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SECTION 48 OF THE COMPANIES ACT 71 OF 2008

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CHAPTER 1

INTRODUCTION

1.1 Introduction

The concept of share capital has been a fundamental feature of significance in South Africa company law for many decades.[1] This feature didn't find its origin in South Africa. It was rather adopted from the English company law which formed the basis of South Africa company law.[2] It is then from the English company law principles around share capital, that provisions were set to restrict the repurchase of company shares by company. This restriction was based on the fact that share capital of the company was seen and deemed to be seen as source of income from which company stakeholders[3] relied upon company liquidation hence it had to be maintained.[4] This meant dividend was the only form of distribution to shareholders that was allowed.

One is entitled to ask why companies generated this key interest of buying back their own shares. The answer to this question will give us the reasons and a good background as to why law makers in the interests of justice came up with counter rules that went against this interest and why over time this rules were deemed to be futile and not of value leading to the current *status quo* where companies can now buy back their own shares.[5]

There are many reasons why companies have always been interested or will find themselves in situations where they would want to buy back their own shares. One of these cases will for instance be; a company trading its shares below their intrinsic value. In order to push the value up the company will be required to buy back its shares from its current shareholders and resale them again at a better price.[6] Other reasons could be, avoiding takeover threats and modifying capital structures so as to provide opportunities such as employee share option plans.[7]

Although this reasons held some truth in them. They were not good enough reasons to convince the courts to allow companies to buy back their shares. In defending its stand against share buyback the court in England argued in the land mark case of

1 From the time of Companies Act 46 of 1926.
2 *Trevor v Whitworth* (1887) 12 App Cas 409.
3 Creditors and shareholders.
4 This principle formed one of the pillars of the capital maintenance rule to be explained in detailed in chapter 2.
5 S 48 of Companies Act 71 2008.
6 HS Cilliers & ML Benade *Company Law* (1982) 165-167.
7 As above.

Trevor v Whitworth[8]; that share buyback was not the intention of the legislature (The Joint Stock Companies Act of 1867). In their arguments the Lords said: legislature was concerned that the capital of companies should not be reduced by distribution except in the manner set out in the legislation, which required court approval. The court in its conclusion held that buy backs were a means of distributing capital to shareholders without having to comply with the formal requirements as to reduction of capital.[9]

This position was adopted and incorporated and became part and parcel of South Africa company law until 1999, when the Companies Act (Act 61 of 1973) was amended by Companies Amendment Act (Act 37 of 1999). The changes meant the capital maintenance rule that was adopted from England restricting share buybacks was partly done away to allow share buy backs upon company meeting certain requirements.[10]

The 1999 amendments propagated the transition away from the old capital maintenance rule and in the process laid a foundation of the subject topic of this thesis, that is, section 48 of the new Companies Act (Act 71of 2008), which came into force together with the Act on the 1st of May 2011.

The main reason behind the drafting of section 48 was to solidify the initial arguments and provisions around share buyback that were first introduced in the 1999 Act.

Therefore, I intend through this thesis to critically analyse the provisions of section 48 of the new Companies Act and mirror them against the provisions under section 85 of Companies Act of 1973 and its amendments and weigh the two provisions against each other and in doing so, I will focus mainly at determining whether the new provisions under the new Act have actually achieved in providing a safe guard and protection for companies' stakeholders in the whole process of companies buying back their own shares.

In this thesis, share buyback and share repurchase will be used interchangeably to mean the same thing.

1.2 Methodology

As an empirical study, in unpacking section 48 of the new Act, I intend to us a combination of three methodologies. The first one is descriptive. I will use this method in explaining the background of share repurchase from the common law era to the modern time share repurchase, so as to draw an objective conclusion.

[8] *Trevor* (n 2 above).
[9] *Trevor* (n 2 above) at 416 per Lord Herschell.
[10] S 85 of Act 37 of 1999.

Analytical method will be used in evaluating the rationale behind section 48, its application and actual effect on companies.

A comparative method will be useful in drawing distinctions if any between the current position under the new Act and what share buyback was under the previous dispensation and also look into what effect has the difference had on share buyback.[11]

1.3 Structure of the thesis

I have divided this thesis in six chapters. In chapter one as explained here in this chapter, is the introduction, focused on the history behind the share buyback concept, also a description of the methodology adopted so see this thesis through. Chapter two, analyses the importance of share capital in a company and why it was strictly protected.

Chapter three is focused on section 48 of the new Act and the requirements thereof. Chapter four analyses the effect that share buybacks under the new dispensation has on company stakeholders.

Chapter five looks at duties and liabilities that the board of directors have as far as share buybacks transactions are concerned.

Lastly in chapter six, a conclusion is drawn and recommendations made in line with the results of my analysis.

[11] D Meinolf, H Weiler & A Antal *Comparative Policy Research* (1987) 21.

CHAPTER 2

THE IMPORTANCE OF SHARE CAPITAL

2.1 Introduction

Like how engine is to a motor car, that is how share capital has been to companies for many years. This attribute has been contributed by the fact that share capital in most instances is the primary source of company's capital.[12] This capital plays a major role in providing a life line to the establishment, running and the later survival of a company. On this account, one ought to take all the necessary steps to see that this life blood of a company is well protected and the interests of those who are responsible for contributing their investments that is; shareholders, in the form of money and other interests like assets to create the share capital of the company are well protected.

It is this characteristic of share capital that makes the share capital of companies[13] unique in its form and distinguishes companies from other forms of business enterprise like sole proprietorship, partnership and close corporation.[14]

The share capital is obtained by a company issuing shares[15] to the contributors (members of the public or to the already existing shareholders) who pay a certain amount for the issued shares. Shareholders upon for instance liquidation will not lose more than the amount paid by them for the acquisition of the issued shares from the company.[16] Therefore share capital can in other words be described as a totality of issued shares in a company.

As a proof of shareholders acquisition of company's shares, the company will issue share certificate to its shareholders. The share certificate constitutes a *prima facie*

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12 HS Cilliers & ML Benade *Corporate Law* (2000) 221.

13 The two forms of companies; private and public companies.

14 Cilliers (n 1 above) 4.The difference between a company and other business enterprises.

15 Shares in terms of S 1 the new Companies Act is defined as one of the unit/units into which the proprietary interest in a profit company is divided. In other words according to *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279, the holder of a share in a company has a claim to part of the share capital of the company. See Cilliers (n 1 above) 224, this claim does not refer to a right of ownership in any part of the net assets of the company.

16 FHI Cassim 'The reform of company law and the capital maintenance concept' (2005) 122 *South African Law Journal* 283.

evidence of the shareholder's title to the shares held by him.[17] The issuing of shares forms an equal exchange between the company and its shareholders, whereby the company benefits the financial support and in return the company issues four basic rights of ownership to its shareholders; a claim on a share of the company's undivided assets in relation to the shares held by him upon liquidation, voting powers in the company, entitlement to dividends once declared by the company and in some instances pre-emptive right of which he can assert against the company and his fellow shareholders.[18]

Often than not, the consideration paid for the shares doesn't always signify a true reflection of what has been contributed by shareholders as the share capital of the company.[19] For instance the share capital can exceed the consideration if its profits are subsequently capitalised or alternately the shareholders who contributed capital of the company use other means not through shares.[20]

To highlight the importance of share capital of the company, Gansen[21] and Delport[22] have between them given four functions of share capital;

i) Source of funds for company daily operations. Companies are free to use the capital generated from shares or the retained earnings of the company in funding the daily operations of the company.

ii) Protection for creditors. This is not always the case due the nature of the share capital of companies as an artificial sum or notional liability and not a true reflection of money put aside for creditors payment. Therefore the share capital of a company doesn't always guarantee creditors of getting

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17 S 94 of Companies Act 61 of 1973.

18 In terms of S 193 of the1973 Act, each shareholder has a right to vote. While S 194 provided for rights attached to preference shares. The new Act on the other hand under S 36(1)(b)(ii), provides that the Memorandum of Incorporation must set out the preference, rights, limitations and other terms associated with a particular class of shares.

19 *Kellar v Williams* [2000] 2 BCLC 390 PC.

20 KE Van der linde 'Aspects of the regulation of share capital and distributions to shareholders' LLD thesis, University of South Africa, 2007 http://uir.unisa.ac.za/bitstram/105001/2543/1/thesis.pdf (accessed 30 August 2011).

