

SECTION 48 OF THE COMPANIES ACT 71 OF 2008

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SECTION 48 OF THE COMPANIES ACT 71 OF 2008

CHAPTER 1:

INTRODUCTION

1. Introduction

With the demise of capital maintenance a new regime has come to company law, this is the time of solvency and liquidity. The following dissertation focuses particularly section 48 of Act 71 of 2008¹. This is the share buyback provision, which allows companies to acquire shares in themselves. This dissertation shall analyse the origin and development of share buyback rules in South African law, and critically analyse the manifestation of this rule in Act 71 of 2008 as it is embodied in section 48.

2. Dissertation Question

South African Company law has been rooted in the doctrine of capital maintenance which was practically borrowed from English law and simply applied. In recent years this doctrine has been seen to be outdated and in a number of jurisdictions there has been movement away from the doctrine and towards a new one of solvency and liquidity. The question this dissertation will attempt to answer is firstly, how successfully South Africa has moved away from this doctrine, and secondly how effective are the new provisions with regard to ensuring that all the interests that need to be protected are protected and finally how effective they are in executing their mandate. Therefore with these new provisions will company law be changed for the better?

3. Significance

The importance of this dissertation and indeed any study in this regard is that, while there were changes towards solvency and liquidity in the 1973 Act², these were marred with some uncertainty and some elements of capital maintenance were still being seen. Capital maintenance is rooted in common law and it is necessary to see if the legislature in this section and in the Act has succeeded in removing it from company law. As we embark on a

¹ The Companies Act 71 of 2008 was promulgated and came into effect on 1st of May 2011

² Companies Act 61 of 1973

new era it will be important to realise exactly how and when provisions apply. Company law has been changed and it is more important now for lawyers, judges and scholars to understand these changes and their importance. Therefore a critical analysis of this section is pivotal because it is necessary to bring a new awareness to companies about what they can and cannot do, and how they can do what they are allowed. Also it is necessary to comparatively study this section to make sure it is as effective as possible in what it is supposed to achieve, which is allowing companies to acquire shares in themselves.

4. Aims of study

- a. Explore the scope and application of section 48
- b. Analyse section 48 with reference to capital maintenance
- c. Analyse the effectiveness of section 48 with regard to protecting interests and achieving its aim
- d. Comparative study of the jurisdictional approach to acquisition of own shares.
- e. Give recommendations on how the section could be more effective

5. Methodology

The methodology followed in this dissertation is to; firstly, give a brief synopsis of the development of the share buy-back rule from one of prohibition in context of the capital maintenance concept, to a generally enabling provision. This is in order to provide a background and historical perspectives for section 48. Secondly an analysis of section 48 will follow, critically discussing the provisions of this section and looking at it in relation to its background and its ability to effectively accomplish what the legislature intended for it. Thirdly, a comparative study will ensue and will attempt to compare section 48 with the provisions of the United Kingdom; the reasons for this choice will be explained in chapter 5. The following chapter will involve giving recommendations on what I opine may be the way forward with this section and finally the dissertation will be concluded.

6. Literature Review

Company law is an undeniably unique part of the law. In most instances it is considered to fall under mercantile or commercial law, presumably because of the purpose which most companies have, which is a commercial endeavour. However the incorporation and regulation of companies is completely separate from its commercial purpose and this is why

company law is so unique because it strives to allow a system in which commercial purposes can be met without too much regulation but also to ensure that abuses do not take place in the name of commercial endeavour. It is quite obvious this being such a unique area of the law a lot of literature has been devoted to it and this will be seen in the books used in answering the dissertation question, it is evidence that in most modern jurisdictions a lot of attention is paid to the formation and operations of a company.

Articles are also another important source of literature that will be considered, they have the distinct advantage of their brevity, being more recent and more up to date than books. This dissertation is dealing with a new Act, and unfortunately there are not as many recent books as would be preferred and there will thus be a heavy reliance on articles. This is not to suggest that articles are less useful than books just not as in depth but given we are focusing on a particular section the brevity may be appreciated.

Case law will be used briefly but only in the discussion of the position in the 1973 Act. The 2008 Act has only recently come into force and there have obviously been decisions, therefore at this point how it will be interpreted is a mystery, and any discussion of its interpretation is simply opinion based. Case law is important in demystifying the law because once an Act has been judicially interpreted whether correctly or not it serves as an indicator for what the law is and all else becomes opinion; it is therefore rather unfortunate that there is no case law to rely on with regard to the interpretation of section 48.

Finally our most important form of literature are the Companies Acts, this refers to the 1973 and 2008 Act, and the Companies Amendment Acts, referring to the 1999 Act and the 2011 Act. These sources will be the most relied on, because it is their interpretation that is the basis of this dissertation. All other sources are just necessary in explaining how these Acts work or could work in practice. Therefore with regard to literature this is the most important form of literature that will be used in answering the dissertation question.

7. Limitations

Due to the fact that Act 71 of 2008 has only recently come into operation my study is limited in that there is no case law that can show how the judiciary will interpret this Act. Therefore the problems that may be encountered are purely speculations as of now and are yet to be

seen in practice. Another limitation is that the focus of this dissertation is only on unlisted companies and will therefore not paint the entire picture when considering acquisition of own shares, the JSE has additional requirements which will not be discussed here. However while listed companies are not the focus of this dissertation there may be rules that may be referred to from time to time for the basis of comparison. It is however safe to say whether listed or unlisted all companies will have to comply with section 48³.

8. Definitions

Share Buy-backs: when used in this dissertation refers to the acquisition by a company of its own shares and not merely to the repurchase of shares.

9. Acronyms

JSE- Johannesburg Stock Exchange

MOI-Memorandum of Incorporation

10. Chapter Outline

Chapter 2: the Capital maintenance concept

Chapter 3: Amendments to 1973 Act, the beginning of Solvency and Liquidity

Chapter 4: Section 48 and share buy-backs

Chapter 5: Comparative study of Section 48 and similar provisions in other jurisdictions

Chapter 6: Conclusion

³ Act 71 of 2008

CHAPTER 2

THE CAPITAL MAINTENANCE DOCTRINE

1. Introduction

As capital maintenance is not really the focus of this dissertation this is only a brief background, to serve to explain the history of share buy-backs. This is only a brief explanatory note of the capital maintenance doctrine in order to understand the background, in which section 48 is set.

2. The Capital maintenance Doctrine

The classical concept has got nothing to do with ensuring that a company has adequate capital to meet the claims of its creditors⁴ (as is popularly believed). All that this concept attempts to do is to ensure that the issued share capital of a company is maintained and not returned to shareholders for the duration or lifespan of the company⁵. The rule merely restricts the freedom of a company to return to shareholders funds which were originally subscribed for shares⁶. The basis of this concept is that the issued share capital of a company is seen as a guarantee fund, or a permanent fund intended for the protection of creditors that each creditor is entitled to look to⁷.

It is a fiction that creditors deal with a company on the basis of its issued share capital⁸ and in fact very few creditors would use the company's share capital as an indication of credit worthiness⁹. There are many companies with small issued share capitals but huge assets and in essence for this to be a safeguard share capital must be adequate¹⁰. In reality many companies start out with more external funding than share capital and how does one ensure in the lifespan of a company, with inflation and external equity that at any given time share capital will be adequate. The simple fact is you cannot control the adequacy of share capital in relation to creditors claim so this as a safeguard is a failure.

⁴ (2005) *SALJ* 283 at 285

⁵ (2005) *SALJ* 283 at 285

⁶ (2005) *SALJ* 283 at 285

⁷ (2005) *SALJ* 283 at 285

⁸ (2005) *SALJ* 283 at 285

⁹ (2005) *SALJ* 283 at 285

¹⁰ (2005) *SALJ* 283 at 285

However despite the limitations of this doctrine a number of important sub-rules have flowed from it¹¹ and they still exist in company law, albeit somewhat differently. In general there are four categories of such rules aimed at protecting creditors; the first is the rules with regard to the raising of capital; the rule that dividends may not be paid out of capital; thirdly the rule that a company may not purchase its own shares; and fourthly, the prohibition against a company giving financial assistance for the purchase of or subscription of its own shares¹².

The focus of this dissertation is the development of rule laid down in *Trevor v Whitworth*¹³, that a company may not purchase its own shares. It was provided in this case a prohibition but the rule has developed in such a way that a completely different variation of it now exists in section 48 (an enabling provision)¹⁴.

3. Trevor v Whitworth

The approach followed by the courts which was strengthened by statutory provisions, was that the contributed capital of a company constitutes the fund to which creditors of the company must look for the satisfaction of their claims, and this fund should be maintained¹⁵

In this case Lord Watson said¹⁶

'The Company had purchased, prior to the date of liquidation, no less than 4 142 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 of their ceasing to be so. I am quite unable to see how this expenditure was incurred in respect of or as incidental to any of the objects specified in the memorandum. And, if not, I have difficulty in seeing how it can be justified. If the claim under consideration can be supported, the result would seem to be this, the whole of the of the shareholders, with 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.'

¹¹ (2005) *SALJ* 283 at 285

¹² (2005) *SALJ* 283 at 285

¹³ (1887) LR 12 App Case 409 (HL)

¹⁴ Act 71 of 2008

¹⁵ Cilliers et al 322

¹⁶ Cilliers et al 322

Cilliers et al, provide that this rule did not develop as an independent rule, but rather as an extension of the *ultra vires* rule¹⁷. I agree with this because it is clear from the passage that what rendered the company's actions untenable was that they could not be justified in their memorandum and thus acted outside of their capacity hence *ultra vires*. This rule was strengthened through the provisions of the 1973 Companies Act, which provided for a clear prohibition. There is a clear reason for the paradigm shift in company law, capital maintenance rules are unnecessarily complex and riddled with obscurity and many have outlived their usefulness¹⁸. This is seen from the fact that the judgement given in the Whitworth case something which in my mind may have been cleared by an enabling provision in a memorandum created an entirely separate prohibition with different consequences which evidences the piecemeal way such provisions came to be.

4. Conclusion

It is necessary to understand the capital maintenance doctrine, even if only briefly because section 48 did not stem from nothing. Sub-rules that flowed from this doctrine its eventual dismissal are events that have led to the existence of Section 48.

¹⁷ Cilliers et al 322 footnote 2

¹⁸ (2005) *SALJ* 283 at 284

CHAPTER 3:

AMENDMENTS TO 1973 ACT: BEGINNING OF SOLVENCY AND LIQUIDITY

1. Introduction

A company's ability to acquire its own shares is not a new concept and any discussion would be incomplete without a considering of the sections that preceded section 48. The Companies Amendment Act¹⁹ brought about massive changes to the 1973 Companies Act and particular attention will be paid to the criticisms of these changes and their application in order to determine if section 48 tackled these issues.

2. Amendments to the Companies Act 1973

One of the objects of the amending legislation was to make South African companies more internationally competitive, there was thus a need for them to be in harmony with modern trends in other jurisdictions²⁰. Therefore sections 85-90 were aptly amended to allow for the acquisition of shares issued by a company. The intention was to allow a company to purchase its own shares but with adequate safeguards for creditors and shareholders²¹. So when considering the amendments focus is on whether companies which intended to use them were likely to be satisfied and the adequacy of the safeguards²².

