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**THE REACQUISITION OF SHARES IN TERMS OF THE COMPANIES ACT 71 OF
2008**

by

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SUMMARY

This mini-dissertation evaluates the regulation of share reacquisitions, as provided for in the Companies Act 71 of 2008 (the “Act”). The need and purpose for a legal system, such as the South African regime, to allow reacquisitions will be studied as background. Protection against the potential prejudice which creditors and shareholders are exposed to due to such distribution is stressed. Thereafter material issues and considerations relating to the provisions in the Act regulating reacquisitions are evaluated, including inconsistent terminologies usage and unnecessary cross-referencing. Significant legal questions such as whether a share reacquisition contemplated in section 48(8)(b) of the Act constitutes a scheme of arrangement or is merely subject to the requirements of sections 114 and 115 is furthermore considered, in light of the judgment in *Capital Appreciation Ltd v First National Nominees (Pty) Ltd* 2022 (6) SA 67 (SCA). The regulation of reacquisitions is also explored in view of the proposed changes in the Companies Amendment Bill, 2021. Finally, against the aforementioned context, this mini-dissertation considers if shareholders and creditors are adequately protected in the Act during reacquisitions. This will include a comparison brief reference to the protective measures offered in the United Kingdom and by the Companies Act 61 of 1973. It is argued in light of the potential abuse that creditors and shareholders may suffer that the Act’s regulation of reacquisitions is inadequate. The mini-dissertation concludes with recommendations for possible legal reform in respect of reacquisitions in terms of the Act.

KEY TERMS

Capital maintenance rule, company law, corporate and commercial, creditor and shareholder protection, dissenting minority shareholder's rights, fundamental transactions, reacquisition of shares by a company, and schemes of arrangement.

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CHAPTER 1

GENERAL INTRODUCTION

1.1 Introduction

The Companies Act 71 of 2008,¹ is currently the main piece of legislation that regulates company law in South Africa and replaced the Companies Act 61 of 1973.² The Act defines a share as “one of the units into which the proprietary interest in a profit company is divided”.³ Shares are also included in the broader concept of securities, which in addition includes debentures and other instruments that are either authorised to be issued or already issued by a profit company.⁴

Under the common law a company was prohibited from entering into a transaction with a shareholder or shareholders in terms of which, in exchange for a consideration payable to the shareholders by the company, the company would take back shares that it has previously issued.⁵ This common law prohibition on the reacquisition of shares was however relaxed in 1999 with the enactment of sections 85 to 89 of the 1973 Act, which allowed a company to repurchase its own shares in our law. Subsequently, section 48 of the Act was introduced, which currently not only regulates and permits a company to purchase directly its shares but also indirectly by means of a subsidiary company.

1.1.1 Categories and types of reacquisitions

The reacquisition of shares by a company is commonly categorised into three main types of reacquisitions, namely *pro rata* offers, selective- and general reacquisitions.⁶

¹ Hereafter “the Act”.

² Hereafter “the 1973 Act”.

³ See the definition of “share” in s 1 of the Act.

⁴ See the definition of “securities” in s 1 of the Act.

⁵ The common law prohibition was established in *Trevor v Whitworth* 1887 12 AC 409 (HL) (hereafter the “*Trevor case*”) and accepted in *Cohen NO v Segal* 1970 3 All SA 308 (W), *Ex parte Vlakfontein Gold Mining Co Ltd* 1970 2 SA 180 (T) and *Sage Holdings Ltd v The Unisec Group Ltd* 1982 1 SA 337 (W) (hereafter the “*Sage case*”). See also para 2.2.1 below.

⁶ See also paras 5.67-5.69, 5.72 and 11.23-11.27 of the JSE Limited Listings Requirements, which distinguishes between these three types of reacquisitions.

1.1.1.1 Pro rata offers

The first mentioned type of reacquisition, a *pro rata* or self-tender offer, refers to an offer made by the company to acquire shares from shareholders who want to sell their shares, so far as attainable on a proportionate basis.⁷

1.1.1.2 Selective reacquisitions

A selective reacquisition describes a transaction in terms of which a company wishes to reacquire shares from one or more particular holders of shares.⁸

1.1.1.3 General reacquisitions

General reacquisitions, on the other hand, are where a company has a general power to reacquire shares at the time when they become obtainable.⁹

1.1.2 The need for statutory regulation

The problem however with share reacquisitions is the fact that they pose various risks, not only for the creditors of the company reacquiring its shares but also for its shareholders, depending on the type of reacquisition.¹⁰ It is therefore imperative that the regulation of share reacquisitions in South African law is such that it provides adequate protection to both shareholders and creditors against the potential abuse of power of a company associated with such transactions.

