom Electronic Law Journal* at 3 (DOI http://dx.doi.org/10.17159/1727-3781/2019/v22i0a4221 at 3.
[175] Jooste above note 90 at 646.

to the decision – even though directors had the fiduciary duty under common law and statute to act in the best interests of the company.[176]

Be that as it may, the situation is different under the current dispensation. As the sole decision-making power – apart of from the exceptions in section 48(8) – lies in the hands of the directors, liability will follow any form of unlawful distribution.

Before the analysis of the liability of the directors commences, it is important to determine the status of a distribution that has not met the relevant statutory requirements. Neither section 46 nor section 48 renders a distribution made contrary to the respective requirements void. Section 218 further determines that, unless the specific provision declares a resolution void, nothing in this Act renders the resolution void unless a court has made an order to that effect.[177]

In the instance where a company becomes aware that shares have been repurchased in contravention of section 46, the board of directors may apply to court for reversal of the acquisition within two years after the acquisition.[178] The court may order the acquiree to return the amount paid by the company and the company to issue an equivalent amount of shares to the acquiree, as was held before the acquisition.[179] Surprisingly, section 46 does not have a similar provision for any other form of distribution. For example, if the board realises that dividends were paid out in contravention of section 46, the basis on which a court may order that a shareholder or a class of shareholders return amounts paid to them (which were "unlawful") is unclear. Perhaps the inclusion of this distribution-specific "remedy" should be extended to other forms of distributions in order to maintain better governance in a company, and encourage more shareholder scrutiny of directors' conduct.

[176] Refer to the above discussion where shareholder approval is required for repurchase of shares and payments to shareholders.
[177] Section 218(1).
[178] Section 48(6).
[179] Section 48(6)(a)(b).

Both section 46(6) and 48(7) incorporate the principle of liability set out in section 77(3)(e). Sections 46(6) and 48(7) can be viewed as mirroring provisions.[180] Non-compliance with the requirements of either provisions where applicable results in the liability of a director as set out in section 77(3)(e).

The test for director liability is three fold: Firstly, the director must have been present at the meeting;[181] secondly, the director must have voted in favour of the relevant distribution; and thirdly, the director must have known that the distribution is contrary to relevant section.[182] The issue of contention is how one proves that the director had knowledge that the distribution was in contravention with the requirements, and in this regard, reference is made to the following definition set out in the Current Act:

> "'knowing', 'knowingly' or 'knows', when used with respect to a person, and in relation to a particular matter, means that the person either
>
> (a) had actual knowledge of that matter;
>
> (b) was in a position in which the person reasonably ought to have;
>
> (i) had actual knowledge;
>
> (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or
>
> (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter."[183]

According to Bidie, the concept of "knowledge" has always been an element that required proof for holding a director personally liable.[184] In principle, the board of directors is responsible for most of the company's financial decisions. A director is required to be

[180] The former relates to distributions in general and the latter with repurchase of shares. The requirements for director liability are the same and it is of no use to mention and deal with them separately.
[181] Sections 46(6)(a) and 48(7)(a).
[182] Sections 46(6)(b) and 48(7)(b).
[183] Section 1.
[184] Bidie "Knowledge as a mechanism to hold a director personally liable for adverse distributive decisions under the Companies act 71 of 2008" 2018 *Journal of Corporate and Commercial Law and Practice* 1 at 17.

satisfied and acknowledge compliance with the solvency and liquidity requirements when confirming a distribution. These decisions are made with reference to the financial statements for which the directors are also responsible. It would be difficult for a director to show that he did not know that the distribution was not effected in compliance with the provisions of the law.

In *Yarona Healthcare Network (Pty) Ltd v Medshield Medical Scheme*[185] it became clear to the court that the phrasing of line items under which payments were made in a company could result in a board not being privy to knowledge, either actual or constructive. However, when scrutinising the financial statements, and if a breakdown is provided and reported to the board, it would be easy for the board to ascertain what a particular line item is comprised of and the board could acquire actual knowledge of the finances of the company.[186]

Even if a director was not present at the "pre-approval" phase of the distribution, at the time of voting in favour of the distribution the onus will be on him or her to take the necessary steps to ensure that he or she has knowledge of the subject matter. In *Minister of Finance and others v Gore*,[187] the court held that:

> "Knowledge is not confined to the mental state of awareness of facts that is produced by personally witnessing or participating in events, or by being the direct recipient of first-hand evidence about them; it extends to a conviction or belief that is engendered by or inferred from attendant circumstances."