Section 85 is the enabling provision and it in brief allows a company, to acquire shares it has issued, after approval by way of special resolution subject to authorization for such acquisitions in its articles²³. The approval by special resolution may be general or specific; if general it is only valid until the next annual general meeting²⁴. A company may not make a payment to acquire shares if there are reasonable grounds to believe that the company would after the payment be unable to pay its debts as they become due in the ordinary course of business or the consolidated assets of the company fairly valued would be after payment less than the consolidated liabilities of the company²⁵. It provides that shares acquired under this

¹⁹ 37 of 1999

²⁰ (1999) *SALJ* 760 at 760

²¹ (1999) *SALJ* 760 at 760

²² (1999) *SALJ* 760 at 761

²³ Section 85(1)

²⁴ Section 85 (2)

²⁵ Solvency and liquidity test section 85(4)

section shall be cancelled as issued shares and restored to the status of authorized shares²⁶. And finally shares may not be acquired under this section if the result is that all the remaining issued shares will either be convertible or redeemable shares²⁷.

The above are the enabling provisions summarised and it is now necessary to dissect the section. The use of the word acquire rather than simply purchase is telling, it is not defined in the Act but one can assume it is meant to intend for something wider than a mere purchase of the shares of a company²⁸. A subscription would include both a purchase and a subscription for the shares of a company²⁹. An acquisition may include a purchase of shares otherwise than for cash³⁰. Which begs the question what can such an acquisition entail, does it include a transmission that may occur at the death of a shareholder, this can only be determined by judicial interpretation of the term.

3. Protection of Shareholders

A share repurchase may appear artificially similar to a dividend payment in that both entail the transfer of money for the benefit of shareholders in their capacity as shareholders³¹. However it is necessary to focus on the fact that these similarities are only artificial and the consequences of either may differ greatly. A share repurchase entails a change in the ownership of the company's shares and, and unlike a dividend payment may be used to change control of a company, or for that matter prevent the change of control³². A share repurchase can also be used to manipulate the market price of the company's shares³³ and have a greater potential for unequal treatment of shareholders. This power may be abused and unless safeguards are provided, enable one group of shareholders to obtain an advantage over another group³⁴. Therefore it is clear the protection of shareholders in this context must be regarded to be as important as that of creditors.

²⁶ A company cannot hold shares in itself; this is the rationale behind this provision.

²⁷ Section 85(9)

²⁸ (1999) *SALJ* 760 at 763

²⁹ (1999) *SALJ* 760 at 763

³⁰ (1999) *SALJ* 760 at 763

³¹ (2005) *SALJ* 283 at 287

³² (2005) *SALJ* 283 at 287

³³ (2005) *SALJ* 283 at 287

³⁴ (2005) *SALJ* 283 at 288

Still focussing on section 85(1) it is clear that measures have been taken to ensure that shareholders are offered some protection by involvement. Not only is it necessary for a company's articles to provide for this which means companies which were already in existence when this amendment came into force were required to amend their articles to provide for this which had to be done by special resolution. It is also necessary for shareholders to pass a special resolution which may be either specific or general, to approve an acquisition of shares. There is no mention of ratification which implies such approval is necessary before the acquisition is made.

The procedure for share buy-backs as provided for in section 87 is regarded to be of fundamental importance in preventing abuse³⁵, this is especially important in view of the fact that section 85(1) provides for general approval by way of special resolution. This section does this by ensuring that shareholders of the same class are offered the same opportunity, equal treatment is its basis³⁶. Two procedures are provided for, the first being a tender offer coupled with an offering circular, and it allows for an offer to acquire unlisted shares from all registered shareholders³⁷. The second deals with listed shares which are outside the scope of this dissertation. Basically it ensures that the offer is made to every shareholder and they are at the very least aware of such an offer due to the notification process.

When this section was initially added into the Companies Act in 1999 it provided in section 87(2) (a) that an offering circular was not necessary in terms of a general approval³⁸. This was a situation obviously open to the very abuse trying to be avoided and the position was changed by the Companies Amendment Act³⁹. This rectified a potential problem and thankfully the legislature was quick enough to see the mistake.

These sections are however, not without reproach and there are valid criticisms against them. Two considerations arise; are the protection measures adequate to ensure there will be no selective repurchases at the detriment of other shareholders and secondly, is a special resolution or an offering circular always necessary?

³⁵ (2005) *SALJ* 283 at 290

³⁶ (2005) *SALJ* 283 at 290

³⁷ (2005) *SALJ* 283 at 290

³⁸ (2002) *JBL* 27 at 28

³⁹ 35 of 2001

One criticism against this section is its failure to distinguish between different types of share repurchases. A comparison with JSE Listing ruled shows that there are 2 types of share repurchases provided for, specific and general repurchases⁴⁰. Specific repurchases are divided into those from named shareholders and those on a pro rata basis⁴¹. In the JSE an offering circular is only necessary for a pro rata offer for shares⁴². This provides companies with general power to repurchase shares on the open market without the need for the offering circular⁴³. An example where it may not be necessary for an offering circular is again in case of an employee share scheme where an employee leaves the company, this general power would allow for a less cumbersome and inexpensive repurchase. This section makes it clear that there is more flexibility for share repurchases for listed companies and unlisted ones are more burdened.

The same criticism applies for the need for a special resolution. The same example of an employee share scheme is used, or even the death of a member. Should it really be necessary to go through the entire process where it is clear that the chances for abuse are minimal? The only other alternative would be in the case of a general approval and in this case an offering circular to all shareholders will be necessary which would be costly. In such instances an ordinary resolution should suffice because the dangers of abuse are not so pronounced⁴⁴.

It would seem in an effort to protect shareholders in the 2001 amendment the legislature took away from companies a very valid and convenient power. This may not have been the intention but it was certainly the result.

4. Protection of Creditors

Section 85(4) (a) and (b) contain the core of the statutory provisions of share buy-backs. The section discards the archaic capital maintenance doctrine and substitutes it for the pivotal twin tests of insolvency and illiquidity, which are designed to protect creditors by ensuring an insolvent or illiquid⁴⁵ company does not repurchase its shares⁴⁶.

⁴⁰ (2002) *JBL* 27 at 28

⁴¹ (2002) *JBL* 27 at 28

⁴² (2002) *JBL* 27 at 28

⁴³ (2002) *JBL* 27 at 28

⁴⁴ (1999) *SALJ* 760 at 767

⁴⁵ This refers to both commercial and factual insolvency.

⁴⁶ (2005) *SALJ* 283 at 288

Section 85(4) provides:

‘A company shall not make any payment in whatever form to acquire any share issued by the company if there are reasonable grounds for believing that-

- a. The company is, or would after the payment be, unable to pay its debts as they become due in the ordinary course of business; or*
- b. The consolidated assets of the company fairly valued would after the payment be less than the consolidated liabilities of the company.’*

Section 85(4) (a) determines whether a company is solvent in the equity sense, which is known as the liquidity sense, which refers to an inability of the debtor to repay his debts as they become mature⁴⁷. Sub-section (b) refers to what is known as the *balance sheet* test or the *solvency* test, and it defines insolvency in the bankruptcy test of liabilities exceeding assets⁴⁸.

The wording of this section is implicit that both these tests are objective in fact it can be regarded as a three part objective test⁴⁹. Its objectivity lies in the fact that the directors are required to have reasonable grounds for believing that a state of affairs which will allow a repurchase exists. Therefore it is not enough to believe in said state of affairs but there must be a reasonable basis for such belief which is what makes the test objective. It is a three part test in that one must first enquire that there were reasonable grounds and only when this is positive will an enquiry into the solvency and liquidity be necessary⁵⁰.

The object of section 85(4) is a careful review of the financial position of the company before they resolve to purchase the shares of the company⁵¹. Whether this is achieved can only be seen in what possible liability a director may incur upon the failure to make such careful review and this will be discussed later.

In *Capitex v Qorus Holdings*⁵² the significance of section 85(4) is clarified, the following quote taken out of the case must be considered:

‘It follows that, in view of the provisions of sub-section 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

⁴⁷ (2005) *SALJ* 283 at 288

⁴⁸ (2005) *SALJ* 283 at 288

⁴⁹ (2001) *SA Merc LJ* 121 at 123

⁵⁰ (2001) *SA Merc LJ* 121 at 123

⁵¹ (1999) *SALJ* 760 at 766

⁵² *Capitex Bank LTD v Qorus Holdings LTD and Others* 2003 (3) SA 302 (W)

*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 an illegality. Nor does s 87 which deals with the procedure to be followed by a company in connection with the acquisition of its own shares affect the legality of the principal agreement or agreement of sale on which the plaintiff relies. Compliance with s 87(1) does not form part of the plaintiff's cause of action.*⁵³

The profoundness of this finding cannot be understated because it makes it clear that the illegality/invalidity of a share buy-back transaction will lie in a contravention of section 85(4) and this refers to payment. Therefore only payment made in contravention of this section would be illegal and not necessarily the agreement itself. What is important as is seen elsewhere, in the case is that section 85(1) has effectively abolished one of the sub-rules of capital maintenance and therefore their cannot be a prima facie finding that an agreement is illegal and this must be raised by the parties claiming section 85(1) or 87 were not complied with. Therefore illegality in this situation would arise in the contravention of section 85(4) and this reaffirms the direction of the law towards solvency and liquidity and the intention to move away from capital maintenance.

Unfortunately the above case did not contain an in depth discussion of the application of the tests as it was not required to do so, and even more unfortunate is the lack of expansive case law on this subject given that the amendments have been in force for about a decade.

A major criticism of the wording of section 85(4) is that it suggests strongly that the company must be liquid and solvent both at the time when the contract is entered into and at the time of payment for the acquisition of the shares, and that after the payment the company should be able to pay its debts as they become due in the ordinary course of business and that its assets exceed its liabilities⁵⁴. This is a position which can practically be a problematic because a company could enter into an agreement and not comply with section 85(4) but at the time when payment is made it may comply with this section. Such difficulties could have been solved judicially but this is yet to be seen.

Another difficulty is the period for which a company must remain solvent and liquid after payment, there is no prescribed period and therefore it brings about the question can liability

⁵³ Supra at pg 309 par 10

⁵⁴ (1999) *SALJ* 760 at 763

based on this section be relied on infinitely. In some common law jurisdictions the period is prescribed and this is an important safeguard that is also seen in the JSE's listing requirements⁵⁵. Another important omission is the price at which shares can be acquired where in the JSE there are limitations there was no mention of this in the amendment and the directors fiduciary duties must be relied upon in this instance⁵⁶. The only question is for a creditor will this be enough, a director only has fiduciary duties towards the company and not third parties, so if a creditor feels the price was unjustified do they have grounds for a complaint? This is discussed in the liability of directors below.

5. Liability of Directors and Shareholders

Section 86 of the Companies Act of 1973 provides for the liability of directors. To begin with it is important to note that liability in terms of this section hinges on a contravention of section 85(4)⁵⁷, this enunciates the importance of solvency and liquidity; and directors are jointly and severally liable to the company for any such payments^{58,59}. This includes directors of a holding company⁶⁰, however no mention is made of persons who had been directors at the time but are no longer directors.