21 SC Heapy 'Company's share capital and the acquisition of its own shares: a critical comparison between the relevant provisions of the companies act 61 of 1973 and the companies act 71 of 2008' LLM thesis, 2010 University of South Africa. http://uir.unisa.ac.za/bitstream/handle/10500/4660/dissertation_heapy_s.pdf?sequence=1 (accessed 1 December 2011).

22 PA Deplort 'The Acquisition of Capital in South Africa Companies with specific reference to the Offer of Shares to Public' unpublished LLD thesis, University of Pretoria 1987, 407.

back the money they invested only to limited extent, for instance from company's available assets.

iii) Protection for shareholders according to their proportionate contributions.

iv) Increases credit worthiness of the company and in the process attracts investors.

2.2 Share capital rules under common law

Share capital as a corporate law concept it's not a foreign thing, it has been significant and carried a lot of weight with it from the origin of company law as its roots are traced all the way from common law doctrine of *ultra vires*.[23]

From the time of its origin share capital of companies was maintained because of the belief as one of its function as discussed above,[24] that share capital constituted money put together for the satisfaction of claims of creditors hence this money had to be protected. This point was emphasised in the case of *Trevor v Whitworth*.[25] In this case the Lord Watson said:

> The company had purchased, prior to the date of the liquidation, no less than 4142 of its own shares; that is to say, considerably more than a fourth of the paid up capital of the company had been either paid, or contracted to be paid, to shareholders, in consideration only of their ceasing to be so. I'm quite unable to see how this expenditure was enquired in respect of or as incidental to any of the objects specified in the memorandum. And, if not, I have a difficulty in seeing how it can be justified. If the claim under consideration can be supported, the result would seem to be this, that the whole of the shareholders, with the exception of those holding seven individual shares, might now be claiming payment of the sums paid upon their shares as against the creditors, who had a right to look to the moneys subscribed as the source out of which the company's liabilities to them were to be met.[26]

This comment made by Lord Watson emphasises the fact that, share capital was regarded by the law as a safe haven for creditors and no act to the contrary could

[23] PA Delport 'Company Groups and the Acquisition of Shares' (2001) 13 *South Africa Mercantile Law Journal* 12.
[24] See para 2.1
[25] (1887) 12 App Cas 409 (HL) 416.
[26] This became a landmark case under common law as far as share capital rules are concerned and it was later applied in South African Companies Law.

justify share buy backs by companies to discredit creditors who had their eyes on the share capital.[27]

Under common law, share capital as it was practiced during Lord Watson's time led to capital maintenance system. From this system three important supporting principles were born;[28]

i) Company may not buy back its own shares;[29]
ii) Company may not pay dividends out of capital[30] and
iii) Company may not issue shares at a discount.

From the pillars mentioned above it is clear that capital maintenance rule held retention of capital at the core of its existence with the aim of protecting the interest of creditors. This meant a very strong protection of company's profit.

For decades South Africa Company law followed this English rule[31] which had as its underlying philosophy protection of the interests of creditors and the investing public.

2.3 The decline of capital maintenance system in South Africa

In principle when capital maintenance was formulated it didn't have as its primary target protection of creditors. What the concept attempted to do was to ensure the issued share capital of the company is maintained and the company does not return

27 Three years later the court in *The Ooregum Gold Mining Company of India Ltd V Roper* [1892] A.C 125 at 133 made the same declaration by stating the following "The capital is fixed and certain, and every creditor of the company is entitled to look to that capital as his security".

28 H Rajak *Sourcebook of Company Law* (1995).

29 In *Trevor's* case The House of the Lords in the 19th century held that a company couldn't purchase its own shares even though there was an express power to do so in its memorandum, since this would result in a reduction of its capital.

30 The court in *Cohen NO v Segal* 1970 (3) SA 702 (W) at 705H, made a stand by prohibiting [ayment of dividend out of capital. It was stated and I quote "[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."

31 S 39 of the Companies Act 46 of 1926. The oblect of this provision, as Goldstone, as he then was, said in *Sage Holdings LTD v The Unisec Group Ltd and Others* 1982 (1) SA 337 (W) at 247 was, 'to enforce the principle that a company may not purchase or traffic in its own shares, reiterating the principle in *Trevor's* case (supra).

its issued share capital to its shareholders except when this is authorized by the Companies Act.[32]

Like many other company law systems that followed the common law legal system, South Africa system also adopted and held the protection of creditors at the fore front. To achieve this philosophy of holding the interests of creditors highly, a grudging and restrictive capital maintenance system was introduced to back up the capital maintenance system and in so doing insured the interests of the creditors are well safe guarded. But again this safe net didn't come without a heavy price tag on it. This came in a form of burdensome formalities which companies had to follow in order to exercise the protection extended by the system. For instance in section 79 of the old Companies Act 61 of 1973, companies were prohibited from paying interest on shares out of share capital unless this was authorised by the articles of association of the company or by a special resolution, and the interest paid was restricted to a maximum of 6% per annum, and the approval of the Minister of Industries, Commerce and Tourism had to be obtained.[33]

Like a rolling snow ball, with time recommendations grew in numbers from various South African scholars[34] which escalated the intensity and the seriousness of the matter to legislature discussions[35] and this eventually led to a unanimous agreement from the government side and business entities, in that, for the sake of attaining a more stable and modern business environment growth which will open doors for investments from outside and for South Africa to compete successfully internationally, change of the system was inevitable. This though did not mean to

[32] See FHI Cassim 'The reform of company law and the capital maintenance concept' (2005) 122 *South Africa Law Journal* 284. This was also emphasised in the case of *Cohen NO v Segal* 1970 (3) S.A. 702 (W) *at 705H* where the court, in prohibiting the payment of a dividend out of share capital, proclaimed that "[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."

[33] http://www.bowman.co.za/LawArticles/Law-Article~id~-639353216.asp (Accessed on the 4th October 2011)

[34] FHI Cassim 'The right a company to purchase its own shares' (1985) 48 *THRHR* 318 and in Cilliers 322: 'Experience has shown that capital maintenance is not only an imperfect way to protect creditors, but that the rules (mostly English common law) that applied the principle were notoriously imprecise and uncertain. It also contained serious flaws in respect of the ability of the company to protect itself against manipulation of share prices'.

[35] General Notice 724 GG 18868 of 8 May 1998.

completely do away with the company law regulations on capital maintenance but rather have them do less than what they initially did and hence avoid over regulation and let the core company law provisions play only a limited role in protecting the interests of creditors.[36]

Despite of the above criticisms and contrary opinions against the capital maintenance rules, capital maintenance system was retained with supportive grounds from the fact that; shareholders had demonstrated a habit of taking advantage at the expense of creditors (outsiders) who had no access to some of the inside dealings of the company and shareholders would make excessive distribution payments to themselves, on the same token the directors also abused their position by paying themselves huge and unjustifiable salaries from companies accounts which left the companies in precarious state I some instances.[37] This control as evidenced by the shareholders was made possible because of the controlling powers given to them by law that have been in existence until the recent changes introduced by the new Companies Act.[38]

The transition moving away from the capital maintenance system was effected in South Africa in 1999. This triggered the movement away from the complete application of capital maintenance regime. It all began by allowing companies to buy back their own shares and at the same time amending the rule that dividends cannot be paid out of company's capital. By amending the first and the second pillars of the capital maintenance regime this meant the companies were free to buy back their own shares as long as they complied with the requirements provided for in the amending Act [39] and companies could make payments out of capital to its shareholders provided again the transaction met the requirements set in the

36 Cassim (n 1 above).

37 For example asset stripping whereby company shareholders and directors will take company assets for themselves. In this case worsen the company position and exposing the company to liquidation and putting creditors investments in jeopardy. http://www.roylaw.co.za/home/article/liquidation--always-the-worst-choice/pageid/business-law (accessed 12 March 2012).

38 S 66 of Companies Act 71 of 2008. This Act shifted the company powers from the shareholders to the board of directors. In that a company under the new dispensation will mean the board of directors and not shareholders as it was.

39 S 85 of the 1973 Act.

Amendment Act.[40] Also the strict rules against reduction of share capital in section 83 and section 84 were abolished.