Where a wrongful distribution is carried out, section 77(4) qualifies the liability of the directors under section 77(3)(e)(vi).[188]A director will only be liable in terms of section 77(3)(e)(vi) if after the distribution is made the company fails to satisfy the solvency and liquidity test.[189] The director will only also be held liable if it was unreasonable at the time of the decision to conclude that the company will satisfy the solvency and liquidity test

[185] 2018 (1) SA 513 (SCA).
[186] Above note 182 at paragraph 64-65.
[187] 2007 (1) SA 111 (SCA).
[188] Cassim above note 20 at 585.
[189] S77(4)(a)(i).

upon carrying out of the distribution.[190] Section 77(4)(b) on the other hand limits the liability as follows:

> “ does not exceed, in aggregate, the difference between—
>
> (i) the amount by which the value of the distribution exceeded the amount that could have been distributed without causing the company to fail to satisfy the solvency and liquidity test; and
>
> (ii) the amount, if any, recovered by the company from persons to whom the distribution was made.”

3.5 Conclusion

It is evident that the regulation of distributions has been completely overturned in the move from the capital maintenance rule to the current solvency-liquidity method. The stringent creditor-orientated rules have been replaced with a balanced test. The interests of creditors and shareholders are placed in the hands of a third party as to whether the shareholder should reap the benefit of a distribution or not. Through the liquidity limb of the solvency and liquidity test creditor interests are definitely protected before a distribution to a shareholder maybe carried out. However, there is still much uncertainty as could be seen from shortcomings and ambiguities identified in this chapter. A decade has passed and there has not been much guidance from the courts, apart from the incidental matters referred to in this chapter. It is possible that the provisions are working and there is no need for a dispute. It is also possible that it just a matter of time before challenges will arising. In order to determine whether possible issues may arise or whether reformation of distributions is more of a legislative as opposed to a judicial matter, I now turn to compare the South African position with that of New Zealand, focusing mainly on the legislative provisions of New Zealand.

[190] S77(4)(a)(ii).

Chapter 4: New Zealand

4.1 Background

New Zealand company law derived mainly from English Law.[191] The first company legislation was implemented in 1860,[192] followed by the New Zealand Companies Act of 1955.[193] The 1955 was a replica of the United Kingdom's Companies Act of 1948 – naturally so, as New Zealand was under British Rule and only gained independence from Britain in the 21st Century.[194] Although the 1955 Act was amended thirty times before 1993, it still remained outdated in contrast with the then-modern company laws of the United Kingdom, Canada and Australia.[195] In 1986, the decision was taken to review the company law legislation.[196] The reform committee favored the principles of the United States of America's Model Business Corporations Act but at the end adopted the regulations depicted in Canada's company laws: the Ontario Business Corporations Act 1982 and the Canadian Business Corporations Act 1985.[197]

With the reform of the 1955 Act and introduction of the New Zealand Companies Act of 1993,[198] the capital maintenance rules as carried forward from English law were abolished. The distinction between capital and profits was removed.[199] As long as there was sufficient resources left within the company's vault to satisfy creditors, all other resources could be turned over to shareholders.[200] Therefore a company was no longer required to create a 'buffer' by preserving capital for creditor claims. Directors could, at any time, apply the resources of the company to the benefit of the shareholders provided that the creditors' rights were not prejudiced.[201]

[191] Ross "Evaluating New Zealand's Companies Law" 1994 *Agenda: A Journal of Policy Analysis and Reform* at 189.
[192] Joint Stock Act 24 of 1860 (Victoria).
[193] 63 of 1955, hereinafter referred to as the 1955 Act.
[194] https://Teara.govt.nz/en/self-government-and-indepedence
[195] *New Zealand Law Commission Report* 9 of 1989 at 8.
[196] Ross above note 191 at 189.
[197] Ross above note 191 at 189.
[198] 105 of 1993, hereinafter referred to as the NZCA.
[199] Ross above note 191 at 192.
[200] Ross above note 191 at 192.
[201] Ross above note 191 at 192.