The abovementioned liable director may apply to the court for an order compelling a shareholder or former shareholder to pay to the company any money paid in contravention of section 85(4)⁶¹. Creditors and shareholders are also empowered by this section and this refers to any creditor who was a creditor at the time of the acquisition, to apply to a court for an order: compelling a shareholder or former shareholder to pay the company any money or consideration given to them; compelling the company to issue equivalent number of shares to shareholder or former shareholder or any order it thinks fit⁶². Therefore it is clear that a shareholder or a creditor does have a claim in terms of this section if there is a contravention of section 85(4). However, in such a case only a shareholder or former shareholder can have a claim instituted against them, and maybe the company in joinder but not for actual payments and this puts *bona fide* shareholders at a disadvantage,

⁵⁵ (2005) SALJ 283 at 289

⁵⁶ (1999) SALJ 760 at 763

⁵⁷ Section 86(1) and this refers to a payment made by a company that is insolvent and illiquid.

⁵⁸ This also enunciates the company law principle that a director has fiduciary duties towards the company

⁵⁹ Section 86(1)

⁶⁰ Section 86(6)

⁶¹ Section 86(2)

⁶² Section 86(3)

This section on liability is criticised on three fronts, the first being; director liability. Firstly, there is no mention of former directors who were directors when the acquisition took place; it seems unfair to exclude them as they played the same role as the other persons who remained directors, but 86(6) is clear on the meaning of directors for this section. Secondly, the reference is only to directors, there is no differentiation amongst those who voted for the wrongful payment and those who did not, and again it is unfair to include a person that was clearly opposed to the repurchase⁶³.

Secondly, is the issue of shareholder liability; there is no mention of the *bona fides* or innocence of shareholders. This seems to impose some sort of absolute liability in that once you have received such consideration it must be returned regardless of your ignorance of the contravention⁶⁴. While I understand it is necessary for the company to recover the money it seems unfair to punish innocent shareholders for directors mistakes. Directors should not carelessly make a decision to repurchase shares with the comfort that if they do, they, a creditor or another shareholder, can get a court order compelling such innocent shareholder to return the consideration. The absolute liability of shareholders slightly dampens the faith that we can expect directors to reasonably make a decision or that the fear of liability will force them to do so.

Thirdly, the liability in terms of this section is strictly limited to contraventions of section 85(4). The lack of price regulation as we see in the JSE has already been mentioned above. This opens up a company to a greenmail situation. Greenmail as I understand it is a form of corporate blackmail, where a person in exchange for not taking over the company forces the company to repurchase its shares at exorbitant prices. This is possible in this case, as the directors will make a decision to buy these shares at an unjustifiable price but cannot be held liable in terms of this section. While this section does not limit or diminish liability in terms of any other section or any other Act, it will be difficult to find such relief elsewhere. Simply put when you allow a company to repurchase shares you have to provide extra measures that will prevent corporate blackmail or even a situation where directors thwart a takeover simply because it does not favour them. Solvency and liquidity is not enough and as fiduciary duties

⁶³ (2005) *SALJ* 283 at 289

⁶⁴ (2005) *SALJ* 283 at 289

are not extended to shareholders or creditors, this is dangerous arsenal to provide without proper regulation.

6. Enforceability of Contracts

A contract with a company providing for the acquisition of shares issued by it is enforceable against the company, except if the company cannot execute the contract without being in breach of section 85(4)⁶⁵. Again the importance of section 85(4) is made clear in this section, solvency and liquidity of a company is what hinges together any proposed share repurchase. A company will have the burden of proving that compliance with a contract will contravene section 85(4)⁶⁶. Until the company has fully performed its obligations in terms of a contract, a shareholder who disposes of their shares retain the status of claimants entitled to be paid out as the company is legally able to do so or, on liquidation be ranked below creditors and shareholders whose claims are in priority to the claim of the class of shares disposed of to the company, but in priority to the claims of other shareholders⁶⁷. It is clear that even though payment is not fully made a shareholder is not automatically turned into a creditor even if they are technically in the relationship of creditor debtor with the company. This was probably wise as not to disadvantage creditors and preferential shareholders who would be forced to share with such shareholders on liquidation if such a provision had not been made.

7. Acquisition of Shares by a Subsidiary Company

While a purchase of shares by a subsidiary does not strictly fall within the definition of a share buy-back as envisioned in this dissertation this is discussed for the following purposes: Section 48 is the main element of our topic and in it provides for acquisitions by subsidiaries so this is discussed in order to enable a comparison. Secondly, sections 85-88 apply to such acquisitions as well. Thirdly, it cannot be doubted that the element of control is important in company law so it is necessary to understand how such control can be shifted either directly or indirectly.

⁶⁵ Section 88(1)

⁶⁶ Section 88(3)

⁶⁷ Section 88(3)

Section 89 provides that:

-Subsidiary companies may mutatis mutandis in accordance with sections 85, 86, 87 and 88 acquire shares in their holding company to a maximum of 10 per cent in the aggregate of the number of issued shares of the holding company: Provided that this section shall not apply to the acquisition of shares by a holding company in a subsidiary of itself.

Prior to the amendment of the 1973 Act, the purchase of shares by a subsidiary in its holding companies was prohibited by section 39. Such prohibition and the reasons for it were clearly explained in *The Unisec Group Ltd and Others v Sage Holdings Ltd*⁶⁸.

The court begins by giving an example of the purchase of shares in a holding company by a wholly owned subsidiary. From the simplified example the court concludes that such does not amount as an investment by a subsidiary in a holding company but as an investment by a holding company in itself⁶⁹. Like taking money from one pocket to put it into another, it doesn't change the amount of money you have just where you put the money. This was described as dividend round tripping where dividends paid to the subsidiary will be returned to the holding company and back to the shareholders of the holding company creating an illusion that they had made more profit than they actually had. From this example the court provides the extract below:

'The possibility of evil and mischief which lurks in the above catalogue is manifest. Although in this example a wholly-owned subsidiary is posited, exactly the same mischief results in the case of a partially owned subsidiary, only to a lesser degree, which will be commensurate with the percentage of its shares owned by H Co. The principle remains the same. The mischief which, in the absence of statutory control, may flow from the H Co/S Co arrangement can be succinctly stated as:

- a. The trafficking by a company in its own shares.*
- b. The reduction of its capital, not by a special resolution of the members, but by executive action of its directors.*
- c. The sterilisation of funds which are available to it for capital investment.*
- d. The entrenchment of the directors' control of H Co.*
- e. The misleading picture presented by the final accounts of H Co which might very well be a gross distortion of the truth without being, technically, inaccurate*⁷⁰.

⁶⁸ 1986 (3) SA 259 (T)

⁶⁹ *The Unisec Group Ltd v Sage Holdings Ltd* pg. 265-267

⁷⁰ Page 267 par G-I

This prohibition as illustrated above was aimed at excluding the indirect purchase (or speculation in) by a holding company of its own shares⁷¹. Therefore when it was no longer disallowed for one to buy its own shares it became irrelevant to continue to prohibit the purchase by subsidiary. With the amendment of section 89 allowing subsidiary companies to purchase shares in holding companies, it was necessary to also amend section 39 and the amended section provided:

'Save as is provided in subsection (2) if shares are acquired in accordance with section 89 by its subsidiary, for as long as shares are held by the subsidiary-

- a. no voting rights attaching to such shares may be exercised; and*
- b. the percentage of votes able to cast at any meeting of the shareholders shall be reduced by the number of shares held by the subsidiary.∅*

This amendment was aimed at curbing the abuse of control envisioned in the *Unisec* case, however it did so ineloquently⁷². The wording itself was not well thought out but the intention is clear, how one is supposed to reduce the percentage of votes by the number of shares held by the subsidiary is unclear. Of course what was intended was that the total number of votes that could be exercised be reduced by the number of those held by the subsidiary but from the wording this is not clear⁷³.

Weiner⁷⁴ further argues that the wording of this section could have led to unintended circumstances. He gives an example where S owns 20% of the shares in H, thereafter H acquires 100% of S's shares and S becomes a subsidiary⁷⁵. Therefore in this case S did not acquire those shares in accordance with section 89 and the voting neutralisation proviso seems intricately linked with an acquisition in accordance with section 89⁷⁶. This could lead to the unintended consequence that such shares could still carry votes. The wording of Section 89 is further criticised by Weiner⁷⁷, this section refers to acquisition and not actual holding. Therefore if for some reason a subsidiary already has shares in a holding company e.g. acquired them before it became a subsidiary, it should still be able to acquire a further 10% of the shares in its holding company⁷⁸. This is because this section limits the amount one

⁷¹ (2001) *S.A Merc L.J* 121 at 124

⁷² (2001) *S.A Merc L.J* 121 at 124

⁷³ (2001) *S.A Merc L.J* 121 at 124

⁷⁴ (2001) *SALJ* 133

⁷⁵ (2001) *SALJ* 133 at 136

⁷⁶ (2001) *SALJ* 133 at 136

⁷⁷ (2001) *SALJ* 133

⁷⁸ (2001) *SALJ* 133 at 137

can acquire in terms of it only and not the amount one can hold, this was obviously not the intention of the legislature but it is the result.

What was most worrying about the amendments to these sections was that the financial aspects of such a transaction were not catered for. Section 39 in its amended form did nothing to prevent the dividend round tripping that was envisioned in the *Unisec* case in fact there is no indication that such an outcome was even considered and overlooking it created a lacuna whereby abuse was still possible.

8. Conclusion

This chapter concludes the background to section 48, as explained in the introduction it was necessary to first discuss the provisions that were the predecessors to section 48. Such a discussion enables an identification of the limitations of the predecessors and possibly be able to critically evaluate section 48 given this background.

CHAPTER 4

SECTION 48 OF ACT 71 OF 2008

1. Introduction

Repurchases of shares are tripartite in nature, they comprise a distribution of assets (with the attendant risk of asset stripping and debt avoidance), a reorganisation in ownership (with the risk of unfair and discriminatory treatment of shareholders), and a transfer of shares (which may lead to insider trading and market manipulation)⁷⁹. When you think of a repurchase in this light it is easy to see that a discussion of Section 48, can also involve a discussion on distributions, take-overs, insider trading and most importantly solvency and liquidity.

2. Provisions of Section 48

From the moment the Companies Act was completed until it came into operation this section and some of those related to it have gone through some form of metamorphosis, such changes are some of the reasons why the Act took three years to come into operation. A great deal of the material may deal with an earlier version of the legislation and some of the criticisms may have been addressed, but all these nuances will be explained. The provisions of section 48 will be discussed individually below with particular consideration being given to their effect.

2.1. Exclusions in Section 48

To follow the same structure employed in the Act the exclusions to this section will first be discussed. Section 48 (1) (a) provides that any obligation by a company to acquire a shares in terms of a shareholders appraisal right is excluded from this section. A discussion of section 164 is outside the scope of this dissertation, however, it is submitted that this exclusion is warranted. A shareholders appraisal right is a right that is accrued to the shareholder, while an acquisition in terms of section 48 is premised by a decision of the company. With these concepts clarified it would be illogical to afford shareholders a right against the company and in the same breath make the realisation of that right subject to a decision of the company. Such a principle is sound in law as is seen in the common law principle that one cannot be a judge in their own case and this exclusion is necessary to ensure that the appraisal right in the Act can be properly and fully utilised by aggrieved shareholders.