This shift from the capital maintenance rule was facilitated by the introduction of solvency and liquidity test.[41] This test had safer mechanism of safe guarding the interests of creditors and shareholders. For instance; the solvency element gave priority to creditors over shareholders upon dissolution of company by preventing the company from favouring its shareholders through a partial liquidation.[42] While on the other hand, the liquidity element insured the creditors are paid on time while at the same time putting a good name for the company that it is able to pay its debts when they become due an incentive for further investment.

2.4 Share buy-backs in terms of Companies Amendment Act 37 of 1999 and its impact on the share capital

The introduction of companies buying back their own shares has had a great impact on the capital[43] and share status[44] of companies ever since its introduction in South Africa on the 1st of July 1999.[45]

Company share buyback came as a result of the South Africa company law partial transition from capital maintenance rule to solvent and liquidity test system. It was referred as a partial transition because of the fact that capital maintenance rules still applied in some instances during this transition.[46] For instance, section 79[47] still prohibited companies from paying their interests on shares out of capital. Retention

[40] S 90 of the 1973 Act. In my opinion the section should have required a special resolution like S 85 in approving payments out of capital to safe guard the interest of the minority shareholders and also hold directors liable for failing to comply with the requirements of this section in effecting the said transactions.

[41] S 85(4) of the 1973 Act.

[42] K Van der Linde 'The solvency and liquidity approach under the Companies Act 2008' (2008) *Tydskrifvir die Suid-Afrikaanse Reg* 226.

[43] Share repurchase will reduce the capital of the company by the money spent by the company in buying back its own shares.

[44] Share buyback reduces the number of shares held by the members of public, that is, shareholders and on the other hand increasing the earnings per share.

[45] S 8 of the Companies Amendment Act 37 of 1999.

[46] *Capitex Bank Ltd V Qorus Holdings Ltd and Others* 2003 (3) SA 302.

[47] Act 61 of 1973.

of this section didn't make sense because companies could simply use section 90[48] to make the same payment and avoid section 79.

Share repurchase entailed a transfer of money from the company to its shareholders, in his or her capacity as a shareholder; an aspect akin to that of dividend payment. Even though the two transactions share the same factor of monetary pay-out to shareholders, they are not the same in function hence cannot be regarded as a substitute of each other. A dividend is company's profit distributed after being declared for distribution to shareholders of the company while on the other hand share buybacks stipulates a money transaction from the company to its shareholders to complete the buyback purchase of its shares from the public. Share buyback can be funded from either share capital or distributable reserves while dividend is only paid out of distributable reserves or from divisible profit.[49]

Another aspect of significance is the fact that dividend attracts Secondary Tax on Companies (STC) while share buyback funded from share capital does not attract such tax. This though is said to change from the 1 April 2012 with the introduction of dividend tax. The changes have been made so as to align the Income Tax Act with the new changes brought about by the new Companies Act.[50]

When introduced for the first time in 1999 in South Africa, share buyback came with teething problems[51] which were later on rectified by the new Companies Act.

In essence the companies were allowed to buy back their own shares as long as the company's article of association authorised it and the members of the company approved the buy back by a special resolution[52]and there are no reasonable grounds for believing that:

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48 As above.

49 See Cilliers (n 12 above) 354. If the directors have in fact caused a dividend to be paid out of capital and not out of divisible profit, they may be personally liable for the repayment thereof.

50 New Act doing away with concepts like per value of shares and share premiums.

51 For instance it became more complicated and complex for financial analyst when evaluating company financial records. For example, if a company has an issued number of shares of 100 and repurchases 8 of its own shares, while its subsidiary purchases 5 of the shares, the number of company shares is 92, while the number of group shares is 87.http://www.accountancysa.org.za/resources/ShowItemArticle.asp?Article=share+repurchases+by+companies+listed+on+the+jse+the+effect+on+market+capitalisation&articleid=1638&issue=1074 (accessed on 11 November 2011).

52 S 85 of 1973 Act.

a) the company is, or would after the payment be unable to pay its debts as they become due in the ordinary course of the business; or

b) the consolidated assets of the company, fairly valued, would after the payment be less than consolidated liabilities of the company once the payment made by the company in acquiring those shares has been made.[53]

The Court in *Capitex Bank Ltd case (supra)* reiterated these two requirements as the two internal requirements to be complied with for the company to approve the acquisition of its own shares.

The Act required the acquiring company to cancel the shares acquired; this meant there was no room for treasury shares because the cancelled shares were to become authorised but unissued shares.[54] This had an important consequence to the share capital of the company, that is, the share capital of the company was reduced by the shares so acquired as stated above.[55]

A strict application of solvency and liquidity test had to be done by the company's directors so as to safeguard companies from the negative impact if share buyback transactions were not well executed considering all possible financial implications.[56] Unlike the laws governing share buybacks in the USA[57] which provides for a particular source of money to be used by companies when undertaking a share buyback, the Amendment Act had imposed no restriction on the source of funds to be used when acquiring companies own shares. Therefore both sides of the test had to be complied with, that is, solvency and liquidity, before and after a share buyback transaction had been undertaken.[58]

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53 S 85(4) of 1973 Act.

54 The only room for treasury shares was left when a subsidiary bought shares from the holding company. The shares will not cancelled as they would be when the holding company would by its own shares hence reducing consolidated share capital.

55 In terms of S 85(5) & (6) in a case of par value shares the cancellation will reduce the share capital by the par value of the shares so acquired, while on the other hand when non-par value shares have been acquired, a value per share must be computed and the stated share capital will be reduced by multiplying the value with the number of shares acquired. Cilliers (n 12 above) 324.

56 Inconsistencies in share repurchases of South Africa companies, example in calculating market capitalisation one was bound to get confused which number of shares to be used when computing market capitalisation.

57 USA Model Business Act 1969.

58 FHI *Cassim*, 'The New Statutory Provisions on Company Share Repurchases: A critical Analysis' (1999) 116 *South Africa Law Journal* 768-769, who argues for the test to be

In its application, solvency and liquidity test dangerously introduced a new concept of companies group in its second part of the test which required reference to the consolidated assets and liabilities. In agreement with Delport the concept was regarded dangerous because it had no backing of common law or other statutory principles.[59]

complied with both at the time when the contract is entered into and subsequently when the payment is made.

[59] PA Delport 'Company Groups and the Acquisition of Shares' (2001) 13 *South Africa Mercantile Law Journal* 121.

CHAPTER 3

COMPANIES SHARE BUYBACK IN TERMS OF THE NEW COMPANIES ACT

3.1 Introduction

The aforesaid transition from the capital maintenance disposition to the solvency and liquidity regime has been improved to a great extent by the new Companies Act[60] filling the loop holes left by the 1999 Companies Amendment Act with a better structured system which is in line with the fundamental company law changes introduced by the Act.[61]

To reaffirm South Africa's transition and to make a more stable, complete and sustainable transition away from the capital maintenance regime, the New Act picked up where the Amendment Act left off, and in terms of section 48 of the new Act just as it was with the old Act; a company or a subsidiary of the company may acquire company's shares.

As It had been alluded earlier, that the value and the sole importance of company's share as the primary source of company finance has been losing its strength but now even more with the latest provisions of the new Act in section 40(5).[62] This section states; share consideration can be realised at a future date after issuing of the said shares, this could be in the form of an agreement for future services, future benefits or future payment by the subscribing party. This means it is possible for company now after the passing of the new Act to have a share capital of nil if the shareholders have agreed with the company to pay at a later stage. It is not clear in terms of the new Act whether the same principle will and can be applied when the company is buying back its shares from its shareholders. One can assume it will depend with what the parties will agree on, either to complete the transaction with future payments for buybacks or cash payments.

[60] Came into effect on the 1st of May 2011.It's impact on share buy-back will be discussed below in Chapter 3.
[61] The shift of power to the board of directors.
[62] The 2008 Act.