From the allowance granted to directors to make decisions about the company's capital for the benefit of shareholders, the codification of director duties and liability stemmed.[202] Director duties and liability in New Zealand only derived from common law.[203] The reform committee was of the view that it would be more efficient if directors could establish what their rights and obligations towards the company were and this would be possible if the rights and obligations were stipulated in statute.[204] The NZCA brought about freedom and flexibility for directors, which were not available under the previous statutory company law.[205] This new found freedom allows directors to consider corporate solvency whenever carrying through transaction which may hinder creditors.[206]

4.2 Distributions

The 1955 Act embodied the capital maintenance rule, and hence did not allow transfer of any sort of a company's capital without the consent of the court.[207] Subsequently, the NZCA included a definition for the term distribution, which entails those transactions which are regarded as transfers or payments to company shareholders. A distribution is defined under the NZCA to take place between a company and its shareholder through:

"

1. *Direct or indirect transfer of money or property or;*[208]

2. *The incurring of a debt to or for the benefit of the shareholder.*[209]

In relation to shares held by the shareholder, either by means of:

1. *A purchase of property;*

2. *Redemption or other acquisition of shares;*

[202] Ross above note 191 at 193.
[203] Ross above note 191 at 193.
[204] Ross above note 191 at 193.
[205] Ross above note 191 at 196.
[206] Ross above note 191 at 196.
[207] Law commission report above note 195 at 1.
[208] Section 2(a).
[209] Section 2(b).

3. *A distribution of indebtedness;*

4. *By some other means*."[210]

Dividends have not been included as an example of a distribution, but has been defined separately in section 1 of the NZCA. When viewing the definition of a dividend, the wording seems to have an exclusionary meaning rather than an inclusionary one. A dividend is defined as any other form of distribution except the repurchase of own shares and financial assistance provided for the acquisition of shares.[211]

Although the definition does not provide any clarity on whether dividends can be paid out capital, or only out of profits,[212] the NZCA provides for two basic rules. A board may not authorise dividends for some shareholders in a class and not for other shareholders in the same class, nor can some dividends be greater in value on certain shares compared to other shares in the same class.[213] The purpose of this provision was to protect the individual shareholders of the same class against discrimination.[214]

4.3 General requirements or restrictions on distributions

4.3.1 Board authorisation

The board of directors hold the power to authorise distributions to any shareholders and as it seems fit.[215] Creditor consent or court approval is not required. Shareholder consent is only required for the repurchase of shares as discussed below.

[210] Section 2 of the definition of distribution.
[211] Section 53 describes a dividend as any other distribution except those in terms of section 59 and 76. These respective sections regulate acquisitions of own shares and financial assistance respectively.
[212] Under the 1955 Act dividends could only be paid out of profit – Ross above note 182 at 192.
[213] Section 53(2)(a)(b).
[214] Law commission above note 195 at 98 para 403.
[215] Section 52(1).

4.3.2 Certificate by directors

Those directors who vote in favor of the distribution are required to sign a certificate. This certificate must set out their decision, reason(s) for the company being able to satisfy the solvency test, and the grounds or reasons for this view.[216]

4.3.3 Solvency Test

When authorising a distribution, the board of directors must be satisfied on reasonable grounds that the company will satisfy the solvency test immediately after the distribution is effected.[217] The solvency test consists of two components:

1. The liquidity test: the company must be able to pay its debts as they become due in the normal course of business; and[218]

2. The balance sheet test: the value of the company's assets is greater than the value of its liabilities, including contingent liabilities.[219]

When assessing the two components that constitute the solvency test, directors must utilize the most recent financial statements that comply with section 10 of the Financial Reporting Act[220] together with any other information of which the director has knowledge or ought to know and that may affect the value of the value of the company's assets and liabilities.[221]

Consideration may also be given to any valuations of the assets and estimation of liabilities, as long as these are reasonable.[222] Contingent liabilities must be taken into account during the balance sheet test, however the NZCA allows the board to consider any expectant claim of the company that would be paid and would possibly reduce or extinguish the said contingent liability.[223]

[216] Section 52(2).
[217] Section 52(1).
[218] Section 4(1)(a).
[219] Section 4(1)(b).
[220] 106 of 1993.
[221] Section 4(2)(a).
[222] Section 4(2)(b).
[223] Section 4(1) (b).