⁷⁹ (2009) *S.A Merc. L.J* 33 at 44

The second exclusion provides that the redemption of redeemable securities is excluded from this section. In theory this is rational exclusion because tying the redemption of a class of shares deemed to be redeemable to a decision by the company limits the advantage of acquiring such a share. The only limitations to the redemption of such shares are those that are provided in the terms and conditions in the issue of such shares and further requirements constitute an imposition that defeats the point of such shares. The 1973 Act recognised the possible effect to share capital of redeemable preference shares, therefore distributions of this type were regulated as specific exceptions to the capital maintenance rule⁸⁰; payments for the redemption of shares were to be made only out of distributive profits and from the proceeds of a further issue of shares⁸¹. While this falls outside the scope of this discussion it becomes unclear what the effect of a redeemable preference share will be to the issued share capital in the new company law regime. Given this lacuna its exclusion only theoretically provides that the issued capital of a company will not be affected, however practically speaking it is very doubtful that this will be the case. On the other hand section 37(5) (b)⁸² provides for redeemable shares subject to the requirements of section 48. However, section 48 provides that redemption of these shares is excluded from its ambit. This brings about confusion because it is not clear if it is possible for redeemable preference shares to exist, given their existence is subject to a section that excludes them. This is an idiosyncrasy, which may lead to unwarranted results. However another way of interpreting this confusion would be that the existence of these shares is only subject to the requirements of section 48(1) (b) and not the whole of section 48. The relevance of this for this dissertation is with regard to issued capital, there is no clear guide as to how this will be affected by redemption not provided for in section 48 or any other clear guidelines.

2.2. Empowering provisions

Section 48(2) (a) empowers the company to acquire its own shares subject to section 46 (the distribution section) and sub-sections 3 and 8. While the section is straightforward, a slight problem arises with the actual wording with specific reference to the use of the word acquire. Acquire in its ordinary meaning is defined⁸³ as :to gain possession of; on the other hand purchase is defined⁸⁴ as :to obtain in exchange for money or its equivalent; buy; I take issue

⁸⁰(2009) *TSAR* 484 at 484

⁸¹(2009) *TSAR* 484 at 485

⁸² Of Act 71 of 2008

⁸³ The concise Oxford English Dictionary

with the use of the word acquire because it refers to something broader than purchasing, one can gain possession of a thing in any number of ways; the term therefore must be understood to include any instance where a shareholder relinquishes rights in respect of a share to the company, whether for consideration or not⁸⁵. To put this in perspective if a shareholder for some reason decided to donate their shares to the company, the company will in this instance acquire the shares in that they will have taken possession of them. This will lead to a problem particularly with regard to the considerations that must be taken before a company can acquire its own shares, these will be discussed in more detail below, but suffice it to say a company may have to be both liquid and solvent to accept a donation of shares in my opinion the purpose of this section will be better served if the acquisition was limited to one for valuable consideration (a purchase) therefore preventing the need to follow procedures in every instance.

The above criticisms aside the section is commended because it simplified a particularly cumbersome process by limiting the need of approval to that of a board resolution⁸⁶. This is discussed in light with the objections to section 87(2) in the 1973 Act, whereby no general power to reacquire was conferred on the company, the shortfall of this was discussed above. This provides that the process of repurchase especially in the instance where only a few shares are involved will not be as expensive and as cumbersome as in the previous regime. This is especially helpful with regard to the examples provided for in chapter 3.

Section 48(2) (a) has to be read with section 35(5) (b)⁸⁷ which provides that the legal nature of shares issued by a company and then subsequently reacquired by the company have the same status as shares that have been authorised but not issued by the company. This is deemed necessary because one cannot hold rights in itself however a discussion of treasury shares below will show its limitations.

Section 48 (2) (b) empowers a subsidiary company to acquire shares in its holding company provided that not more than 10% in aggregate of the number of issued shares of any class of shares may be held for the benefit of all the subsidiaries of the company together, and no voting rights will be attached to the shares will be exercised while they are held by a

⁸⁴ The concise Oxford English Dictionary

⁸⁵ (2009) *TSAR* 484 at 488

⁸⁶ Of course subject to section 46, section 48(3) and 48(8) of Act 71 of 2008

⁸⁷ Act 71 of 2008

subsidiary which remains a subsidiary. This section unfortunately does not materially differ from the amendments in the 1973 Act and the problems envisioned in that Act will apply here.

These difficulties will be explained again, firstly, with regard to pre-existing holding: e.g. if company X held 30% of shares in company H, and thereafter company H acquired all the shares in company X; it would mean that X holds 30% of shares in H but these were not acquired as a subsidiary however the 10% limit will still apply, because the shares are held by a subsidiary⁸⁸. No provision has been made for the subsidiary to dispose of these shares and as soon as it becomes a subsidiary it will be in contravention of this section unwillingly.

Secondly, the neutralisation of voting rights dealt with in this section is not articulate enough. The wording implies only those shares held by the subsidiary in a holding company that were acquired when it was a subsidiary are neutralised. If the aim was to prevent abuse by the holding company, this will not be prevented in the case of pre-existing shares because they will not have been acquired by a subsidiary. One can envision a situation where X holds 10% in Y, Y then buys all the shares in X and given that X holds only 10% it will not be in contravention of section 48(2) (b) (i) and the neutralisation section will not apply as they were not acquired by a subsidiary, therefore the voting rights can still be exercised. It is submitted this could not have been the intention of the legislature as these shares will be open to abuse by the holding company. Furthermore the financial aspects of subsidiaries being allowed to purchase shares from holding companies as discussed in the *Unisec* case above have not been addressed. The only limitation to an acquisition is the participation in voting meaning a subsidiary will still be entitled to dividends and the risks in relation to this as discussed still exist. It is difficult to see how putting a limit of 10% prevents this, at best it mitigates it but it cannot prevent this.

The saving grace in the 2008 Act is that it managed to deal with the problem that caused by the ineloquently worded section 39 of the 1973 Act⁸⁹ whereby; it was not clear how the total percentage of voting shares will be affected. In this case section 64 (a) which provides for quorum at a meeting, thwarts all problems created in the previous section 39. In fact quorum will only be met if 25% of all voting rights entitled to be exercised at the meeting are present. Section 48(2)(b)(ii) makes it very clear that a subsidiary is not entitled to exercise voting

⁸⁸ (2009) *SALJ* 806 at 823

⁸⁹ Act 71 of 2008

rights, therefore they will not even be included in the consideration of the quorum and thus there can be no question as to how the total voting percentage is to be reduced.

2.3. Limitations to acquisitions

Sections 48(3) and (8) put limitations to a company's ability to acquire its own shares; these subsections must be complied with in order for a share repurchase to be valid in terms of section 48.

In the first instance section 48(3) provides that despite any other instrument (law, order etc.) a company cannot acquire its own shares if the only remaining shares will be those held by one or more subsidiary or convertible or redeemable shares. Firstly, it is submitted the reasoning behind section 48(3)(a) is necessary to avoid a situation whereby a company buys all the other shares and the only remaining shares are those held by a subsidiary which it controls. In essence the company will be in a position whereby it could have full control in itself as it controls the subsidiary. The other limitation is also necessary in that if the only shares left were convertible or redeemable. For convertible shares they could be converted into redeemable shares and in future redeemed, and for redeemable shares they could simply be redeemed. Therefore if no other shares existed this would lead to a situation where a company can reacquire or redeem all the shares it issued and have no issued share capital, essentially changing its structure.

While the reasoning behind the section is unassailable the wording is faulty. The use of the words or between subsections (a) and (b) of section 48(3) will in my opinion lead to undesired result. This wording does not provide for a situation whereby, the only remaining shares will be those held by subsidiaries and convertible or redeemable shares. The wording suggests that a contravention only arises if only shares held by a subsidiary remain or only convertible or redeemable shares remain, but not if both remain. It would seem that if both of these shares were present there would be no contravention; however the problems that have been discussed above with regard to control would still exist. It is submitted that a further subsection should have been included providing for a situation where this exception will apply if the only remaining shares are both of those envisioned in subsection 48(3) (a) and (b).

Section 48(8) was initially not in the Act and was only included through amendment before the Act became operational. This section will be discussed under shareholder protection, because that is essentially what it aims to do.

3. Distribution

Section 46 of the 2008 Act regulates distributions made by the company. This section is an example of the legislature's attempt to simplify a previously cumbersome process. The 1973 Act regulated 4 types of payments which were essentially distributions⁹⁰ and different financial restrictions applied to each of these payments. In an aim to ensure that all distributions are regulated by a single section a comprehensive definition for distributions was provided in section 1 of the 2008 Act. It is not necessary to fully discuss the definition of a distribution, suffice it to say the following are within the definition;

- a. Consideration for shares acquired by a company as contemplated in section 48.
- b. Consideration for the acquisition, by any company within a group of companies of any shares of another company in the same group.

Therefore the conduct of paying for consideration for shares acquired by a company, or of a subsidiary purchasing shares in its holding company will amount to a distribution regulated by section 46.

The requirements for a distribution are broadly:

- a. Board authorisation
- b. Financial restrictions (compliance with solvency and liquidity test)
- c. Declaration of solvency and liquidity

These will be discussed individually below.

3.1. Board authorisation

In terms of section 46(1) (a) (ii) a company cannot make a proposed distribution unless the board of the company has authorised the distribution by a resolution (this also refers to the board of a subsidiary company). A distribution is also possible without board authorisation if it is pursuant to an existing legal obligation of the company and a court order. The MOI can

⁹⁰ (2009) *TSAR* 484 at 484. The four types of distribution are

- Payments to shareholders for acquisition of their shares;
- Payments to shareholders on redemption of their shares;
- Payments to shareholders as interest on their shares; and
- Payments to shareholders by reason of their shareholding.

impose any other requirements but in principal these are the only requirements with regard to authorisation. It would appear that this authorisation can take place any time before the distribution is made.

The confusing element is that section 48 requires that a decision to acquire shares should be subject to the requirements for a distribution; however, two of those requirements are decisions in themselves (board authorisation and acknowledgement)⁹¹. The difficulty that arises is the question how a decision can satisfy another decision⁹². It is thus unclear whether a separate decision is envisaged or the reference is to the decision to be taken in section 46⁹³.

3.2. Financial restrictions

This refers to the financial position of the company as there must be a reasonable appearance that the company will satisfy the solvency and liquidity test after (it is important to note the timing) the proposed distribution⁹⁴.

Given solvency and liquidity are the cornerstones of the new regime the test provided in terms of section 4⁹⁵ must be comprehensive. Section 4 provides for a solvency and liquidity which differs from the previous regime which provided for an insolvency and illiquidity, giving directors a negative rather than positive duty, this Act has gone a step further and been proactive in giving a positive duty⁹⁶.