Also other factors such as tax systems and securities regulations have supported or have given advantage to the use of debt financing and strict regulation of the public offering of shares which have pushed companies to use other forms of financing that are not subject to such extensive regulation.[63]

Before the 1st of May 2011 all the ordinary company shares were either par value shares or no par value shares.[64] This meant the shares could either have an indicator of value known as nominal value or carry no indicator of value.[65] All this was changed by the new Companies Act 71 of 2008. In terms of the new Act, Section 35 changed the company's share value indicator characteristic; in a sense that a share issued by a company will no longer have an indicator of value. According to schedule 5, item 6 (2) and (3), a pre-existing company will not have an immediate obligation to convert its existing issued par value shares and may continue to have the nominal or par value assigned to them when issued after the effective date.[66]

3.2 Companies share buyback as a form of distribution

The acquisition of company's shares by the company or its subsidiary in terms of the new provisions is in line with the international standards[67] and it's been considered

63 KE Van der Linde 'The regulation of conflict situations relating to share capital' (2009) 21 *South Africa Mercantile Law Journal* 37.

64 S 74 of Companies Act 61 of 1973.

65 Cilliers (n 12 above) 222.

66 The earlier draft had with it a 5 years period from the effective date of the Act of which companies which had shares with indicators of value to convert those shares to no par value. This though did not form part of the latest draft of the Regulations. And in terms of the final amendments as amended by Companies Amendment Act, No 3 of 2011, the minister and the member of cabinet responsible for national financial matters, must make regulations, to take effect as of the general effective date, providing for the transitional status and conversion of any nominal or par value shares, treasury shares and capital accounts of a pre-existing company.

67 For instance the re-establishment of The Financial Reporting Standards Council (FRSC) as an advisory committee to the Minister with responsibility to advice on the regulations establishing financial reporting standards, which will govern the form, content and maintenance of companies' financial records and statements. http://www.sanas.co.za/assessorcon/2011/Presentation%206%20-%20Companies%20Act%20and%20regulations.pdf.(Accessed on 2 October 2011).

as a company's distribution[68]; hence it must comply with distribution requirements as set out under section 46.[69]

In terms of the new Act section 48 (2) makes it clear that that; a company may acquire its own shares or a subsidiary may acquire its holding company's shares if the decision by the board of directors to do so satisfies the requirements of section 46. This marks a new addition to the share buyback provisions.

The definition section of the Act[70] defines distribution as a direct or indirect-

a) Transfer by a company of money or other property of the company, other than its own shares, to or for the benefit of one more holders of any of the shares, of that company or of another company within the same group of companies, whether –

i) In the form of a dividend;
ii) As a payment in lieu of a capitalisation share, as contemplated in section 47;
iii) Is consideration for the acquisition –
aa) by the company of any of its shares, as contemplated in section 48; or
bb) by any company within the same group of companies, of any shares of a company within that group of companies; or
iv) Otherwise in respect of any of the shares of that company or of another company within the same group of companies, subject to section 164 (19)

b) Incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares; or

c) Forgiveness or waiver by a company of a debt or other obligation owed to the company by one or more holders.

This can be marked out as one of the biggest change brought in by the new Companies Act, since it's the first time distribution and its methods have been comprised into one definition and there has been an introduction of a new aspect of distribution in the form of forgiveness or waiver by a company of the money yet

68 The definition of distribution under the new Act is similar to that of New Zealand Companies Act as provided for under S 52 of Companies Act 1993 of New Zealand.
69 The 2008 Act.
70 S 1 of the 2008 Act.

paid or partly by a shareholder to the company.[71] Each of the above three forms of distributions can either be done directly or indirectly.[72]

My focus will be on the first method of distribution, which has four different forms of which the distribution can be undertaken and I will analyse further by narrowing my discussion on how this distribution is done through transferring money or other properties of the company, other than its own shares, to or for the benefit of one more holders of any of the shares, as a consideration for the acquisition by the company of any of its shares, as contemplated in section 48[73] or any company within the same group of companies, of any shares of a company within that group of companies.

3.2.1 Distribution as a form of consideration for acquisition of shares

All three forms of distribution mentioned in the definition have one common factor and that is they all have to be concluded subject to the solvency and liquidity test.[74]

It is not clear from the wording whether the list of different forms of distribution through transfer of money or property is exhaustive.[75] The lists consists of payments in a form of dividends, payment in lieu of capitalisation of shares, consideration for the acquisition of own shares, transfers of any shares of that company or of another company in the same group.

What is clear is the acquisition of companies shares seems to have a wider application than it was under the old Act in a sense that, under the new Act as it

71 Shares don't have to be fully paid for in terms of S 40 (5).This provision though plus the one for the incurrence of a debt can be criticised for pushing (left open) distribution to not only shares but debts incurred and forgiveness of debt incurred otherwise than through shares.

72 Meaning the distributions can be done directly by the company or indirectly by its representatives.

73 The 2008 Act.

74 S 46(1)(b) of the 2008 Act. The test is applied strictly in this instance. It must reasonably appear that the company will satisfy the test immediately after the distribution and the board of the company are to acknowledge the application of the test and the reasonable satisfaction thereof.

75 KE Van der Linde 'Aspects of regulation of share capital and distribution to shareholders' unpublished Phd thesis, University of South Africa, 2008, She is of the opinion that because of the generality of the last form in the definition it's an indication that this is an exhaustive list of the distribution that can be effected by way of transfer of money or property.

has been distinctively described, as a distribution it can either mean a direct or indirect, transfer of money or other property of the company, other than its own shares, to the shareholder or any holder of any beneficial interest in any such shares of that company or the subsidiary of a holding company.

When this is translated it means the impact of distribution on the share capital of the company will be more than what it was in the old Act. Because under the new dispensation the company can transfer money or other property (assets) of the company to not only shareholders but any holder of a beneficial interest[76] in any shares of that company or its subsidiary and equally so the subsidiaries can acquire their shares from not their shareholders but also its shares held by its holding company. This provision has put to bed the uncertainties that had been raised in the old Act with regards to the recognition of group companies since the new Act has reintroduced the notion of group companies with these clear words under the definition of distribution.

The new Act has also strengthen the position of other distributions other than dividend by allowing companies to establish in their Memorandum of Incorporation preferences, rights, limitations or other terms that entitle the shareholders to distributions calculated in any manner subject to the requirements of sections 46 and 47.[77]

Despite of the good outcomes and promising introduction; the new Act, has come without its fair share of teething problems upon its introduction to the South Africa company law sphere. For instance when it comes to the acquisition of shares by the company, under the new Act distribution has been extended to the shareholders of the subsidiary of the holding company by the holding company.[78] This certainly proves to be a challenge and I herewith agree with Van der Linder

[76] This formed part of the draft before the final amendments. It was later changed and in the amendment Act of 2011 the holder of beneficial interests was removed. This means the extent of the impact of distribution as anticipated earlier has been reduced.

[77] S 37(5)(c). This again marks an enhanced protection of shareholders as explained below Chapter 4.

[78] Judging from the wording of the definition of distribution this seems to be an intended results since a company can acquire shares from any of its shareholders in the group.

in her doctoral thesis. First challenge will be in determining the extent to which one has to go in applying the solvency and liquidity test.[79]

What also has emanated from the extension of the group concept is the acquisition by a subsidiary of shares in its holding company and even more problematic submission of group financial statement when a subsidiary acquire shares from its shareholders.[80]

It is clear from the definition of a distribution that, for an acquisition of companies own shares[81] to occur there has to be either an indirect or direct transfer of money or any other assets from the company to the shareholder in exchange of the shares held by the shareholders.[82] This in one way or the other gives shareholders a claim against the company for the shares the company has acquired from him, marking yet another protection of shareholders, because this can be included in the memorandum of incorporation as shareholders rights upon this form of distribution.[83]

3.2.2 Distribution in terms of section 46 of the 2008 Act

Companies have been strictly prohibited to conduct any distribution unless the distribution is in compliance with four important requirements as stated in section 46 and as further discussed below.

1) The distribution must be in pursuant to an existing legal obligation or a court order. This is a shift from the old position under the 1973 Act were court order share repurchase didn't form part of the "payment" as described in section 90(3) of the Act. This means in an instance where the company is being ordered by the court to purchase shares from its shareholder as it was under

79 KE Van der Linde (n 75 above) 379 and 387. Looking at how much information is required to make up the financial statements for the application of solvency and liquidity test...one wonders how and which format should one follow when there is a consolidated distribution between companies in one group.

80 How can a holding company make a distribution to its own? When a subsidiary acquires shares from holding company? Especially when the subsidiary is a wholly owned subsidiary by the holding company?