1.2 Research aims and motivation

The aim of this mini-dissertation is to evaluate the regulation of the reacquisition of shares, as provided for in section 48 of the Act. In this context, specific consideration will be given to whether shareholders and creditors are adequately protected, in the Act, against the potential abuse inherent to the reacquisition of shares.¹¹ The interrelationship between sections 48 and 114 of the Act will also be critically considered to establish whether the reacquisition of shares by a company can under certain circumstances be regarded as a scheme of arrangement, as provided for in section 114 of the Act, and the effect this might have on shareholders' and creditors'

⁷ Van der Linde "Share repurchases and the protection of shareholders" 2010 *TSAR* 288 289.

⁸ Van der Linde *Aspects of the regulation of share capital and distributions to shareholders* (LLD thesis 2008 UNISA) 493.

⁹ Van der Linde (LLD thesis 2008 UNISA) 493.

¹⁰ Van der Linde 2010 *TSAR* 288 288. See para 2.3 below.

¹¹ See Chapter 4 below.

protection.¹² The current regulation of the reacquisition of shares by a company will also be considered in light of the changes proposed by the Companies Amendment Bill, 2021,¹³ and the effect it will have thereon.

A critical evaluation of the regulation of share reacquisitions, specifically the protection afforded to shareholders and creditors, is important in light of the fact that both these categories of persons are exposed to potential prejudice flowing from reacquisitions in the absence of adequate statutory protection and control of share reacquisitions.

1.3 Research problem

In light of the above, a critical evaluation of the regulation of the reacquisition of shares in terms of the Act is required.

1.4 Research questions

Relevant research questions, with reference to the above-mentioned research problem, have been formulated to define the scope of this study. The research questions are as follows:

- (a) What is the need and purpose of regulating share reacquisitions?
- (b) How are share reacquisitions for the different types of companies currently regulated in South African corporate law and the considerations and difficulties that arise in this regard?
- (c) Whether the protection afforded to shareholders and creditors under the current regime of the regulation of share reacquisitions in South African law is adequate?
- (d) Whether the application of sections 114 and 115 of the Act to certain share acquisitions is appropriate in the protection of shareholders?

1.5 Methodology

The nature of this study has taken the form of a desktop research. Various sources from mainly South African law are focused on, as this mini-dissertation is not a comparative study. Reference to foreign jurisdictions' legislation and case law are however made where relevant throughout this mini-dissertation. The main source that is reviewed and analysed is the Act, and where appropriate, is compared to the 1973

¹² See para 3.6 below.

¹³ GG 41913 dated 1 October 2021.

Act as well as the manner the Companies Amendment Bill, 2021 proposes to amend the Act. The evaluation of the Act has furthermore been done by considering and analysing South African case law, journal articles, and legal textbooks of various authors that fall within the scope of this mini-dissertation.

1.6 Limitations

The focus of this study is on the regulation of share reacquisitions as provided for in section 48 of the Act and the interaction between this section and other provisions of the Act within this context. The study includes an evaluation of the relationship of sections 114 and 115 with section 48 of the Act.

1.7 Chapter overview

This mini-dissertation has five chapters, commencing with chapter one in which the study is introduced. An overview of the remaining four chapters will hereafter follow.

1.7.1 Chapter 2

In chapter two the need and purpose of regulating share reacquisitions are evaluated by first considering the common law prohibition against the reacquisition of shares that existed in our law before 1999, as this will provide insight into why the need to regulate reacquisitions exists. Thereafter the potential prejudice associated with the different types of share reacquisitions from shareholders' and creditors' perspectives is considered, being the predominant reason why the reacquisitions should be regulated. Lastly, the rationale behind why a company would want to reacquire its shares is investigated. This is important as it provides light on the fact that it is undesirable to prohibit share reacquisitions as a rule and therefore a need has developed for adequate regulations of such transactions.

1.7.2 Chapter 3

Chapter three reviews the current regulation of share reacquisitions in our law of the different recognised types of companies – private-, public-, and listed companies – and the challenges and uncertainties that arise in the interpretation of the relevant regulating provisions, specifically section 48 of the Act. This includes a study of the regulation of the reacquisition by a company of its shares as well as indirect reacquisitions.