3.2.1. The solvency test

The solvency test entails that the assets of a company should exceed or equal its liabilities after the distribution has been taken into account, thus distributions must only be made out of net assets⁹⁷. This is usually referred to as the bankruptcy test and is determined through the balance sheet test⁹⁸. A few anomalies stand out with this test as worded in the Act, to begin with the opening statement of the section requires the consideration of all reasonably foreseeable circumstances; a balance sheet test

⁹¹ (2009) *TSAR* 484 at 492

⁹² (2009) *TSAR* 484 at 492

⁹³ (2009) *TSAR* 484 at 492

⁹⁴ Section 46(1) (b)

⁹⁵ Act 71 of 2008

⁹⁶ (2009) *TSAR* 224 at 237

⁹⁷ (2009) *TSAR* 224 at 225

⁹⁸ (2009) *TSAR* 224 at 225

determines the net assets and liabilities at a specific moment in time⁹⁹. The solvency test itself does not state it should appear that the assets will exceed the liabilities; therefore there has been an element of prediction introduced by the opening statement which is essentially not required for the test. While prediction may be necessary in some instances e.g. distribution of dividends this should have been made clear in the particular sections and not for the test itself¹⁰⁰. The other anomaly is the reference to fair value of liabilities, this creates a situation whereby a company can use an amount lower than the amount actually owed¹⁰¹. For instance a company in financial strife would calculate the fair value as the estimated recoverable amount and not the amount actually owed and that would be the fair value considering all reasonably foreseeable financial circumstances¹⁰². This leads to a situation whereby, a company may actually be insolvent but due to the fact that they need not consider the total value of the liabilities they will satisfy the test¹⁰³.

3.2.2. The liquidity test

The liquidity element of the test will be satisfied if considering all reasonably foreseeable financial circumstances of the company at the time, it appears that the company will be able to pay its debts as they become in the ordinary course of business for a period of 12 months following the distribution¹⁰⁴. The specification of a time period is a break away from the previous position; this is in line with the JSE listing requirements and other jurisdictions. Van Der Linde¹⁰⁵ argues that while this specification will provide certainty for the directors it may be a disadvantage for creditors as it does not consider longer-term commitments. It is argued that companies operate under widely differing circumstances and giving a time frame is impracticable¹⁰⁶. I agree with Van Der Linde's submission that the ordinary course of business for each company should be the decisive factor and not a set time¹⁰⁷. Another possible solution if a time limit is deemed necessary it creates a presumption that if

⁹⁹(2009) *TSAR* 224 at 227

¹⁰⁰ (2009) *TSAR* 224 at 227

¹⁰¹ (2009) *SALJ* 806 at 807

¹⁰² (2009) *SALJ* 806 at 807

¹⁰³ (2009) *SALJ* 806 at 807

¹⁰⁴ Section 4 (1) (b) (ii)

¹⁰⁵ (2009) *TSAR* 224

¹⁰⁶ (1981) *University of Richmond Law Review* 839 at 870

¹⁰⁷ (2009) *TSAR* 224 at 229

the company is liquidated within a specific time period it did not satisfy the test, this is seen in the Close Corporations Act and can provide creditors with more protection¹⁰⁸.

3.2.3. Considerations when applying the tests

Section 4 stipulates when applying the solvency and liquidity test:

- *A faire valuation of the company's assets and liabilities including any reasonably foreseeable contingent assets and liabilities, irrespective of whether or not they arise as a result of the proposed distribution must be considered*¹⁰⁹.
- *Any other valuation of the company's assets and liabilities that is reasonable in the circumstances may be considered*¹¹⁰.

Section 4 requires that the financial information considered in applying the solvency and liquidity tests must be based on accounting records that satisfy section 28 and 29¹¹¹. It is unnecessary to discuss these sections however, I noted from reading them what is required in a financial statement is assets, liabilities and equity as well as income and expenses¹¹². It has already been discussed that some level of prediction is required in the solvency and liquidity test; this is why it is difficult to understand how reasonably foreseeable contingent assets and liabilities can be found on financial statements. It has been clearly stated that all financial information to be considered must be based on the statements, it is unlikely that financial statements that are already available in the company will have information regarding the proposed distribution which is yet to take place. In my opinion the only way to apply this is to prepare a financial statement before every proposed distribution and thus that information will be based on a financial statement in terms on section 29.

With regard to the rights of preferential shareholders the Act provides that unless the MOI provides that preferential liquidation rights should be taken into account as liabilities of the company, the person applying the solvency and liquidity test should

¹⁰⁸ (2009) TSAR 224 at 229

¹⁰⁹ Section 4(2)(b)(i) of Act 71 of 2008

¹¹⁰ Section 4(2)(b)(ii) of Act 71 of 2008

¹¹¹ Section 4(2)(a)

¹¹² Section 29(1) (c)

not take into account the amounts necessary to satisfy these rights¹¹³. It is assumed that the legislature's intention was to ensure that shareholders with preferential liquidation rights were not provided for before every distribution¹¹⁴, however the result is entirely different.

Section 4(2) (c)

'...a person is not to include any amount that would be required, if the company were to be liquidated at the time of the distribution, to satisfy preferential rights of shareholders whose preferential rights upon liquidation are superior to the preferential rights upon liquidation of those receiving the distribution.'

Ordinary shareholders do not have preferential liquidation rights, so the absurd situation is that this will only apply if distributions were to be made to preferential shareholders where another class of preferential shareholders existed but whose rights were superior¹¹⁵. Therefore if a distribution was made to ordinary shareholders, the amount required to satisfy preferential rights upon liquidation can be considered even if the MOI did not provide for it.

The default point with regard to shareholders with preferential liquidation rights is they should not be considered when applying the solvency and liquidity test. For one it is not possible to apply liquidation rights to a liquidity test because they are not debts in the ordinary course of business and it can be assumed this would only refer to the solvency test¹¹⁶. The bigger point is that this provision makes such shares less attractive, in expressly refusing to provide for such shareholders with regard to a guarantee on a return on their investments it forces shareholders who specifically want such protection to ignore companies who do not provide for this in their MOIs. It is submitted that the default position be that these rights are provided for unless the MOI dictates otherwise¹¹⁷

¹¹³ (2009) *TSAR* 224 at 233

¹¹⁴ This is limited to distribution in the form of transfer of money and not every distribution as provided for in the Act.

¹¹⁵ As noted by Van Der Linde in footnote 42 of (2009) *TSAR* 224.

¹¹⁶ (2009) *TSAR* 224 at 233

¹¹⁷ (2009) *TSAR* 224 at 234

3.3. Declaration of solvency and liquidity

This should be distinguished from the board authorisation it refers to an acknowledgement¹¹⁸ by the board by way of resolution, that it has applied the solvency and liquidity test as set out in section 4 and concluded that the company will satisfy the solvency and liquidity test immediately after the distribution is completed. This acknowledgment serves as an assurance that the company is not only solvent and liquid at the time of the proposed distribution but it will remain so afterward. This acknowledgement is tied to the liability of directors which will be discussed later.

4. **Protection of Shareholders**

Before Act 71 of 2008 was amended it was strongly criticised for not offering shareholders much protection¹¹⁹. However the amendment Act¹²⁰ brought about some much needed changes. The tripartite risks inherent with share repurchases discussed above are significant to shareholders when one considers the reorganisation of ownership and the possibility of market manipulation.

The risk faced by shareholders depends on the type of repurchase involved. In a selective repurchase the company acquires shares from one or more specific shareholders¹²¹. It cannot be assumed all selective repurchase have a sinister reason behind them; however in some situations the motivation may be to get rid of a particular shareholder or to prevent a takeover and entrench certain directors. If the price of the shares is too low the remaining shareholders will benefit at the expense of the vendor shareholder which may be a problem if the vendor is being coerced¹²². On the other hand if the price is too high the remaining shareholders will be disadvantaged in that their shareholding will be diluted, this could happen in the case of greenmail where a company buys out a potential bidder to a takeover¹²³.

Theoretically a pro rata offer will lead to a much more equitable result if every shareholder accepts the offering in the same proportion their rights will remain unaffected¹²⁴. However, if some shareholders wish to not participate but do not want their shareholding to increase they

¹¹⁸Section 46(1)(c)

¹¹⁹ Wainer (2009) *SALJ* at 806, Luiz (2010) *SA Merc LJ* at 443 and Van Der Linde (2010) *TSAR* at 288

¹²⁰ (2010) 2 *TSAR* 288 at 288

¹²¹ (2010) 2 *TSAR* 288 at 288

¹²² (2010) 2 *TSAR* 288 at 288

¹²³ (2010) 2 *TSAR* 288 at 289

¹²⁴ (2010) 2 *TSAR* 288 at 289

may be coerced into accepting the offer, therefore the presumption of free choice may not be true in all situations¹²⁵. This may also be the case where different classes of shareholders exist in that company and the offer is made to the members of only one of the classes the other classes will be discriminated against in that the offer will not have been made to them¹²⁶.

The new company law regime does not differentiate between pro rata and selective repurchases, therefore, unlike the previous regime the requirements will be the same regardless of the type of purchase. Section 48(8) brings in an element of protection and while the section as a whole does not differentiate between repurchases however it is clear some selective repurchases are catered for. A special resolution by the shareholders is required if the shares being acquired are from a director, a prescribed officer, or a person related to a director or a prescribed officer¹²⁷. I believe the rationale for ensuring that these types of acquisitions are particularly singled out because with all other repurchases the power essentially lies in the board of directors as the approval required is that of the board, therefore, if the directors were allowed to approve the repurchases of their own shares it may bring about some injustice. These are the only type of a selective repurchases where it has been expressly provided that the shareholders will have to give their approval by way of special resolution, however it is possible as well for other selective repurchases to require approval as will be discussed below.