81 The Act has not defined what an acquisition entails. But since a company cannot hold shares in itself, it is safe to imply that an acquisition occurs when a shareholder relinquishes his rights in respect of shares he holds in the company to the company.

82 S 1 definition of distribution

83 Discussed below in chapter 4.

the old Act[84] and also in the new Act under section 46, such an order will have to comply with liquidity and solvency test. I view this as a positive move since the new mechanism of subjecting the court's order to the solvency and liquidity test reduces the possibilities of courts abusing their powers and also protects the company and the surviving shareholders from a possible company liquidation that could have been brought about by the share buyback as ordered by the court, because despite of the court order, the transaction will not take place if the company will not meet the tight requirements of the test. Even though in the same token the company can apply to the court to vary its original order if after considering the solvency and liquidity test it appears the company will not be able to comply with the court order,[85] the financial position of the company will still play a pivotal role in determining the new order to be made by the court and the timing of the payment to be made by the company to the shareholder.

2) The board of the company, by resolution must authorise the distribution.[86] This is a whole new approach from the old position under the 1973. The new Act has brought with it a shift of powers from shareholders to the board of directors, meaning when one is referring to a company is referring to the board of directors and not the board of shareholders as it was then.[87]

Therefore the board of directors have to pass a resolution to authorise any distribution that the company wants to undertake, where failure to do so the directors will be held liable as discussed further below.[88] This resolution does not apply to the distributions ordered by the court as discussed above.

It is not clear what will be the form or forms of the resolution taken by the board of directors under the new Act. Because under the old Act the shareholders special resolution could either be of a general approval or a specific approval for the acquisition of shares companies by the company.[89] Arguably the form even though not stipulated in the Act it could be included in

84 S 252(3) of 1973 Act.
85 S 46(5) of the 2008 Act.
86 S 46(1)(a)(ii) of the 2008 Act.
87 S 66 of the 2008 Act.
88 Chapter 6.
89 S 85 of the old Act.

the Memorandum of Incorporation as one of the rights or obligations to be complied with when undertaking a distribution.[90]

It is unclear though whether decision by the board should be taken before the solvency test as discussed below. For me it comes out as over regulation or abuse of the process the manner in which the two processes are going to be followed and applied.[91]

3) The next two requirements are based on the solvency and liquidity test. Therefore it will only be prudent in order to get a better understanding of these important requirements to look and analyse the test separately here below as provided in the new Act and draw noticeable differences if any from the old Act.

3.2.2.1 Solvency and liquidity test in terms of the new Act.

As a distribution, a company will only be able to buy back its own shares and make a distribution once the proposed transaction by the company and its board has reasonably appear to have satisfied the solvency and liquidity test immediately after completing the acquisition and that the board of directors by resolution, has acknowledged[92] that it has applied the test, as set out in section 4 of the new Act.[93]

Section 4[94] provides and determines what solvency and liquidity test entails and how it should be applied. In terms of this section which applies to all distributions and beyond;[95] a company would satisfy solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at the time; the 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

[90] S 37 of the 2008 Act.
[91] Logically speaking the decision of the board of directors should go first followed by the application of the test to confirm and insure that the board made the right decision in proposing the said distribution. It should act therefore as a check and balance tool of the decision made by the board and limit the possible abuse of power.
[92] As to be discussed in details below.
[93] S 46 (1)(c) of 2008 Act.
[94] The 2008 Act.
[95] Financial assistance by the company, in terms of S 44 of the 2008 Act.

[or, if the company is a member of a group of companies, the aggregate liabilities of the company] as fairly valued and it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period 12 months after the date on which the test is considered.[96] The period of 12 months carries with it a lot of significance as far as an increase of director's responsibilities is concerned. In terms of this provision, directors will be held personally liable if they fail to foresee insolvency within the 12 months period after approving a distribution transaction.

Share buy-back transaction will not be successfully completed in terms of the Act if the board after giving effect to the authorization of the transaction, it finds reasonable grounds that the company upon completion of the test will not satisfy the solvency and liquidity test after making reasonable reference to the accounting records and financial statements of the company.[97] This objective element added to the tests ensures that the directors before approving a share buyback a detailed study of the financial position of the company's accounts has been sufficiently done ensuring the company remains liquid and solvent even after the reduction of capital from the distribution made in the form of share buyback.

From the above synapse of solvency and liquidity test under the new company law dispensation, it is clear that the new share buyback provisions have gone further in their attempt to secure the share capital of companies than it was in the past with the old Act. For instance now in terms of the new Act the directors are currently expected to consider "all reasonably foreseeable financial circumstances of the company when applying solvency and liquidity test. This means the directors will not only be expected to focus on the accounting records of the company in applying the test but also possible external economic and political circumstances which may have an impact on the financial status (share capital) of the company. This signifies a better protection mechanism for the share capital of the company and ensures

[96] S 2(a) of Companies Amendment Act 3 of 2011.
[97] S 4(1) of the 2008 Act.

that directors in executing their managerial role they put in a higher performance than they used to in the past.

This brings me to the last two requirements of a distribution which involve solvency and liquidity test, which is, the third and the fourth requirements from the above sequence:

i) This requirement requires a company to reasonably appear to satisfy the solvency and liquidity test immediately after completing the proposed distribution.[98]

This is one of the highlights of progress in the new Act in protecting the creditors with the solvency and liquidity test. It is the first time a reasonable test is being put in place in the application of the test since its first introduction in 1999. This is a major difference from the old act[99] where the test was more of a subjective one, in a sense that the distribution was restricted based on the board's reasonable belief. This meant the drafters of the old Act were not interested in the actual solvency and liquidity of the company.

In addition to the progress above, the second leg of the test that is liquidity; under the new Act[100] for the sake of completeness and certainty a time frame of 12 months has been introduced from which a company in applying the test should weigh its ability to pay its debts as they become due over that period in its ordinary course of the business before any distribution can be made by the company. This was significant because the lack of a specific time frame created a loop hole where by directors would not apply their mind to insure a lengthy financial position of the company before allowing a share buyback, hence creditors interests were in jeopardy and whose debts to the company were not secured enough especially in buybacks situations.

[98] S 46(1)(b) of the 2008 Act.
[99] S 85(4) of the 1971 Act.
[100] S 4 of the 2008 Act.

The new Act puts more weight on the reasonableness assessment of the test by applying more tangible approach in the form of an appearance. This means if down the line after the distribution has been undertaken by the company and the company fails to comply with test, the directors in being held accountable they can be required to produce evidence of the company's appearance to have met the tests' reasonable requirement. Also on the other hand, the same evidence of appearance can be used by directors to their defence, in that they undertook the distribution bona fide the appearance.

1) Lastly, the board of directors of the company, by resolution, has to acknowledge that it has applied the solvency and liquidity test, as set out in section 4, and reasonably conclude that the company will satisfy the solvency and liquidity test requirement immediately after completing the proposed distribution.[101]

Under the old Act no acknowledgement of the solvency and liquidity test was required from the board in approving company's acquisition of its own shares. With such a positive acknowledgement which imposes responsibility on the directors to act responsibly it marks another step forward in securing the interests of the creditors and shareholders. This acknowledgment must be acted upon within 120 business days by the board, upon expiring of the days thereof a fresh acknowledgement has to be made by the board either reconsidering the test or adopt another resolution.[102]

It doesn't stop with the acknowledgment; directors have also been made to make a reasonable conclusion that the company will satisfy the test immediately after completing the proposed distribution.

I believe from the wording and the timing of the application of the test is when the said share-back has been suggested by the company.[103] This will act as a preventative and a deterrent mechanism as it is applied just before the

[101] S 46(1)(c) of the 2008 Act.
[102] S 46 (3) of the 2008 Act.
[103] S 46 (1)(b) of the 2008 Act.

company is about to conclude a distribution (buy-back its shares) in the process help companies not to find itself completing transactions it doesn't have the means to complete or obligations it can't honour and in doing so protecting the interests of the stakeholders (shareholders and creditors).

3.3 Conclusion

It is therefore my submission that the new solvency and liquidity test is a better tool than it was in the old Act and its content relevant, even though complex in its application, still holds up as a positive move towards steering companies into sound financial environment and successfully completes the move from capital maintenance by ensuring creditors and shareholders a better protection.