In addition chapter three includes an analysis of the interrelationship that exists between section 48 of the Act – regulating share reacquisitions – and schemes of arrangement as envisaged in section 114 of the Act. This is done, firstly, by a broad overview of the latter section and thereafter more specifically when a share reacquisition will be a transaction as contemplated in section 114(1)(e) of the Act. Subsequently, the question is considered of whether a share reacquisition, as envisaged in section 48 of the Act, on the other hand, under certain circumstances will be regarded as a scheme of arrangement and accordingly require compliance with the material requirements of sections 114 and 115 of the Act. The study includes a discussion of the recent case of *Capital Appreciation Ltd v First National Nominees (Pty) Ltd*,¹⁴ which had to consider the aforementioned issue. The effect of the Companies Amendment Bill, 2021, on the interrelationship between sections 48 and 114 of the Act is also considered.

A critical evaluation of the interaction between share reacquisitions and schemes of arrangement, specifically whether the former could amount to the latter, is important in light of the fact that it has an effect on the procedure that has to be followed and the approvals that the company is obliged to obtain. The last-mentioned considerations in turn have an impact on the protection enjoyed by shareholders.

1.7.3 Chapter 4

In chapter four the focus is on the protection afforded to shareholders as well as creditors under the existing regime of share reacquisitions in South African law and whether this protection enjoyed by the last two mentioned persons is adequate. This evaluation includes brief references in footnotes to the regulation of reacquisitions in the United Kingdom,¹⁵ and the protection afforded to shareholders and creditors during such transactions.

A consideration of foreign law – such as the English law – when interpreting the Act, is endorsed by section 5(2) of the Act, read with section 233 of the Constitution of the

¹⁴ 2022 6 SA 67 (SCA) para 8 (hereafter the “*Capital case*”).

¹⁵ Hereafter the “UK”.

Republic of South Africa, 1996.¹⁶ I chose the English law as it originally formed the foundations of our company law, and more specifically because the capital maintenance rule, which was accepted by our law, originates from the former jurisdiction.¹⁷ It will therefore be valuable and of assistance to briefly consider how the UK's company law regulation of reacquisitions has developed compared to our law, in its post-1994 constitutional framework, and whether safeguards currently employed under the English law could strengthen the protection afforded to shareholders and creditors under the Act.

A reference to the 1973 Act is made, where applicable, and how the Act compares to same, in light of the protection enjoyed by shareholders and creditors during share reacquisitions. The impact the Companies Amendment Bill, 2021 will have on the aforementioned protection, provided currently by the Act, is also evaluated. Lastly, the possibility for shareholders and creditors to rely on general protection mechanisms in the context of share reacquisitions is furthermore explored.

1.7.4 Chapter 5

In chapter five, namely the final chapter, conclusions are drawn and, where applicable, recommendations are made based on the research done in the respective chapters of this mini-dissertation.

¹⁶ In the context of comparative law, it is however important to note, as confirmed by the Constitutional Court in *S v Makwanyane* 1995 3 SA 391 (CC) paras 35–36, that “we are required to construe the South African Constitution, and not an international instrument or the constitution of some foreign country, and that this has to be done with due regard of our legal system, our history and circumstances, and the structure and language of our own Constitution. We can derive assistance from public international law and foreign case law, but we are in no way bound to follow it”. See also *Peninsula Eye Clinic (Pty) Ltd v Newlands Surgical Clinic* 2014 1 All SA 592 (WCC) para 37, confirmed on appeal: 2015 4 SA 34 (SCA).

¹⁷ See the Department of Trade and Industry policy paper, GN 1183 GG 26493 of 23 June 2004 12, describing the history of SA's company law. See also Van der Linde “The regulation of share capital and shareholder contributions in the Companies Bill 2008” 2009 *JSAL* 39 40 for further grounds on which a comparison with the UK is warranted.