An acquisition will be subject to section 114 and 115 if considered alone or together with other transactions in an integrated series of transactions; it involves the acquisition of more than 5% of the issued shares of any particular class of the company's shares¹²⁸. It would seem that if more than 5% of the total share capital were to be acquired but in such a manner that not more than 5% of the issued shares of any of the classes in that company would be acquired then this sub-section will not be applicable, my understanding of the wording does not lead to a rational result and it was possibly an omission. A complete discussion of these sections is outside the scope of this dissertation therefore only a brief discussion is necessary. Section 114 provides for proposals for scheme of arrangements and section 115 provides for the required approval with regard to such transactions. It would seem that in the new regime every repurchase that exceeds 5% of the issued shares of any particular class of shares would

¹²⁵ (2010) 2 *TSAR* 288 at 289

¹²⁶ (2010) 2 *TSAR* 288 at 289

¹²⁷ Section 48(8)(a) Act 71 of 2008

¹²⁸ Section 48(8)(b) Act 71 of 2008

be a scheme of arrangement, because all acquisitions that exceed this amount are subject to this section. While unlike the previous regime it is not necessary for a court to sanction a scheme¹²⁹, it will be necessary for the company to attain an independent expert who must prepare a report to the board and such report must be distributed to all holders of the company's securities. The report must contain at a minimum:

- a. All prescribed information relevant to the value of securities affected by the proposed arrangement;
- b. Identify every type of and class of holders of the company's securities affected by the proposed arrangement;
- c. Describe material effects that the proposed arrangement will have on the rights and interests of the above persons
- d. Evaluate any material adverse effects of the proposed arrangement against; the compensation that any person will receive and any reasonably probable beneficial and significant effect of the arrangement on the business and prospects of the company
- e. State any material interest of any director of the company or trustee for security holders
- f. State the effect of the proposed arrangement on the interests of any director or trustee for security holders
- g. Include a copy of section 115 and 164.¹³⁰

Section 115 provides for approval of a proposed scheme by way of special resolution by persons exercise voting rights on such a matter, and the quorum at such meeting will be 25% of all voting rights entitled to be exercised unless the MOI requires any higher percentage. Court approval may be necessary in certain instances¹³¹ but unlike in the previous regime it is not a requirement for a scheme. The question of who is actually entitled to vote for the proposed scheme is one of great debate and one that is not answered by this Act, while section 115 (4) excludes an acquiring party from voting, it is clear from the definition of an acquiring party, the persons involved in a scheme will not qualify as such. And this is only

¹²⁹ Verimark v Brait Specialised Trustees, Brait Multistrategy Trustees and Securities Regulation Panel 2009/11928 GSJ, Ex Parte Natal Coal Exploration Co Ltd (1985) 4 279 (W), Ex Parte NBSA Centre Ltd 1987 (2) SA 783 (T)

¹³⁰ Section 114(3) (a)-(f)

¹³¹ Section 115(3) if more than 15% of the voting rights that were exercised on that resolution opposed that resolution and any person who opposed the resolution requires the company to seek court approval or in the event that such threshold is not met (15%) any person who opposed the transaction can apply for a review of the transaction with leave from the court.

one of the problems possible with regard to schemes; however it can be assumed that the decisions that were taken in accordance with section 311 schemes¹³² will still be applicable. Therefore, the question will always be is it all the members of that class that are entitled to vote in that special resolution, if we consider *Verimark Holdings Ltd V Brait Specialised Trustees NO*¹³³, then we would answer this question in the negative, the court in this instance provided:

'The offer in question, 'on a true analysis', was made to the minority shareholders, i.e. the 'scheme participants', it was not made to the proposer, nor to the 'excluded members'. Only the 'scheme participants', as defined, were entitled to accept or reject it. Only they should have been allowed to vote on it. It follows that I do not have the power to sanction the scheme of arrangement.'

If we look at this decision in context of a reacquisition the position would be that, if a more than 5% of shares of a particular class are to be acquired, a scheme between the company and the shareholders will be entered into and in terms of the *Verimark* decision only the members who the offer has been made to will be entitled to participate. Therefore in the case of a selective repurchase only those persons will be involved in the meeting and in case of a pro rata repurchase then all the members of the class will vote. This may lead to an inequitable position especially with regard to selective repurchases where the other members of the class may oppose this but are not entitled to voice their opposition by way of a vote.

The possibility of a shift in control in share repurchase is very real and it is necessary to guard against. A discussion on control is outside of the scope of this dissertation but as it is closely linked with repurchases it will be briefly considered: There are different types of control but those relevant to shareholders in this instance are:

- a. *De jure* control- 50% plus 1 of the votes in the company
- b. Minority control (*De facto* control)- less than 50% but still control the company (quorum is 25% this will therefore refer to the people actually voting at the meeting)

¹³² Act 61 of 1973

¹³³ Supra at note 130

There are two possibilities whereby as a result of an acquisition in terms of section 48 a person, persons acting in concert or two or more inter-related persons are obliged to either make a mandatory offer¹³⁴ or a comparable offer¹³⁵. With regard to mandatory offers if any of the above mentioned persons are able to exercise more than 35% of all the voting rights attached to the securities of that company, such persons must offer to acquire any of the remaining securities in the company¹³⁶. With a comparable offer, if a company with more than one class of securities acquires the securities of one class in terms of section 48, and as a result of that the above mentioned persons exercise more than the 35% of the general voting rights of all the issued securities of that company, such person must make a comparable offer to acquire securities of each class of issued securities in that company¹³⁷. These measures are necessary so that if the control in a company shifts the members who no longer want to be a part of that company have an opportunity to relinquish their rights. However the limitation to these measures is that they only apply to regulated companies as defined in section 118 (1) of the Act. Therefore it is not a given that the takeover provisions will apply in every situation where control shifts and in some instances control may be affected by an acquisition in terms of section 48 without the benefit of these provisions.

In addition to the above shareholders are also provided with the dissenting shareholders appraisal right in terms of section 164¹³⁸ and relief from oppressive and prejudicial conduct or from the abuse of separate juristic personality of a company in terms of section 163¹³⁹. In terms of these sections any part of the consideration paid for his shares or an equivalent amount may be returned to the aggrieved shareholder¹⁴⁰ or the fair value for the relevant shares held by that person¹⁴¹.

If any of the above protective measures is deemed not to be sufficient the shareholders can take comfort in the fact that directors required to exercise their powers for a proper purpose¹⁴². This means that when considering an acquisition of shares in terms of section 48 the directors have to do it with a proper purpose in mind. This of course would require the

¹³⁴ Section 123 Act 71 of 2008

¹³⁵ Section 125 Act 71 of 2008

¹³⁶ Section 123 (3) Act 71 of 2008

¹³⁷ Section 125 (2) Act 71 of 2008

¹³⁸ Act 71 of 2008

¹³⁹ Act 71 of 2008

¹⁴⁰ Section 163(2)(g)

¹⁴¹ Section 164(11)(c)

¹⁴² (2010) *TSAR* 288 at 303

development of a proper purpose doctrine in terms of reacquisition of shares, a duty that will fall on South African courts¹⁴³.

5. Protection of Creditors

From a creditor's point of view there is no difference between the payment of a dividend in respect of a share and the repurchase of that share. In fact the protection of creditors depends on effective distribution mechanisms and a sound solvency and liquidity test. Due to the scheme of this new Act these have already been discussed, however a few aspects will be discussed especially with regard to creditors.

Given a repurchase will be like any other distribution it is necessary to protect creditors to ensure that all distributions made are in accordance with the Act or that distributions are only made when the company can afford them. This is why section 46(3)¹⁴⁴ was put in place to ensure that the directors consistently consider the solvency and liquidity. This section provided that if distribution is contemplated but has not been completed within 120 days, the board is obliged to reconsider the solvency and liquidity test and despite any law or order the board cannot continue with that distribution unless a further resolution in terms of section 46(1)(c) is adopted¹⁴⁵. This ensures that a company is not obliged to continue with a distribution it cannot afford, however the limitation to this is that a company is only obliged to do this if a distribution is not completed in 120 days. Therefore it would seem that if within the 120 day period the company will not satisfy the solvency and liquidity test they are still required to carry out the distribution. This is clear from section 46(2) which states a once a board resolution has been adopted acknowledging they have applied the solvency and liquidity test the distribution must be fully carried out only subject to subsection (3)¹⁴⁶. Therefore the result of this is that if the company will no longer be solvent and liquid but it is within 120 days the distribution must still be carried out. This should be worrying for creditors who need to guarantee the company is always solvent and liquid.

The directors' liabilities for unlawful distributions which will be discussed below can reassure creditors. This perhaps will be the saving grace to the problem created above that directors aware that they could be held liable will ensure that they do not continue with a

¹⁴³ (2010) *TSAR* 288 at 303

¹⁴⁴ Act 71 of 2008

¹⁴⁵ Section 46(3) Act 71 of 2008

¹⁴⁶ Section 46(2) Act 71 of 2008

distribution that is within 120 days but may affect the solvency and liquidity of the company. However, it will also be questioned whether directors can in earnest be held liable for obliging with the Act, however, this may be an area where their fiduciary duties will come into play to ensure that unwarranted unlawful results do not come about.

A further control mechanism is the possibility of having a court order varied¹⁴⁷. In essence even if a distribution is to be made in terms of a court order, the solvency and liquidity test must be complied with and if the company will not satisfy it the company can approach the court to vary the order to ensure that when it does comply with the court order is also satisfies the solvency and liquidity tests.

Creditors will be protected by a sound solvency and liquidity test, and while this has already been discussed above two aspects have to be mentioned. In comparing the solvency requirements applicable in different jurisdictions¹⁴⁸ to South Africa, it has been found the test in South Africa is lenient, only requiring the assets to equal the liabilities at a minimum, there is no provision for a solvency margin¹⁴⁹. With regard to the liquidity test the danger is for creditors with foreseeable longer-term commitments that are not payable within 12 months¹⁵⁰. The imposition of a time period effectively excludes them from being considered in liquidity test and therefore creating a likelihood that the distribution may cause a situation where their debts will not be payable when they become due but they do not need to be considered.

6. Liability of Directors and Shareholders

6.1 Directors

When considering an acquisition of shares in terms of section 48 directors can be held liable in terms of both section 46 and 48. Section 46(6) read with section 77(3)(e)(vi) makes directors liable for unlawful distributions and section 48(7) read with section 77(3)(e)(vii) imposes liability where shares are acquired in violation of section 48 and 46¹⁵¹. While it

¹⁴⁷ Section 46(5) Act 71 of 2008

¹⁴⁸ (2009) *TSAR* 224 at 228: In California two alternative balance sheet restrictions apply namely the retained earnings test and the asset-liability ratio test. Each of these requires a margin of assets over liabilities subsequent to a distribution: the retained earnings test has the effect that the assets have to exceed the liabilities by at least the value of the original investment of shareholders, while asset-liability ratio requires assets to exceed liabilities by a margin of 25%.

¹⁴⁹ Section 4(1) (a) Act 71 of 2008

¹⁵⁰ (2009) *TSAR* 224 at 229

¹⁵¹ (2009) *TSAR* 484 at 495

would seem that for purposes of liability the term "director" has a wide meaning¹⁵², when regard is given to the specific provision it seems only a director in the narrow sense can be held liable because they have to actually participate in decision making for liability¹⁵³.

6.1.1 Requirements for Liability

The first requirement for liability is that the director must have been present at a meeting where the board approved the distribution or the acquisition or otherwise participated in the making of the decision¹⁵⁴¹⁵⁵. Due to the cross reference to the word "approval" in section 46(6) and 48(7), it would appear that liability depends on the director's participation in the resolution authorising the distribution or acquisition but not the resolution acknowledging application of the solvency and liquidity test¹⁵⁶. Therefore a director who only participated in the acknowledgement may very well escape liability. Similarly, no liability can be imposed in respect of a distribution in compliance with a court order that does not satisfy the solvency and liquidity tests¹⁵⁷. It is doubtful the legislature intended to restrict liability to only these instances even when non-compliance with financial restrictions occurs.

The second requirement is that the directors must have failed to vote against the resolution despite knowing¹⁵⁸ that the distribution or authorisation is contrary to the provisions. Therefore if a director fails to note their dissent while they know the provisions may be violated they will be liable.

Two further requirements are imposed for liability under section 77(3) (e) (vi), or liability for a distribution in violation of section 46, these are¹⁵⁹:

- a. Liability only arises if after the making the distribution, the company does not satisfy the solvency and liquidity test¹⁶⁰; and

¹⁵² Section 77(1) Act 71 of 2008

¹⁵³ (2009) *TSAR* 484 at 495

¹⁵⁴ (2009) *TSAR* 484 at 496

¹⁵⁵ Section 74 of Act 71 of 2008 provides that board resolutions can be taken otherwise than at a meeting.