CHAPTER 4

EFFECT OF SHARE BUYBACKS ON COMPANIES STAKEHOLDERS

4.1 Introduction

I believe equal protection of creditors, shareholders and the investing public who are the main role players in the establishment and the survival of companies played a major role in pushing for and advocating for the introduction of share buybacks in South Africa.[104]

Historically in countries including South Africa, were the doctrine of capital maintenance was followed and practiced there were insufficient mechanisms that were created to provide protection for the stakeholders who had invested heavily in the companies. Often than not because of this shortcoming, shareholders and creditors found themselves losing the finances they had invested leading to clashes between shareholders and creditors who will find themselves fighting and scrambling for the remaining funds if any upon liquidation of the companies they had invested in, since often than not one always found to be given advantage at the expense of the other.[105]

With time this raised a need therefore for a well-established set of regulations geared at protecting the share capital of companies and the distribution thereof so that the conflicts experienced as highlighted above are avoided and the companies' coffers are not negatively affected by distributions.

Therefore the essence of this chapter is to draw a comparison and contrast the two positions, that is, look at how things were during the capital maintenance rule and how things have changed under the new Act and establish whether the new Act has indeed been able to provide a sustainable and reliable protection of share capital and in the process offer protection to the creditors and shareholders. I will also

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104 South African Guidelines for Corporate Law Reform 24.

105 In most cases because the shareholder is a mere residual claimer he only gets his share of the pie once the creditors have been paid out.

examine the role and duties of the board of directors under the new Act in facilitating this protection, since the board of directors has been vested with this power under the new dispensation and in also particular look at the role they have to play in the share buyback transactions.

4.2 Effect on Shareholders

Shareholders as the owners of companies have always been in most cases on the risky side of the scale as far as their investment to the companies they have invested in for many years. This is because; the share capital contributed by them doesn't represent a debt owing by the company to the shareholder company's equity, meaning the shareholders are basically residual claimers who only have a claim or interest on the company's assets once company's liabilities have been paid out to creditors.[106] In the accounting sense, shareholders equity represents the remaining interest in assets of a company, spread among individual shareholders of common or preferred stock.[107]

Because shareholders' interests on the capital is limited to the residual assets active only once all company's liabilities have been accounted for, it was important that a system was in place to see that the share capital is well regulated and monitored by the company so as to ensure a good return to shareholders.

Capital maintenance rule and it's pillars, that is; prohibition on companies buying their own shares, no payment of dividend out of capital and no issuing of shares at a discount as discussed in chapter 2, appeared to have been the right system to have been put in place to safe guard the interests of shareholders, because the capital (shareholders' equity) was not to be reduced. On the basis of the background it will be important to see whether this old safe guarding principles under the capital maintenance rule have been sufficiently been improved by the new rules safe guarding rules under the new and if so, have the shareholders been extended with

[106] Shareholders funding into the company creates a liability on the company in the form of capital since the company is a separate entity from the shareholders. As a company is also regarded as a totality of assets and liabilities; shareholders claims only become due to him once liabilities have been accounted for.

[107] http://en.wikipedia.org/wiki/Equity_%28finance%29. Accessed on the 5th of September 2011.

enough knowledge in terms of clear provisions in the Act on the protection offered to them?

Under the capital maintenance rule before it was partly revoked as lengthily discussed in the previous chapters, prohibited companies from buying back their own shares. The questions that follow are; whether this prohibition actually succeeded in protecting the right of shareholder to residual capital remaining after the winding up of a company and secondly whether shareholders were equally treated in apportioning the residual capital?

4.2.1 Shareholders right to the residual capital under capital maintenance rule

When looking at the protection of shareholders rights one has to draw two different scenarios; firstly is when the company is solvent and secondly when the company has been wound up. With the first scenario under the capital maintenance rule, the companies were prohibited from making distributions unless the distribution was less than the profit available for distribution. Therefore this meant a company could only distribute or make payments out such as dividends to its shareholders from the profit made if the company was solvent. This in one way or the other gave shareholders a claim against the company, marking yet another protection of shareholders, because this could be included in the memorandum of incorporation as shareholders rights upon this form of distribution.

With the second scenario, when the company is wound up, the shareholders had to wait for the company to pay-out the monies owed by it from the creditors and only then could the company pay-out the interests the shareholders had on the company from the residual or the left-offs after all the creditors' debts have been satisfied.[108]

4.2.2 Rights of shareholders to equal treatment under capital maintenance rule

Share buyback became or is an important piece to shareholders interests puzzle because of the effect it can have on the shift of control in a company and the stake

[108] PL Davies *The Principles of Modern Company Law* (2003) 813.

percentages of the surviving shareholders once there has been a share buyback by the company. This goes against the general rule of shareholders especially those of the same class to be equally treated. Therefore one could argue that shareholders were in a better place in terms of their percentage shareholding during capital maintenance regime because of the restriction it had against share buyback. During this era shareholders were almost certainly guaranteed of having their shareholding stake unchanged by the company's actions in the form of the company concluding transactions that will have an effect on the shareholder's stake/percentage. Also the rules gave shareholders some protection against actions of directors that could diminish the value of their shares.

4.3 Protection on creditors under capital maintenance rule

Protection of creditors under capital maintenance rule emanated as one of the principles under common law that meant; contributed (paid up) capital of a limited company constituted the fund to which creditors of the company were entitled to look at for the satisfaction of their claims against the company and this fund had to be maintained.[109] This principle was seen as an extension of *ultra vires* rule when it was applied in *Trevor v Whitworth*[110] because the act with respect to capital was not to be *ultra vires* and was not to prefer the shareholders above the creditors. Lord Herschell in presiding *Trevor's* case emphasised that; the capital contributed shouldn't be spent for any other purpose other than for the legitimate course of the business[111] this explains why companies were then prohibited to buy back their own shares because this was regarded as illegitimate course of the business.

Also the advantage of creditors over shareholders was strengthened by legal contracts entered between the creditors and the companies before an investment was made. This contractual relationship then with the company means that the directors of the company didn't have to keep a lookout or get much involved to

[109] Cilliers (n 12 above) 322. In JT Pretorious *Capital maintenance doctrine in South African Corporate law* Student Accounting Magazine 1 October 2000; the purpose of the capital maintenance rules was to turn the concept of capital into a rigid yardstick fixing the minimum value of the net assets which must have been raised initially and then, as far as possible, retained in the business.

[110] (1886-1890) All E.R Rep 46.

[111] As above.

protect the interests of creditors against the company the contracts in themselves offered that protection.[112] One then can safely say that because of the nature of the relationship that the creditors have with companies, a creditor is expected to do a proper due diligence on the company before investing so as to reduce or possibly avoid the risk of investing wrongly.

So if one was to compare the two positions of creditors and shareholders under the capital maintenance rule it is clear that the creditors received better protection and they were in an advantageous position than the shareholders since the share capital was deemed to be a guarantee fund for creditors.

Even though it can be argued that on the balance of probabilities creditors received much better protection than the shareholders as explained above, the protection wasn't sufficient because of the fact that no minimum share capital was guaranteed to be maintained for either a public or a private companies from which creditors could seatback with assurance. [113] The same with shareholders, since the shareholders relationship with the company was based on corporate flexible duties.[114]

4.4 Shareholders rights and protection under the new Companies Act

In 1999 when share buyback was firstly introduced, substantial protection was extended to company shareholders, in a sense that, for the company to buy back its own shares the transaction had to first be approved by a special resolution of the shareholders, this approval had to be included in the company's memorandum and articles [115] and the company was required to distribute an offering circular as prescribed in the Act to all shareholders holding shares of the class that the company proposes to acquire. [116] Once the circular had been accepted by the

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[112] In LS Sealy '*Directors "wider" responsibilities-Problems conceptual, practical and procedural'* (1987) 3 *Monash University Law Review* 176, it was said creditors deal with a company as a matter of bargain, not of trust, and bargain involves risk.

[113] Also the company under capital maintenance rule was not expected to keep its capital intact. Pretorius (n 109 above).

[114] D Harvey 'Bondholders' Rights and the Case for a Fiduciary Duty' (1991) 65 *St John's Law Review* 1023.

[115] S 85(1) of the 1973 Act.