CHAPTER 2

THE NEED FOR AND PURPOSE OF REGULATING SHARE REACQUISITIONS

2.1 Introduction

Transactions that lead to a change of a company's share capital – as with share reacquisitions – are known to be a potential source of conflict of interests and rights between the management of the company,¹⁸ and other stakeholders such as creditors and shareholders.¹⁹ This results in potential prejudice to be suffered by the last-mentioned stakeholders of a share reacquiring company, which will be considered in this chapter. An understanding of the aforementioned prejudice is important to determine whether there is a purpose and need to regulate share reacquisitions. The rationale and reasons why a company would want to commence with a share reacquisition will also be explored, which is linked to the question of whether a prohibition of reacquisitions should be preferred over a legal system that adequately regulates same. Before considering the aforementioned aspects, an overview of the development of the regulation of share reacquisitions in South African law will be provided to give insight into the current form of statutory provisions regulating the reacquisition of shares.

2.2 Development of the law regulating reacquisitions

2.2.1 Pre-1999: Common law prohibition

Share capital is not a concept that has a fixed definition but can be said to reflect the consideration that is due or payable to the company, in return for the issuing of shares.²⁰ A company's share capital was originally viewed as a creditor's guarantee fund from which claims will be satisfied and was regulated in our law under the so-called capital maintenance rule.²¹ In terms of this rule, the money that a shareholder has paid as consideration for its issued shares had to be retained by the company as funds from which creditors could be paid if the company was unable to do so.²² The

¹⁸ See s 66(1) of the Act which confirms a company's board of directors' obligation to manage the company's business and affairs and gives it the power to perform the company's functions and exercise its powers.

¹⁹ Van der Linde "The regulation of conflict situations relating to share capital" 2009 *SA Merc LJ* 33 33 & 42.

²⁰ Van der Linde 2009 *SA Merc LJ* 33 34.

²¹ Rajak *Sourcebook of company law* (2 ed) (1995) 761 as referred to in *Capitex Bank Ltd v Qorus Holdings Ltd* 2003 3 SA 302 (W) para 7 (hereafter the "Qorus case").

²² *Cohen NO v Segal* 1970 3 All SA 308 (W) 312.

capital maintenance rule consisted of three sub-rules, which included the limitation that a company may only declare dividends out of profits and, secondly, that it was not allowed to issue shares at a discount.²³ The last sub-rule – and most relevant to this study – prohibited a company from acquiring its own shares.²⁴

The capital maintenance rule dates to the 19th Century, and was introduced, as mentioned above, in the *Trevor*²⁵ case. In terms of South African company law a company was accordingly, until an amendment to the 1973 Act in 1999, not allowed to reacquire its shares, either directly or indirectly, even if the company's constitutional documents authorised it to conclude such a transaction.²⁶ Although the capital maintenance doctrine was given effect in our company law by legislation,²⁷ it was a fundamental principle forming part of South Africa's common law for decades before any such statutory recognition.²⁸

The primary purpose of the common law prohibition was to prevent an unlawful decrease of a company's capital, which would subsequently potentially prejudice the company's creditors' interests.²⁹ It, secondarily, ostensibly protected a company's shareholders by disallowing a company to traffic its shares and preferring one shareholder group above another.³⁰ The reason behind the prohibition was therefore that the shares' purchase price should not be returned to the company's shareholders.³¹

²³ Rajak (1995) 761.

²⁴ Rajak (1995) 761.

²⁵ *Trevor* case 423-424.

²⁶ See *Wolfe v Liquidators Smyth and Crawford* 1914 CPD 187; *Sage* case 347–349; *Unisec Group Ltd v Sage Holdings Ltd* 1986 3 SA 259 (T) 264–265 (hereafter the “*Unisec* case”).

²⁷ See s 39 of the 1973 Act, prior to its amendment in 1999, which provided, *inter alia*, that “no company shall be a member of a company which is its holding company, and any allotment, issue or transfer of shares of a company to its subsidiary shall be void.”

²⁸ *Unisec* case 264.

²⁹ *Trevor* case 416-417; *Sage* case 348. See also Yeats (ed) *Commentary on the Companies Act of 2008* (2018) 2-459-2-460.

³⁰ *Sage* case 348-349; Yeats (ed) (2018) 2-460. See *Trevor* case 417, 428, 437 and 438 for additional reasons which were provided by individual judges for the common law prohibition. For example, Lords Herschell and Macnaghten held that there are no legitimate purposes in their opinion for which a company's authority to reacquire its own shares could be use. According to Lord Watson a company cannot become one of its own members and cannot lawfully cancel or sell the reacquired shares again, as this would amount to a reduction of capital or be *ultra vires*, respectively.

³¹ Van der Linde “A company's purchase of its own shares” 1999 *JBL* 68 68.