¹⁵⁶ (2009) *TSAR* 484 at 496

¹⁵⁷ (2009) *TSAR* 484 at 496

¹⁵⁸ (2009) *TSAR* 484 at 497: A person is regarded as knowing something when they have actual knowledge, or was in a position where they reasonably ought to have had actual knowledge, investigated the matter or taken measures to have provided them with actual knowledge

¹⁵⁹ In terms of section 77(4)

¹⁶⁰ Section 77(4)(a)(i)

b. It was unreasonable at the time of the decision to conclude that the company will satisfy the solvency and liquidity test after making the distribution¹⁶¹. This effectively introduces an objective *ex post facto* solvency and liquidity test¹⁶². In essence if the directors were unreasonable in making their decision but the company nevertheless is still solvent and liquid liability will not arise or in the converse if the directors were reasonable in making a decision but the company still does not satisfy the test liability will not arise. Also due to these additional requirements it seems liability in terms of section 46 only arises if there is a non-compliance with financial restrictions, this is clear from the wording of section 77(4) which states -liability arises only if...ø the financial restrictions are not complied with.

6.1.2 Extent of Liability

A director is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of an unlawful distribution or an unlawful acquisition of shares¹⁶³. Section 77(4) limits the liability of directors to the difference between the amount by which the value of the distribution exceeded the amount that could have been distributed without causing the company to fail the solvency and liquidity test¹⁶⁴; and the amount, if any, recovered by the company to whom the distribution is made¹⁶⁵.

This limitation does not apply when section 77(3)(e)(vii) applies, which means that if directors contravene section 48 only due to their non-compliance with the financial restrictions in section 46 they may potentially face wider liability¹⁶⁶. This may have been unintended because it puts directors who have essentially committed the same wrong in different liability brackets. Disappointingly, the lack of price regulation mentioned in chapter 3 that can lead to potential abuse by directors remains a problem.

¹⁶¹ Section 77(4)(a)(ii)

¹⁶² (2009) *TSAR* 484 at 497

¹⁶³ Section 77 (3) of Act 71 of 2008

¹⁶⁴ Section 77(4)(b)(i) of Act 71 of 2008

¹⁶⁵ Section 77(4)(b)(ii) of Act 71 of 2008

¹⁶⁶ (2009) *TSAR* 484 at 499

6.2 Shareholders

The new Companies Act does not expressly provide for liability of shareholders with regard to either unlawful distributions or an unauthorised acquisition of shares. This is a departure from the position in the 1973 Act¹⁶⁷. In absence of statutory provisions an action for recovery would be based on common law principles. Invalidity would form the basis of recovery of any distribution¹⁶⁸. And such invalidity would arise due to non-compliance with any of the provisions¹⁶⁹. It also appears that shareholders will be liable to restore any unlawful payment to the company whether or not they receive it in good faith or without knowledge¹⁷⁰.

In the previous regime director could institute an action to recover amounts from a shareholder¹⁷¹, this is not the position in the new Act however, recovery can be achieved through the company, thus achieving the same result.

7. Enforceability of Contracts

Section 48(4) provides that an agreement with a company for the acquisition of its shares is enforceable against the company subject to subsection (2) and (3)¹⁷². These provisions set out the power of a company to acquire shares subject to the decision satisfying the requirements of section 46¹⁷³, the requirements of section 48(8) and the requirement that the only shares remaining in issue will not be shares held by subsidiaries or convertible or redeemable shares¹⁷⁴. Therefore, if these requirements will not also be met a company must apply for a court order to postpone the date when they will be obliged to comply with the agreement¹⁷⁵.

The 1973 Act clearly provides for the position of vendor shareholders who have not been fully paid for their shares upon the liquidation of the company¹⁷⁶. The 2008 Act did not make any provisions with regard to vendor shareholders and therefore, it would seem such claims will rank concurrently with the claims of other creditors¹⁷⁷. I find this result undesirable because considering that preference shareholders may already not be provided for in the

¹⁶⁷ Sections 86(2) and (3) and 90(4) of Act 61 of 1973

¹⁶⁸ (2009) *TSAR* 484 at 499

¹⁶⁹ (2009) *TSAR* 484 at 499

¹⁷⁰ (2009) *TSAR* 484 at 499

¹⁷¹ Section 86(2) Act 61 of 1973

¹⁷² Section 48 (4) of Act 71 of 2008

¹⁷³ Discussed above in this chapter

¹⁷⁴ Discussed above in this chapter

¹⁷⁵ Section 48(5) of Act 71 of 2008

¹⁷⁶ Discussed above in chapter 3

¹⁷⁷ (2009) *TSAR* 484 at 495

solvency and liquidity test it seems unfair that upon liquidation they will still have to be ranked below these vendor-shareholders.

8. Conclusion

This concludes a discussion of section 48 it becomes clear that this section has a very large impact, much larger than the previous buy-back provisions. It impacts on different aspects on company law and it can never be considered in isolation, every instance where section 48 is mentioned one must consider distributions, takeovers, decisions by directors, decisions by shareholders, schemes of arrangement etc. The point is the list goes on and when dealing with this section one must be careful of the implication it would have to other sections.

CHAPTER 5

COMPARATIVE STUDY

1. Introduction

One of the main aims of the new Companies Act was to make South African companies more competitive internationally by providing a regime that was more in line with other jurisdictions. Therefore a dissertation without a comparative study no matter how brief would be incomplete.

2. The United Kingdom (UK)

I chose to use the current company law regime in the UK for various reasons outlined below. To begin with South Africa has a very English based common law of companies; in fact many of the rules of English common law were readily accepted by South African courts with little or no modification¹⁷⁸. Not only was their common law adopted but where no guidance was provided in the law English precedents were followed¹⁷⁹. In addition to this one of the previous Companies Acts (46 of 1926) was largely based on the English Companies Act of 1908¹⁸⁰. It is for these reasons that the United Kingdom was chosen the two jurisdictions have an almost identical historical background in company law and it is only with the 1973 Act that one could see the move away from English law in South Africa.

3. The Provisions of the Companies Act 2006¹⁸¹

The doctrine of Capital maintenance is one that survives in the UK and the rules with regard to capital are centred on this doctrine. However, this doctrine is against the backdrop that a company can be allowed to adjust its legal capital within certain prescribed rules. Two important instances whereby, a company has the freedom to adjust its legal capital downwards is in the redemption of redeemable shares and the acquisition of own shares. The focus of this dissertation is on acquisition of own shares¹⁸² and redeemable shares will be briefly mentioned later.

¹⁷⁸ Cilliers et al 21

¹⁷⁹ Note important English cases that formed the basis of South African Company law e.g. *Trevor v Whitworth* (supra in chapter 2) *Foss v Harbottle*. Cillers et al 21

¹⁸⁰ The historical background to this Act was also adopted into South African company law. Cilliers et al 21

¹⁸¹ 2006 Chapter 46

¹⁸² This is in terms of Part 18, Chapter 4 of the Companies Act 2006

The General rule in terms of section 658 is that a company may not acquire its shares other than in accordance with Part 18 of the UK Act. The exception to this general rule is in terms of section 659 where a company may acquire its own shares other than for valuable consideration. A list of exceptions is provided in this sections but it would seem in instances where the company received the shares as a gift or they were forfeited it would not be necessary to follow the procedure provided for in the UK Act¹⁸³.

The default rule as provided in section 690¹⁸⁴ is that both private and public companies may acquire their own shares subject to restrictions or prohibitions in the company's articles. Acquisition as used in the UK Act seems to refer to something wider than purchase; it refers to both a purchase and the redemption of redeemable shares. However, a repurchase cannot be made if the result would be that there were no longer members of the company holding non-redeemable shares or only treasury shares remained¹⁸⁵. In addition to this a company may only purchase shares that have been fully paid for¹⁸⁶ this is to avoid situations where the shareholders avoid personal liability to the company by virtue of selling their shares to the company¹⁸⁷.

4. Protection of Shareholders

With regard to shareholder protection this is achieved by ensuring shareholders are involved in the process of authorisation for a repurchase of shares. The type of authority required depends on the type of purchase, and the provisions are made for off-market and market purchases. Given that the focus of this dissertation has been on unlisted shares, the provisions for market purchases will not be discussed.

An off market purchase can only be made in pursuance of a contract the terms of which have been authorised by a special resolution of the company before it is entered into¹⁸⁸. Any member who holds shares to which the resolution relates is not allowed to vote in the special

¹⁸³ Davies at 318

¹⁸⁴ Section 690 (1)

¹⁸⁵ Section 690 (2)

¹⁸⁶ Section 691 (1)

¹⁸⁷ Davies at 321

¹⁸⁸ Section 694

resolution and if they do so and the resolution is passed because of such a vote it is invalid¹⁸⁹. A copy of the contract to be voted on must be made available to the shareholders prior to the meeting disclosing all the relevant information¹⁹⁰. If there is to be a variation of the contract to repurchase after the resolution has been passed, such a variation must be approved by another special resolution and members precluded from voting in the original resolution are still precluded from voting¹⁹¹.

In addition to having the power to authorise the purchase shareholders can apply to a court to have a resolution cancelled within 5 weeks of it being passed. This right of a dissenting shareholder is the same as that of a creditor discussed below.

5. Protection of Creditors

With regard to protection of creditors two positions arise, because the requirements are different with regard to private and public companies, these will be discussed separately (these provisions apply to the purchase of shares and the redemption of shares).

5.1. Public Companies

A public company may only purchase its own shares out of distributable profits or out of the proceeds of a fresh issue of shares made for the purpose of financing the shares¹⁹². Any premium payable by a company on the acquisition of its own shares must be made out of distributable profits¹⁹³, unless the shares being acquired were issued at a premium therefore any premium payable may be paid out of the proceeds of a fresh issue of shares¹⁹⁴. Finally the company must create a capital redemption reserve (CRR) which is equivalent to the amount that the company's issued share capital is diminished by a purchase wholly out of profit¹⁹⁵.

¹⁸⁹ Section 695

¹⁹⁰ Section 696

¹⁹¹ Section 697 and 698

¹⁹² Section 692 (2) (a)

¹⁹³ Section 692 (2) (b)

¹⁹⁴ Such proceeds will be up to an amount equal to: (a) the aggregate of the premiums received by the company on the issue of the shares purchased, or

(b) the current amount of the company's share premium account (including any sum transferred to that account in respect of premiums on the new shares); whichever is less.

¹⁹⁵ Section 733 (2)

These are the rules available to protect creditors and they work in the following ways. The first instance is if shares without a premium are purchased wholly out of distributable profits. Creditors cannot object to the use of these funds for the very reason that they are distributable and therefore could have been paid out as dividends¹⁹⁶. A company may cancel the shares acquired and this would mean the company's share capital account is diminished. If this situation was left as it was the company's distributable profits would be increased compared to what would have been available had the shares not been acquired¹⁹⁷. Therefore the CRR plays the role in countervailing this by ensuring the amount by which the share capital is diminished is transferred and not distributed, and this maintains the company's capital yardstick.