On the question of how long after the distribution is made must the company be able to pay its debts, the NZCA offers no assistance. Villa suggests that that the time frame for testing liquidity should align with the business cycle following the assessment period, in effect considering whether the company must be able to pay its debts should form part of the planning for the next financial period.[224]

4.3.4 Acquisition of shares

Although one of the critical distribution prohibitions of the capital maintenance rule was the acquisition by a company of its own shares, the New Zealand Law Commission found comfort in the solvency test as an adequate measure for creditor protection for this form of distribution.[225] Section 52 sets out the requirements for all distributions in general. However when it comes to a company repurchasing its own shares, further requirements are set. The NZCA distinguishes between listed and unlisted shares for the purposes of repurchase of shares.[226] The constitution of the company must permit repurchase of its own shares.[227] A company may repurchase shares in four cases:

1. An offer is made to acquire a portion of shares from all shareholders;[228]

2. An offer is made to certain shareholders to acquire their shares (selective offers);[229]

3. An offer is made to acquire shares that are listed on a stock exchange with prior notice to shareholders;[230]

4. An Offer is made to acquire shares listed on a stock exchange without prior notice to shareholders.[231]

[224] Villa "Creditor Protection and the Application of the Solvency and Balance Sheet Tests under Company Laws of Finland and New Zealand" 2008 *Nordic Journal of Commercial Law* 2 at 15.
[225] Law Commission above note 195 at 99.
[226] New Zealand Treasury Share Guide IBA Corporate and M &A Committee 2014 at 4.
[227] Section 59(1).
[228] Section 60(1)(a).
[229] Section 60(1)(b).
[230] Section 63.
[231] Section 65.

4.3.4.1 Proportional offers of shares

The offer to acquire shares must be made on a pro-rata basis.[232] A pro-rata acquisition takes place where a company acquires a portion shares from each shareholder and not all the shares held by the shareholders. This type of offer must be authorised by the company's constitution and approved by all shareholders. [233] Before making an offer, the board of directors must authorise and certify that:

1. The acquisition would be in the best interests of the company;[234]

2. The terms and consideration offered in relation to the acquisition are fair and reasonable to the company; and[235]

3. That the board is not aware of any material information which will impact the value of the shares and will result in unfair consideration offered to shareholders who accept the offer.[236]

4.3.4.2 Selective offers

A selective offer may be made to one or more shareholders, or to all shareholders but on different terms if:

(i) all shareholders must approve the selective offer; [237] or

(ii) if authorised by the company's constitution.[238]

The same requirements applicable to proportional offers are applicable to selective offers, i.e the board must approve and confirm that the acquisition is beneficial to the company and the terms and consideration in relation to the acquisition are fair and reasonable to the remaining shareholders.

[232] Section 60(1)(a).
[233] Section 60(1)(b).
[234] Section 60(3)(a).
[235] Section 60(3)(b).
[236] Section 60(3)(c).
[237] Section 60(1)(b)(i).
[238] Section 60(1)(b)(ii).

In addition to the aforesaid requirements each shareholder must receive a disclosure document which sets out who the intended recipients of the offer are and details of any director who has an interest in any of the shares which are part of the offer.

The offer must be made after ten working days, but within twelve months after the disclosure document was distributed to shareholders.[239]

The disclosure document need not be distributed if the company is listed on a stock exchange and the offer relates to acquisition of shares which are below the minimum holding of shares in the company, as determined by the relevant stock exchange.[240]

4.3.4.3 Listed shares on a stock exchange with prior notice

The board of directors of a listed company may make an offer on one or more stock exchanges to all shareholders to acquire shares in the company if it is in the best interest of the company and its shareholders and the terms and consideration are fair and reasonable.[241]The directors must also confirm that all information relating to the assessment of the value of shares has been disclosed and that no shareholder that has accepted the offer will be prejudiced as result of an omission of non-disclosure.[242] The disclosure documents with the same requirements mentioned for selective offers must be distributed to all shareholders[243] i.e the maximum number of shares that may be acquired, the terms of the offer and details on any interest a director may have in shares on offer.[244]

The offer is must be made ten working days after the disclosure document was distributed but not more than twelve months after the disclosure document was sent to all shareholders.[245]

[239] Section 60(6).
[240] Section 61(5) and (7).
[241] Section 63(1)(a) and (b).
[242] Section 63(1)(d).
[243] Section 63(6).
[244] Section 64.
[245] Section 63(7).