The reacquisition prohibition's rigidity and its ineffectiveness, due to its failure to properly protect a company's stakeholders, have however been harshly criticised.³² The capital maintenance rule therefore deprived a company of the right to reacquire its shares, and the benefits associated therewith.³³ In addition, the last-mentioned rule also did not really fulfil its main purpose of protecting creditors. The perceived protection could in reality only be illusory due to the share capital being, for example, either negligible in size or strapped in assets and not available to creditors.³⁴ In the late 20th Century there has also been an increasing realisation in the international business sphere that a company's creditors can be protected through more modern mechanisms, such as a solvency and liquidity test.³⁵ It is accordingly not surprising that the common law prohibition started to be rejected during this period by countries such as the UK³⁶ and, in 1999, by South Africa.³⁷

2.2.2 Post-1999

The aforementioned rejection by our law manifested by way of the Companies Amendment Act 37 of 1999.³⁸ This amendment to the 1973 Act, specifically section 85, empowered a company in South Africa to reacquire its shares, subject to a liquidity and solvency test, the passing of a special resolution and the authorisation of such transaction in the company's articles of association.³⁹ The 1973 Act was also amended to allow a company to reacquire shares in its holding company.⁴⁰ Such indirect reacquisition required, as far as possible, compliance with the same aforementioned requirements applicable when a company proposed to acquire its own

³² Van der Linde 1999 *JBL* 68 68. See Bradstreet "Regulating Legal Capital Reduction: A Comparison of Creditor Protection in South Africa and the State of Delaware" 2012 *SALJ* 736 741, which describes the doctrine of capital maintenance as flawed and highlights the fact that its shortcomings are mainly based on the legal capital amount's elusiveness and its inclination to being manipulated in financial records.

³³ See para 2.4 below.

³⁴ Van der Linde (LLD thesis 2008 UNISA) 25.

³⁵ Van der Linde 1999 *JBL* 68 68. See also Bradstreet "Should Creditors Rely on the Solvency and Liquidity Threshold for Protection: A South African Case Study" 2015 *J AFR L* 121 122; Cooke "A critical analysis of the regulation of distributions by a company's board" 2012 *SA Merc LJ* 371 371, which described the capital maintenance concept as "outdated".

³⁶ See the Companies Act 1981, which effectively abolished the rule against a company reacquiring its shares in the UK.

³⁷ Cassim (ed) *Contemporary company law* (2021) 386. See also Bidie "A Critical assessment through *Capprec*" 2022 *SA Merc LJ* 52 57.

³⁸ See ss 85-90 of the 1973 Act.

³⁹ *Capital* case para 8. See also Delpont "Validity of contract for purchase of own shares by company" 2003 *THRHR* 681 683.

⁴⁰ See s 89 of the 1973 Act.

shares.⁴¹ These amendments, which came into force on 30 June 1999, were mainly welcomed by the company law community and were described by authors such as Cassim as “long overdue”.⁴²

As confirmed in the *Qorus*⁴³ case, the above-mentioned amendments to the 1973 Act effectively led to the abolishment of the outdated capital maintenance sub-rule – which prohibited a company to reacquire its shares – and replaced it with the solvency and liquidity test.⁴⁴ The 1999 amendments to the 1973 Act therefore, in my opinion, marked an important point in our law, being the commencement of the shift from the capital maintenance doctrine towards testing certain proposed transactions against the solvency and liquidity test. An important question is accordingly whether the latter test – as a replacement for the capital maintenance rule – adequately protects creditors and shareholders during share reacquisitions, which will be studied below.⁴⁵

2.2.3 Current position

The position regarding the regulation of share reacquisitions was once again changed through the enactment of the Act, specifically sections 46 and 48 thereof. The latter section regulates and empowers a company to reacquire its own shares as well as the acquisition of its holding company’s shares.⁴⁶ The former section in turn deals with distributions in general, the definition of which includes, *inter alia*, the consideration that is transferred in exchange for the reacquisition by a company of its shares.⁴⁷ If a company’s memorandum of incorporation,⁴⁸ prescribes a procedure for a share reacquisition, it will be supplemental and secondary to the Act’s process.⁴⁹

2.3 Prejudice associated with share reacquisitions

As highlighted recently by the Supreme Court of Appeal,⁵⁰ inherent to a share reacquisition is a potential for abuse by the reacquiring company, of some or all of the

⁴¹ Van der Linde 1999 *JBL* 68 70.