In the second instance if the acquisition is of shares and not at a premium but out of the proceeds of a fresh issue of shares, the issue of new shares will increase the company's share capital account and there will be no need to create a CRR. The new issue will balance the reduction caused by the cancelled shares and thus in effect the company will have substituted one form of capital for another and the capital yardstick will be maintained protecting the creditors¹⁹⁸.

If shares are repurchased at a premium this must be done wholly out of distributable profits. The reason for this is that if a fresh issue of shares was used in this case and a larger amount is issued than the amount actually acquired, the capital yardstick will not be maintained. This is because only a certain amount of shares will be cancelled and the amount of new shares issued will be more than the cancelled shares increasing the amount of shares without a corresponding increase in the share capital account. This also explains why a fresh issue is allowed where the shares being repurchased were initially issued at a premium. The share capital account will only be reduced by a certain amount (given a premium was paid) and it will be necessary to issue fresh shares to ensure that the shares issued will correlate with the share capital account.

In all the above instances creditors are protected by the maintenance of a capital yardstick.

¹⁹⁶ Davies at 322

¹⁹⁷ Davies at 322

¹⁹⁸ Davies at 323

5.2. Private Companies

In addition to the rules mentioned above a private company is allowed to purchase shares out of capital¹⁹⁹. Such an acquisition is only allowed after applying for such acquisition:

- a. Any available profits of the company; and
- b. The proceeds of any fresh issue of shares made for the purpose of that purchase.²⁰⁰

Such amount is referred to as the permissible capital payment (PCP)²⁰¹

With regard to creditor protection in this instance the Directors of a company are required to make statement; termed a directors' statement²⁰². Such statement must:

- a. specify the amount of PCP for the purchase²⁰³
- b. state that having made a full enquiry into the affairs and prospects of the company and formed the opinion that immediately following the date of the proposed payment there will be no grounds found that the company will be unable to pay its debts²⁰⁴
- c. state that (having made a full enquiry into the affairs and prospects of the company and formed the opinion) with regards to its prospects for the year immediately following that date, that having regard to
 - (i) their intentions with respect to the management of the company's business during that year, and
 - (ii) the amount and character of the financial resources that will in their view be available to the company during that year, the company will be able to continue to carry on business as a going concern (and will accordingly be able to pay its debts as they fall due) throughout that year.²⁰⁵

In forming their opinion for the purposes of subsection, the directors must take into account all of the company's liabilities (including any contingent or prospective liabilities)²⁰⁶.

Annexed to this statement there must be report by the company's auditor; that he made an

¹⁹⁹ Section 692(1) this is subject to any restrictions or prohibitions in its articles (section 709)

²⁰⁰ Section 710 (1) (a) and (b)

²⁰¹ Section 710 (1)

²⁰² Section 714

²⁰³ Section 714 (2)

²⁰⁴ Section 714 (3) (a)

²⁰⁵ Section 714 (3) (b)

²⁰⁶ Section 714(4)

enquiry into the company's affairs, that the amount specified in the statement has been properly determined, and he is not aware of anything to indicate that the opinion given by the directors is unreasonable²⁰⁷. Directors who make a statement without having reasonable grounds for their opinion commit an offence and are liable for conviction²⁰⁸. While a time limit of one year is imposed if the company is wound up within one year of the date of payment, the directors will be held liable unless they can prove they had reasonable grounds for forming an opinion²⁰⁹.

In addition to the director's statement a company must publish in the Gazette unless it notifies each creditor in writing, and in an appropriate national newspaper a notice giving detail about the intended purchase out of capital²¹⁰. The Act entitles any creditor to within 5 weeks of the passing of the resolution for the purchase to apply to a court to cancel the resolution²¹¹. This allows for court scrutiny in order to allow for creditor protection²¹².

6. Treasury Shares

Treasury shares are shares issued by a company and thereafter reacquired by the company by way of a share repurchase but neither cancelled nor restored to the status of unissued shares²¹³. Around the world the mood towards this type of share has changed because of the flexibility in which it allows companies to control their share capital²¹⁴. When a company repurchases its shares and subsequently has to cancel them giving them the status of authorised but unissued shares if the company wants to sell these shares the entire procedure for a share issue must be followed, unlike with treasury shares which are not cancelled. Another advantage is the pre-emptive right of shareholders which applies to a new issue of shares will not apply to these shares²¹⁵. A further advantage is that such shares can be used by a company as a pledge for a security for a loan²¹⁶.

²⁰⁷ Section 714 (6)

²⁰⁸ Section 715

²⁰⁹ Section 76 of the United Kingdom Insolvency Act; (2009) *TSAR* 484 at 498

²¹⁰ Davies at 336

²¹¹ Davies at 336

²¹² Davies at 336

²¹³ Mongalo (ed) at 151

²¹⁴ Mongalo (ed) at 151 examples are Hong Kong, Singapore, Malaysia, Indonesia and member states of the European Union.

²¹⁵ Mongalo (ed) at 155

²¹⁶ Mongalo (ed) at 156

Part 18, Chapter 6 of the UK Act provides for treasury shares, and this is an example that complex legislation to curtail abuses with regard to treasury shares is unnecessary²¹⁷. It was submitted that these shares will allow companies additional flexibility to manage their level of capital and their ratio between debt and equity. In essence this chapter in 9 sections provides for who can have treasury shares²¹⁸, what type of shares can be held in treasury²¹⁹, how the shares can be repurchased²²⁰, maximum number of shares that can be retained²²¹, the possibility to subsequently cancel the treasury shares²²² and measures to curtail abuses²²³. This brief summary shows just how possible it is to allow companies this extra flexibility without necessarily creating complex legal rules.

7. Comparison of the two jurisdictions

It seems fairly clear that while the UK still applies the doctrine of capital maintenance relying on them for legal precedent or guidance will become less and less likely. However, some instances whereby, even with divergent views it would be prudent to consider the position they have taken. For one it is commendable that redeemable shares have been properly provided for in terms of payments and creditor protection, a situation that has been left woefully unclear in our new Act as redemption will amount to an acquisition just one that does not need to be authorised by shareholders who are already aware of their existence. In the second instance the exclusion of acquisitions that are not for valuable consideration gives the company the ability to accept shares without the necessity of having to comply with provisions which will be unnecessary as there is no consideration, another situation not provided for in the new Act. Thirdly, while the possibility of a criminal conviction with regard to the directors' statement may be considered harsh it will ensure decisions are taken carefully and while it may seem obvious that companies will consult an auditor in determining solvency and liquidity, the fact that such an extensive statement will be made available to shareholders will allow them to make an informed choice. Fourthly, with regard to treasury shares, it seems a shame that while the underlying theme to the new Act was

²¹⁷ Mongalo (ed) at 151

²¹⁸ Section 724 (1)

²¹⁹ Section 724 (2)

²²⁰ Section 724 (1) (b)

²²¹ Section 725(1)

²²² Section 729 (1)

²²³ Section 726 - 732

flexibility²²⁴; it failed to see the value such shares could bring to that theme. Fifthly, the shareholder protector measures where the members vote on a contract is in my opinion desirable in that it prevents situations where shareholders are left in the dark as to exactly what terms (especially price) the company agrees to which may be unfavourable. Finally section 48 can be commended for providing a less complex process with regard to payment and indeed creditor protection, it moves away from complicated provisions with different funds and reserves and just simply allows the company to control its capital as long as it remains solvent and liquid.

8. Conclusion

In a lot of ways the provisions of Section 48 as compared to those of the UK do allow it to compete internationally as the processes can be considered simpler; however in other instances there have been omissions in achieving a system that can be considered extremely expeditious and effective. Legal comparisons are necessary in order to help us improve our systems but also in a way that suits us and only a few of the provisions above would be suitable.

²²⁴ The Department of Trade and Industry South Africa policy paper: "South African Corporate Law Reform" Mongalo (ed) at 163

CHAPTER 6

RECOMMENDATIONS AND CONCLUSION

1. Recommendations

Recommendations for the application and interpretation of section 48 have been given throughout the body of this dissertation and it will be unnecessary to repeat all of them. I find it necessary to list a few which are particularly significant because they require amendments to the Act. These are;

- 1) The position of redeemable preference shares in the Act should be clarified and the effect that they have on the share capital of a company should be clearly outlined.
- 2) The term "acquisition" should either not be used in section 48 or should be qualified as has been seen in the UK Companies Act.
- 3) Section 48(3) should provide for a position where both redeemable or convertible shares as well as those held by a subsidiaries are the only shares left in a company.
- 4) The rights of preferential shareholders should be considered when applying the solvency and liquidity test as a default and provisions in the MOI can exclude this.
- 5) With regard to directors who essentially commit the same wrong the extent of liability should not be wider simply because they are acting in terms of section 48; while the contravention essentially involves section 46.

The above are recommendations that speak to legislative amendment, however, as has already been mentioned this is a new Act and the hope is adjudication will clarify a lot of the aspects which have been cloudy and create precedent as to how the Act should be interpreted.

2. Conclusion

To conclude this dissertation we must consider the unique part that company law plays in our law. It is necessary to ensure that companies can function easily enough while preventing abuses that can occur due to a separate legal personality. Companies in most instances have a commercial endeavour and the aim of any legislation is to ensure that this can be

accomplished with minimum regulation and interference. The analysis of section 48 was aimed at looking at how effectively this provision manages to give companies enough freedom to participate commercially as well as ensure that these companies do not abuse the advantage of having a separate legal personality.

In view of this Section 48 was analysed against the provisions of the 1973 Act's share buy-back provisions as well as compared to those of the UK. Therefore have the questions asked of this dissertation been answered. In the first instance in the analysis of the capital maintenance doctrine it can be answered in the positive that the new company law regime has indeed completely moved away and one can say capital maintenance is dead. The in between point that existed with the amendments in the 1973 Act where we were halfway between has been abolished. In answering how effective the provisions are the entire chapter 4 gives a thorough analysis of this section and the challenges that may be faced, it would thus be premature to comment on its effectiveness and only when it is seen in practice and all the kinks are worked out can that be determined. Finally and possibly most difficult is has company law in South Africa been changed for the better, based on the comparisons with the 1973 Companies Act and the UK Companies Act it is difficult to deny there has indeed been a simplification of processes; the new distribution regime which fails to differentiate between different types of distribution thus does not require different mechanisms and accounts is a breath of fresh air; a once complicated process has now been made simple and easy with sometimes unwanted consequences (redeemable shares). In the area of governance directors have more leeway to perform functions that would previously have required costly and lengthy approval procedures. It is concluded at this point it is difficult to tell if company law has been changed for the better because the Act has yet to be seen in practice and one cannot at this point predict how companies will react and adapt to it. However, in my opinion this is a step in the right direction; companies will gain from less restriction and the abolishment of outdated rules; if directors take their fiduciary duties seriously then shareholders need not worry that this new regime will lead to abuse but to more effective governance and better processes.

This is a new piece of legislation and therefore it is hoped that with judicial interpretation of the section the challenges identified will be clarified and perhaps dealt with. Legislation is a continuous process of learning and improvement and only in practice will we be able to improve on the existing legislation, therefore it is a good first step but it is not complete and

in time it will be changed and perfected to suit the needs of companies as and when they become apparent.

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