4.3.4.4 *An offer to acquire shares on a stock exchange without prior notice*

The board of directors a listed company may acquire shares listed on a stock exchange from its shareholders if it has resoluted to acquire shares as in the case of offers on stock exchange offer with prior notice[246] and the company has not acquired more than five per cent of the shares in the same class in any twelve month period.[247]

The company must give notice to the relevant stock exchange of any listed shares it has acquired and the notice must contain the following:

(a) The number of shares and the class of shares acquired;
(b) The amount that has been paid or will be paid as consideration for the shares acquired; and
(c) If known to the company, the identity of the seller or the beneficial owner. [248]

Disclosure as required in the other scenarios is not required. Shareholders are only required to be notified within three months after the acquisition was made.[249]

4.4 Non-compliance and director's liability

4.4.1 Recoverability of unlawful distributions

A company may want to recover any distribution made to a shareholder or shareholders where post-completion of the distribution, it was unable to comply with the solvency test.[250]

However, a shareholder is not obligated to return the distribution if he or she can prove that:

[246] Section 65(1)(a).
[247] Section 65(1)(b).
[248] Section 65(2).
[249] Section 65(2A).
[250] Section 56(1).

1. He or she received the distribution in good faith and without any knowledge that the company failed to comply with the solvency test, and[251]

2. He or she has altered his financial position as a result of the distribution; and[252]

3. It would be unfair to require repayment of the distribution in full or at all.[253]

According to Haynes the second exemption will require extensive proof on behalf of the shareholder.[254] A shareholder will have to proof that he actively spent the money which he wouldn't be in a position to had he not received the money in the first place.[255] A director may also be required to reimburse the company for the portion of the distribution which cannot be recovered from the shareholder.[256] This form of accountability will arise where

1. the director failed to take the necessary steps to follow the required procedure or sign the relevant certificate as required in section 52, or[257]

2. where the director failed to take the necessary steps to prevent the distribution from being carried out, despite knowing that the procedure was not followed.[258]

If it can proved that the company would have complied with the solvency should a lesser a distribution been paid out, a director or shareholder may be relieved from liability equal to the value of the lesser distribution.[259]

4.4.2 Punitive liability

Every director who fails to issue a certificate with the reasons for authorising the relevant distribution commits an offence and will be liable to pay a penalty as set out in section

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[251] Section 56(1)(a).
[252] Section 56(1)(b).
[253] Section 56(1)(c).
[254] Haynes, " The Solvency test, a new era in directorial responsibility" 1996 *Auckland University Law Review* 126 at 139.
[255] Haynes above note 254 at 139.
[256] Section 56(2)(d).
[257] Section 56(2)(c) and (d).
[258] Section 56(4).
[259] Section 56(5).

373(1) of the NZCA.[260] A director will be liable to pay a maximum fine of $5000 for non-compliance.[261]

4.4.3 Other

If the distribution was authorised but not carried out, and the board of directors fails to be satisfied that on reasonable grounds, the solvency test will be met should the distribution be effected, the authorised distribution is automatically regarded as cancelled.[262]

[260] Sections 52(5), 60(7), 61(9) and (10), 62(10), and 65(3)(a).
[261] Section 373(1)(4), as at eg 12 March ZAR 53 818.21.
[262] Section 52(3).

Chapter 5: Conclusion and Recommendations

5.1 Introduction

The purpose of this research was to investigate whether the new paradigm of regulating distributions is favorable to creditor protection or not. Globally, most jurisdictions have moved from the orthodox capital maintenance rule to the modern approach of regulating distributions. From a South African perspective, our company law has undergone a radical change from the previous capital maintenance principles to the current principles embedded in the Current Act.

Similarly, New Zealand moved away from the old regime of capital maintenance fifteen years before South Africa did. With the strong influence of English law for more than a century, it was also a revolutionary time for New Zealand companies and interested stakeholders who needed to adapt to the change from capital maintenance rules to American-based principles.