⁴² Cassim “The new statutory provisions on company share repurchases: a critical analysis” 1999 *SALJ* 760 760.

⁴³ *Qorus* case para 10.

⁴⁴ See Cassim 1999 *SALJ* 760 765.

⁴⁵ See para 4.3.1 below.

⁴⁶ See Jooste “Issues relating to the regulation of ‘distributions’ by the 2008 Companies Act” 2009 *SALJ* 627 628.

⁴⁷ See s 1 of the Act.

⁴⁸ Hereafter a “MOI”.

⁴⁹ Bidie 2022 *SA Merc LJ* 52 58. See also para 4.4.2.5 below.

⁵⁰ Hereafter the “SCA”. See *Capital* case para 10.

different functions such transaction fulfils.⁵¹ The aforementioned functions include an asset distribution by the company as well as a reorganisation of the ownership of the company, due to the change in the issued share capital achieved by reacquisitions.⁵² Thirdly, reacquisitions also involve a transfer of the company's shares.⁵³ The risks associated with share reacquisitions rest largely on the type of reacquisition in question.⁵⁴ A brief analysis of the potential abuse accompanying the latter three functions will hereafter follow.

2.3.1 Reacquisition as a distribution

Firstly, since share reacquisitions result in a distribution, they effectively may lead to an avoidance of claims of both the creditors and shareholders have against the reacquiring company.⁵⁵ From a creditor's and a shareholder's perspective, the latter consequence is problematic, since a company may, after it has reacquired its shares, be left with insufficient funds to pay claims, preference dividends or, repay capital on liquidation.⁵⁶

A reacquisition also possibly invites unfair and unequal treatment between shareholders, especially in the case of selective reacquisitions, since directors can favour specific shareholders at others' expense.⁵⁷ If the price offered by the company – to the selected shareholder(s) in exchange for their shares – is too high, it will be to the selling shareholders' benefit but detrimental to the remaining shareholders since their shares' value will be diluted and they will receive an increased burden of corporate debt.⁵⁸ The latter concern of potential abuse is especially prominent during transactions known as "greenmail".⁵⁹ On the other hand, if the price is too low it will benefit the non-selling shareholders but be prejudicial to the disposing shareholders.⁶⁰

⁵¹ Yeats (ed) (2018) 2-463.

⁵² Yeats (ed) (2018) 2-463. See also Van der Linde (LLD thesis 2008 UNISA) 487.

⁵³ Yeats (ed) (2018) 2-463. See also Van der Linde (LLD thesis 2008 UNISA) 487.

⁵⁴ Van der Linde 2010 *TSAR* 288 288.

⁵⁵ Van der Linde 2010 *TSAR* 288 288.

⁵⁶ Yeats (ed) (2018) 2-463.

⁵⁷ Yeats (ed) (2018) 2-463; Van der Linde (LLD thesis 2008 UNISA) 488; Cassim 1999 *SALJ* 760 774.

⁵⁸ Yeats (ed) (2018) 2-463; Van der Linde 2010 *TSAR* 288 288; Cassim 1999 *SALJ* 760 774.

⁵⁹ Van der Linde 2009 *SA Merc LJ* 33 45. See also Cassim 1999 *SALJ* 760 774, in which a greenmail transaction is described as an unfriendly suitor who acquires a substantial number of the target company's shares with the primary goal of forcing the target company to reacquire the said shares from it at a premium. Greenmail is therefore regarded as a form of corporate blackmail, where the greenmailer threatens to take the target company over, unless the company buys him out.

⁶⁰ Yeats (ed) (2018) 2-463; Van der Linde 2010 *TSAR* 288 288.

The aforementioned risks therefore already, in my opinion, highlight the importance of considering not only the selling shareholder, but all the purchasing company's shareholders' interests when evaluating a legal system's regulation of share reacquisitions, since these transactions may affect the shareholders in different ways.