[116] S 87(1) of the 1973 Act. This provision though had a limited application, in a sense that it was either a general approval or a specific approval, s 87(2). Therefore a company could easily

shareholders, a share buyback contract was signed and entered into between the company and the selling shareholders of a particular class thereof and only then was it enforceable against the company, except if the execution of the contract will result in a contravention of section 85(4).[117] Meaning shareholders could legally enforce their claims against the company for the shares bought from them.[118] This is still the case even after the coming of the new Act.[119]

For the remaining shareholders; an advantage was extended to them in the form of an increase of their shareholding interest/percentage and in return better earnings per shares held by them since there will be less shares in the issue. Under the new Act as discussed above shareholders can strengthen their protection by including in the memorandum of incorporation their rights to payment/distribution soon after share buyback transaction.[120]

One will not be criticised for expecting the new Act to go further and offer better protection to shareholders through its share buybacks provisions looking at how for instance under the old Act, the minority shareholders could find themselves coerced into selling their shares by the majority shareholders via special resolution.

In moving away from giving powers to the majority shareholders as explained above the new Act set aside the above mentioned special resolution requirement and it has replaced this with the board of director's resolution.[121] Even though the acquisition doesn't have to be approved in the memorandum of incorporation, nothing stops companies from including terms and conditions regulating share buybacks in the memorandum of incorporation as long as such terms are not contrary to the act.[122]

The new Act went on and offered further protective mechanisms such as giving powers to shareholders to apply to the High Court for an appropriate order to restrain the company from doing anything inconsistent with this Act.[123] This access to the

avoid a proper disclosure by choosing to use a specific approval when acquiring shares from its shareholders, affecting the rights of shareholders in return.

117 Failure to comply with the solvency and liquidity test.
118 S 88(1) of the 1973 Act.
119 S 164 of 2008 Act, where a provision for appraisal remedy has been made for a dissenting shareholder as discussed in detail here below.
120 S 37 of the 2008 Act.
121 S 46(1)(a) and S 48(2) of the 2008 Act.
122 S 15(1) of the 2008 Act.
123 S 20(4) of the 2008 Act.

courts will provide shareholders with the much needed protection by putting pressure on the directors to comply with all the requirements in accordance with the Act in executing a share buyback transaction.

Secondly, the next mechanism is found in section 37(1) which states; shares of any particular class authorised by a company have a preferences, rights, limitations and other terms that are identical to those of other shares of the same class. This put into perspective will mean that shareholders cannot be discriminated against when a company or the board of directors is passing a resolution on company buying back its shares from a particular class of shareholders. Because all the shareholders of that particular class are to be treated equally because the shares they hold have identical rights, limitations and other terms. In an instance though where the board is considering through a resolution to amend a memorandum of incorporation by altering the preferences, rights, limitations or other terms of any class of its shares resulting in materially adversely affecting the rights or interests of shareholders of that company, in the process resulting into discriminating one of the shareholder when the company is buying back its shares from the shareholders; this affected and discriminated shareholder can give the company a written notice objecting to the resolution.

Thirdly, the new Act offers shareholder protection in a form of a relief from conducts with oppressive or prejudicial results with regards to the interests of the shareholder.[124] This can be through an act or an omission of the company or the carrying on of the business of the company or a related person, for instance in our case a company buying shares from its shareholders resulting to an oppressive or prejudicial conduct imposed on a shareholder. This affected shareholder is entitled to apply to the court for an order restraining the share buyback transaction complained.[125] This will play a major role especially in protecting the rights of minority shareholders who can now apply for the setting aside a repurchase agreement in favour of controlling shareholders.[126]

124 S 163(1) of the 2008 Act.

125 S 163(2)(h) of the 2008 Act; where a court can make an order varying or setting aside a transaction or an agreement to which a company is a party.

126 KE Van der Linde 'Share Repurchases and the Protection of Shareholders' (2010) 2 *Tydskrifvir die Suid-Afrikaanse Reg* 304.

On the hand shareholders can also claim damages against any person who fraudulently or due to gross negligence causes the company to do anything inconsistent with the Act or a limitation, restriction or qualification.[127] Added to this section 218(2) also allows any person including a shareholder to claim damages suffered by him as a result of any person contravening any provisions of the Act, which includes share buybacks provisions.

In protecting the interests and rights of the shareholders again the new Act has given securities holders of a company powers to apply to a court for a declaratory order determining any rights of the securities holder in terms of the Act, the company's memorandum of incorporation, or any rules of the company or any other appropriate order necessary to protect any right or to rectify any harm done to the securities holder by the company or any of its directors in a share buyback that contravened the Act or violated the rights of the shareholder.[128]

And lastly, a dissenting shareholder in terms of section 164 can and is entitled to force the company buying shares from him, to purchase the shares at the fair value. This is also known as appraisal shareholder's remedy.

4.5 Conclusion

In conclusion I strongly believe shareholders' approval should have been maintained from the old Act in share buyback transactions, because at the end of the day it's the interests of the shareholders which are at stake and going to be directly affected, hence putting the people involved in charge of monitoring the interests will make what has been a way forward to the right direction piece of legislature complete. And what could have been added to tighten up the process restrictions could have been set up for the shareholders or a group thereof to whom the offer is being made so as to insure fairness.

On the other hand; since there has been a shift from shareholders' special resolution to the boards' resolution, strengthening of directors fiduciary duties will strengthen

[127] S 20(6) of the 2008 Act.
[128] S 161 of the 2008 Act.

shareholders protection and their interest. A lot more should be expected from directors and as discussed in the chapters above, directors should be held accountable in an instances where they don't fulfil their role and damage has been suffered by a shareholder and on the same token shareholders should be allowed access to monitor the actions and decisions of the board of directors especially when it comes to share buyback transactions.

One more recommendation is the fact that, like the position in countries like New Zealand, I expected the new Act to include the right to return capital of preference shareholders.[129]

Be as it may, the new Act has in deed as explained above provided valuable provisions and rights to shareholders all aimed at protecting them and ensuring fairness around share repurchase.

[129] Van der Linde (n 118 above) 305. Shareholders miss out on the return of capital in cases where a share buy-back has been conducted and company has become insolvent as a result.

CHAPTER 5

DUTIES, LIABILITIES OF DIRECTORS ON SHARE BUYBACK TRANSACTIONS

5.1 Introduction

Directors have been for a long time criticized for being passive in their role and in fulfilling their duties as provided for by the statutes and common law.[130] These criticisms were in one way or the other justified looking at the failures of companies and losses suffered by the shareholders and creditors who had heavily invested in the companies whose everyday management was vested in the hands of the board of directors.[131] This partly contributed to the reason why changes had to be made in the new Companies Act so as to rectify and make right the office of directors and put stringent rules in place so as to hold directors not only responsible but personally liable for any losses caused by their negligence and have them account for lack of proper performance especially in cases of share buybacks.

In this chapter I will focus on directors' position, specifically looking at the role they have to play under the new Act; and whether they are in a better position under the new dispensation to protect the interests of the shareholders and creditors than they were under the previous Companies Act. I will also look into whether moving the company into the hands of directors from the shareholders[132] improved the management of share buyback transactions.

Directors' duties and responsibilities to shareholders differ from those tended to creditors, and this explains why the two positions will be analysed separately from each other and a conclusion will be drawn as to which side is best served with these new directors' extended duties under the new Act.

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130 This could be attributed by the fact that no accountability provisions to hold directors responsible were provided for in this statutes.

131 M Havenga 'The directors in action' in JT Pretorius, PA Delport, M Havenga & M Vermaas (eds) *South African company law through cases* (1999) 368. This was contributed by the fact that in most cases, directors were not personally liable to a third party on a contract into which he has entered with in the name of the company.

132 S 66 of the 2008 Act.

5.2 Directors duties on shareholders

It has been regarded in the past that shareholders are the indirect recipients of directors' duties; company being the direct recipient.[133] This indirect relationship has been generated from the relationship shareholders have with companies as the owners thereof, giving powers to shareholders to hold and call for general meetings to ratify breaches of directors' duties and even going as far as instituting actions against directors who is in breach on behalf of the company.[134] This though has over the years been hugely criticised as piecing of the corporate veil of a company as a separate legal entity.[135]

Shareholders position was recognised as noted earlier in share buybacks under the old Act where share buybacks transactions had to be authorised by articles of association of the company and a special resolution of shareholders.[136] This protected the shareholders whose interests were going to be affected by the actions of the company. This meant with shareholders deciding on the subject and on the fate of their stake in the company, this lead to a reduction in the possibility of directors abusing their powers and in return make a resolution which the shareholders were not going to be happy with and leave shareholders' stake at risk.[137]

The above position took a dramatic change under the new Act, after the shareholders resolution was replaced by the board of director's resolution.[138] This has marked as a significant point of departure when one is looking to analysing the relationship between the board of directors and the shareholders.