A decade has gone by since the implementation of the Current Act and there has been no reports of distributions to shareholders and/or the regulation thereof coming under judicial review. This perhaps may be a positive sign for creditors and shareholders, however, there is still room for improvement when comparing the South African position to that of New Zealand.

5.2 Overview and recommendations

The definition of a distribution in both jurisdictions is wide. Basically, the various laws provide for "distribution" as an umbrella term for all transactions that entail payments to shareholders or potential shareholders, and which may result in capital reduction.[263] The examples listed in both definitions differ marginally, for example South Africa includes dividends as an example of distributions and New Zealand does not specifically list it, is of no material consequence for the purposes of determining whether payments of dividends are regarded as distributions or not. The list of distributions that can be carried

[263] See paragraphs 3.2 and 4.2.

out are exhaustive and may vary based on the nature of each business. Therefore, it is quite sufficient that an all-encompassing example is included in both definitions: “otherwise in respect of any of the shares of that company or of another..” in the Current Act and “ or by some other means” in the NZCA.[264]

However the issue of dividends remains unresolved. Dividends, being an inherent part of shareholder expectation, are still not privy to provisions in either of these jurisdictions in a manner that meaning can be ascribed to the term for the purposes of company law. Apart from the non-discriminatory rules provided for in the NZCA, dividends are to be treated like any other form of distribution. One will still have to look outside of statutory company law for the true meaning of "dividends" and specialized regulations for dividends, if need be.

The power to authorise distributions, unless ordered by court, is in the hands of the board of directors. Both jurisdictions have shifted this responsibility from court and shareholder approval to the board of directors.[265] Sections 46 and 48 of the Current Act require acknowledgment by the board that it has applied the solvency and liquidity test and the company will meet the test after carrying out the authorised distribution. The form of this acknowledgment is not prescribed. Nor are directors who authorised the distributions to provide reasons anywhere for their decisions. This is unlike the position in New Zealand, where every director who voted in favor is required to sign a certificate.[266] The format of the certificate is not prescribed but what is of importance is that the reasons for the director's decision must be set out in this certificate. This requirement is welcomed. It will assist either in attributing director liability or on the other also assist a director in possibly alleviating any liability based on the reasons provided in the certificate. The question of "reasonableness" may also be measured appropriately based on the reasons provided in such a certificate. It would be recommended that this level certification or acknowledgment be included in the current regulatory framework pertaining to

[264] See paragraphs 3.2 and 4.2.
[265] See paragraphs 3.3.1 and 4.31.
[266] See paragraph 4.3.2.

distributions in South Africa. I recommend that an amendment to the Current Act should be considered in this regard.

The critical requirement of the solvency and liquidity test was the true break, away from the old capital maintenance rules. Although the naming convention differs immaterially[267] the essence of the test requirement in both jurisdictions are the same. A company must be able to meet its debts after the distribution is carried out, and this is tested in terms of a two-step method. Neither jurisdiction offers any guidance on which assets and liabilities are to be used in the balance sheet test.[268] The only guidance is the use of the company's account records and financial statements, which must be compliant with the relevant provisions of the respective acts. The NZCA stipulates further that the board must rely on the most recent financials in the assessment. The Current Act does not indicate this. As it may sound logical to use the latest records for proper compliance and governance purposes, it would be advisable that this be iterated in the Current Act.

The cash flow analysis can be viewed as an important factor of the solvency and liquidity test. Although a company may have assets that exceed the liabilities, if the company lacks liquid assets in order to settle debts arising out of the ordinary course of business, the test is not satisfied. The question that arose on more than one occasion was: How long after the distribution is carried out, does the company need to be able sustain itself in this manner? The NZCA has no time limit stipulated, however the Current Act requires a period of twelve months after the distribution has been carried out. Although the view of some writers is that the time lines in terms of the insolvency requirement of 24 months will be a better option for company law as well, I am of the view that the twelve month period is sufficient. This is also in line with Ross's recommendation for New Zealand regarding planning until the next financial period.[269]

It is also important to note that he purpose as set out in the Current Act for the need to flexibly maintain companies and creating platforms for aggregation of capital together whilst also spreading economic risks can be said to be have been achieved with the

[267] See paragraphs 3.3.2 and 4.3.3.
[268] See paragraphs 3.3.2 and 4.3.3.
[269] See paragraph 4.3.3.