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[133] S Lombard *Shareholders and Directors* (2007) 32.

[134] In indorsing the powers of shareholders in holding directors liable, S 424 of 1973 Act mandated any person (including shareholders) to apply before the court to hold a director who has been operating in a reckless manner to be held personally liable for the losses the company has suffered as a result of his reckless actions.

[135] As a company is regarded as a separate entity from its owners, it has its own rights and duties separate from the shareholders.

[136] S 85 of the 1973 Act.

[137] This protection has a limited scope under the new Act. Only when the repurchase has been done in the form of a scheme of arrangement. Otherwise shareholders no longer have a say in officiating a share buyback transaction.

[138] S 46(1) (a) and S 48(2)(a) of the 2008 Act.

The shift formed a foundation of the move intended by this new Act to move the company from the hands of shareholders to the board of directors. Since share buyback transactions affect the rights of the shareholders in so many ways, the decision to move the authority of authorising share buybacks from the shareholders to the board will have a great significance not only to the shareholders to whom the shares are going to be bought from but also to the remaining shareholders in the company:

i) With the remaining shareholders;[139] The shift in control is one of the major results and hence often raises concerns when a share buyback is proposed by a company, hence one would expect because of this resulting effect on shareholders' interests, an opportunity would have been given to shareholders and allow them to have a say on the decision making process of the said share buyback transaction. Therefore one cannot overlook this process and what it means to shareholders, because once the board of directors has passed on the resolution and it is satisfied that the company has met all other requirements and the company has gone ahead and bought back its shares, the shareholding percentages of the remaining shareholders in the company will change and this will affect not only minority shareholders (whose shares have been brought from) but also the remaining shareholders in the company, whose interests can be seriously affected and on the other hand improve others situation by increasing their stake in the company. Besides the shift in control, takeover can also be marked as another possible outcome of a company buying back its shares. This is because, the resulting effect of acquired shares being cancelled once in the possession of the company.[140] Therefore this can be one of the techniques which can be used to move control to the interested party especially when he or she is facing resistance from the rest of the shareholders.

[139] Those who didn't sell their shares.
[140] S 37 (9) (b) of the 2008 Act.

ii) With the outgoing shareholders; there is a room under the new Act for a coercive share buyback.[141] With the latest changes directors can just decide and pass on a resolution to force the company to buy back its own shares, whether there is a shareholders' approval or not. Even though section 48(4) of the Act provide for an agreement with a company for the acquisition by the company of the shares held by company's shareholders, nothing in this Act suggest that this is has the power to actually stop the directors from pursuing the buy back. Therefore to avoid this possibility of abuse the Act should have retained shareholders special resolution. But again this signifies the powers that the board of directors has been given by this new Act.

On the other hand if a share repurchase has been proposed and implemented by the company in a form of a scheme of arrangement,[142] this procedure could afford shareholders more protection. The Act has not given a definition of what a scheme of arrangement is hence the common law definition will suffice, which means expropriation between a company and a shareholder and not a confiscation. There has to be a give and take of enforceable rights between the two parties (the company and the shareholder).[143] Therefore when a company is repurchasing its shares there has to be an expropriation and not a confiscation of rights between the company and a shareholder. If the board of directors has passed on a resolution to the effect that a scheme of arrangement should be completed, a fair exchange should be put in place one that will not disadvantage the shareholders.

Besides the protection offered by the common law definition of a scheme of arrangement to shareholders, in order for a company to complete a scheme of arrangement they ought to retain an independent expert who must prepare a report and present it to the board identifying the type and class of holders of the company's securities affected by the proposed transaction, describing the material effects on the rights and interests of the affected holders and lastly this expert must make an evaluation looking at how the shareholders have been affected and how they should

141 Van der Linde (n 20 above) 302.
142 S 114 of the 2008 Act.
143 *Ex Parte NBSA Centre Ltd* 1987 (2) SA 783 (T) at 786 - 789. The relevant scheme must have as its object the affecting of the respective rights and obligations *inter se* of the company and its members (that is shareholders).

be fairly compensated.[144] Secondly, shareholders affected can find solace in relying on appraisal remedy afforded to shareholders.[145] In terms of this remedy, a shareholder will be assured of getting a fair value of all the shares held by him of which the company is repurchasing from him subject to the shareholder sending a notice objecting the resolution passed in favour of the scheme affecting his rights. This protection can be emphasised by the fact that the new Act has given all shares of a particular class identical preferences, rights and limitations[146] therefore if a company offers to buy shares from shareholders of the same class but at different prices, the shareholder who has been offered a lesser amount can make use of the appraisal right to force the company through the director to increase the amount so as to have the shares bought at an equal and fair price.

5.4 Conclusion

In conclusion one can say since the directors have also been required to comply and act in accordance with the memorandum of incorporation which has not been limited to include in its provisions share buyback; therefore the board of directors in executing a share buyback they ought to abide and follow what has been provided for in the memorandum, otherwise if a shareholder suffers a loss because of the fraudulent act of the board of directors in executing their duties; the shareholder will be entitled to claim the damage of the loss from him or apply to the High Court before the loss has been materialised to restrain the company or the directors from acting contrary to the Act.[147]

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[144] S 114(3) of the 2008 Act.
[145] S 164 of the 2008 Act.
[146] S 37 of the 2008 Act.
[147] S 20 of the 2008 Act.

CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

Therefore in answering the research question I posed in my introduction, that is whether the new Act has managed to provide a sufficient safe guard for companies stakeholders in the whole process of share buyback, I will conclude by saying yes an adequate protection has been extended by the new Act with its extensive provisions on share buybacks, and in particular through the solvency and liquidity test. The Act has insured that directors can be personally responsible and liable if they fail to apply the test accordingly, and in my opinion this liability has in the process created a good safe net for the share capital of the company, by insuring directors accountability at all times and in the process giving a peace of mind to creditors and shareholders and in return giving confidence to the members of the public interested in investing in companies that their interests are better managed and those liable of miss-management will certainly be brought to task.[148]

For instance in addition to the protection explained above, section 48(3) of the new Act states that; despite any provision of any law, agreement, order or the Memorandum of Incorporation of a company, the company may not acquire its own shares, and a subsidiary of a company may not acquire shares of that company, if as a result of that acquisition, there would no longer be any shares of the company in issue other than; shares held by one or more subsidiaries of the company or convertible or redeemable shares. This was taken from the old Act but re-introduced into the new Act because a subsidiary (or subsidiaries) can also acquire shares in the holding company, but the aggregate number of shares held by or on behalf of the subsidiary may not exceed 10% of the number of any class of shares and no voting rights attached to those shares held by one or more subsidiaries of the company.[149] This will help avoid instances where companies were exposed to possibility of being

[148] S 20(4) of 2008 Act. Where one or more shareholders, directors or prescribed officers of a company, or trade union representing employees of the company, may apply to the High Court for an appropriate order to restrain the company from doing anything inconsistent with this Act.

[149] S 48(2)(b). This provision brings with it an effect on the percentage shareholding of the shareholders. And I agree with Prof. Delport in the New Companies Act Manual page 37 where he raised the same concern.

controlled by their subsidiaries or a small class of shareholders after share buy backs. Again this proves a better piece of legislation in favour of protections share capital of the company.

Judging and analysing this new piece of legislation it's clear that the share buyback provisions have been improved to insure better protection of companies share capital. As part of the progress the drafters insured that directors' standard of duty and care has been raised and a lot more is expected from the board of directors.[150]

In my recommendations, I expected the new Act in order to avoid problems like cohesive share buyback decision by directors as discussed above, to retain shareholders' special resolution in share buyback. Because with shareholders resolution directors will not have the powers to forcefully call on the share buyback.

150 S 76 of 2008 Act.

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