introduction of the solvency and liquidity test. Whereas the 1973 Act prohibited transactions relating to capital reduction the solvency and liquidity test allows through its directors to manage the interests of shareholders with those of creditors on a case by case basis. Each and every distribution that the board of directors wants to carry out is assessed on its own financial merits at the given time by application of the test.[270]

The Current Act does not distinguish between "listed" and "unlisted" when it comes to the repurchase of shares by a company, nor is there any reference to the applicable statute or provision relating to the process to follow when a company decides to purchase any of these shares as per section 48. The board has the sole discretion – apart from the exceptions stipulated in section 48(8) – to authorise the acquisition subject to fulfillment of the solvency and liquidity test. In New Zealand, however, directors have the authority to make an offer to repurchase shares but the shareholders must give their consent or disclosure must be made to shareholders where applicable.[271] No such feature is found in the Current Act. Although the purpose of this research was to look at the safety nets for creditors in relation to distributions, the disclosure requirement provides for shareholder protection. By disclosing to the shareholder the decision to repurchase shares listed on a stock exchange, the company is prevented from being the "insider" in insider trading. One commendable restriction on repurchasing of shares in the Current Act is that subsidiaries may only acquire shares in its holding company up to 10% in aggregate of shares in any class.[272] It is appropriate to treat this type of transaction as a distribution because such an acquisition within a group structure means that the subsidiaries' wealth are transferred to the holding company. This may prejudice the claims of the subsidiaries' creditors. The NZCA does not specified whether a subsidiary company may purchase shares in it holding company, but also does not prohibit it.

Shareholder and court authority for distributions has shifted to director authority.[273] Thus, director liability would follow naturally. Both jurisdictions have codified director's duties and liabilities. The Current Act holds a director, who was present at the meeting and failed

[270] See paragraphs 3.3 and 4.3.
[271] See paragraph 4.3.4.
[272] See paragraph 3.3.4.
[273] See paragraph 3.3.1 and 4.3.1.

to vote against the relevant distribution, liable in terms of section 77. Section 77, however, does not extend the type of liability or sanction applicable to this type of wrongful decision.[274] The NZCA enforces punitive liability in the form of a fine not exceeding $5000.[275] In South Africa, it would be up to the company to quantify the losses or damages suffered as a result of the wrongful distribution. It is unclear from the NZCA whether the fines imposed therein are credited to the loss experienced by the company. Without further research on that factor a recommendation for the inclusion of a punitive sanction in the Current Act cannot be justified.

The question that needs to be asked is whether a shareholder should remain the holder of a benefit to which he was not actually entitled to? The Current Act is silent on recovery from recipients in respect of all other distributions except for the repurchase of shares in terms of section 48. If the solvency and liquidity test was not met, and the company proceeded to repurchase shares, the company may apply to court for the reversal of the acquisition.[276] The court has a discretion to decide that the person must repay the money to the company and that the company must issue equivalent shares to that person. In New Zealand, the NZCA permits a company to recoup any unlawful distributions paid to a shareholder and it should be returned to the company unless the shareholder can prove that he received the distribution in good faith or that as a result of the distribution his financial position has been altered or that it would unfair for him repay a part or the full amount of the distribution back to the company.[277]

If the company is unable to recoup any or only a portion of the distribution, the directors who voted in favor of the distribution will be liable to pay the full amount or the remaining balance.[278]. The punitive function is meant to serve as a deterrent to a director who does not fulfill his or her duties adequately, whilst also restoring the company with the funds that are actually required for creditor claims. Once it is established what the purpose of

[274] See paragraph 3.4.
[275] See paragraph 4.4.2.
[276] See paragraph 3.4.
[277] See paragraph 4.4.1
[278] See paragraph 4.4.1.

the fine entails perhaps South Africa could adopt the dual approach of director liability on distributions specifically for the need to protect creditor interests.

5.3 Conclusion

Although the existing system of creditor protection has remained untested for almost decade in South Africa, looking at other scopes of creditor protection globally is valuable. There is room for improvement in the Current Act, specifically in respect of formalising the meaning of critical distributions such as dividends and being more prescriptive when it comes to the financial assessment of the solvency and liquidity tests. A dual system for director liability will also enhance corporate governance when it comes to regulating distributions.

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