Furthermore, since a share reacquisition amounts to a distribution, as described above, and a reorganisation, mentioned below, it has an element of coercion in its consequential effect. This is especially in the case of selective reacquisitions where the shareholders, who were excluded from the offer, are forced to accept their new increased shareholding in a company with a profile that differs from when they initially invested in it, with regards to aspects such as ownership and liquidity.⁶¹

In the event of a *pro-rata* offer, where a company offers to reacquire willing shareholders' shares on a proportionate basis, it can still have a discriminatory effect between shareholders if not all the shareholders decide to accept its offer.⁶² A shareholder in the latter situation is coerced to either dispose of its shares at a company-determined price or maintain its shares, but once again on changed terms; the company is in a different position compared to the pre-reacquisition *status quo*.⁶³ The reacquisition of shares might accordingly be a voluntary agreement between the transactional parties, but it is, I believe, important to note that the effect of the transaction can potentially have a coercive component from, for example, the non-selling shareholders' perspective.

2.3.2 Reorganisation of ownership

The reacquisition of shares has, as described by Van der Linde, a "composite nature", because such a transaction is not only a distribution, as described above, but it also

⁶¹ Yeats (ed) (2018) 2-465. See Cassim (ed) (2021) 390, which highlights the fact that a shareholder's investment may have been tainted due to the reacquiring company, for example, increasing its debt-equity ratio or disposing of all its liquid assets via a share reacquisition, which makes it an unattractive- or an attractive target, respectively. See also Parrino *et al* *Fundamentals of Corporate Finance* (2018) 17-8, noting that a reacquisition of a large percentage of shares can change the company's ownership and thereby change the percentage of shares held by majority shareholders, and as a result their means to control the company. Furthermore, if a large amount of cash is distributed to the selling shareholders through a reacquisition, it will result in a diminishing of liquidity for the remaining shares.

⁶² Van der Linde 2010 *TSAR* 288 289.

⁶³ See fn 61 above for examples of how a reacquisition can affect a non-selling shareholder's investment. See also Cassim (ed) (2021) 389, stating that although a reacquiring company's earnings per share increases after a share reacquisition there is no real increase in the available earnings for distribution.

increases the remaining shareholders' shareholding.⁶⁴ This last-mentioned function of share reacquisitions, which leads to a change in the company's ownership, creates a vehicle for directors or majority shareholders to preserve, acquire or consolidate their control or positions.⁶⁵

Share reacquisitions, not only offer a platform for abuse of power but may also lead to directors facing a conflict of interests even if they are not company shareholders.⁶⁶ Directors may employ selective reacquisitions to eliminate shareholders who are a threat to the company's management, by employing the company's funds as an exit bribe.⁶⁷ The interest of the directors will however even be affected by a general offer, as the selling shareholders normally have an unproportionate number of shareholders disaffected with the company's board of directors.⁶⁸ Share reacquisitions are therefore a means by which directors can apply the company's funds to alter the shareholders' composition – a reorganisation of ownership – which affects the voting process' outcome.⁶⁹

2.3.3 Transfer of shares

Lastly, a company that reacquires its shares has been described as the “ultimate insider”, because the reacquisition of shares – as a share transfer – creates the opportunity for insider trading as well as market manipulation.⁷⁰ In this context, a selling shareholder is at risk of accepting an under-valued purchase price for its shares because the company withheld price-sensitive information.⁷¹ Furthermore, the manipulation of the market value of a company's shares can be done via the directors

⁶⁴ Van der Linde 2009 *SA Merc LJ* 33 44.

⁶⁵ Yeats (ed) (2018) 2-463; Van der Linde 2009 *SA Merc LJ* 33 44.

⁶⁶ Yeats (ed) (2018) 2-464. Directors who are shareholders of the purchasing company have an inherent interest in a share reacquisition. Non-shareholder directors will however also have an interest due to the reorganisational effect of share reacquisitions.

⁶⁷ Yeats (ed) (2018) 2-464.

⁶⁸ Yeats (ed) (2018) 2-464.

⁶⁹ Yeats (ed) (2018) 2-464.

⁷⁰ See Van der Walt *The definitions of 'inside information' and 'insider' in the Financial Markets Act 19 of 2012* (LLD thesis 2019 Stellenbosch) 270, in which it is argued that the Financial Markets Act 19 of 2012 (the “FMA”) by implication provides that a company can be an insider, as defined. S 77 of the FMA defines insider, *inter alia*, as a “person” who is in the possession of inside information. If the definition of “person” in s 77 of the FMA, which defines such term as inclusive of “a partnership and any trust”, is read with the same definition in s 2 of the Interpretation Act 33 of 1957, a strong argument can be made that an “insider” includes a company. See also Cassim (ed) (2021) 1318, in which it is advanced that there exists no basis why the insider trading provisions in the FMA should not find application if a company purchase its shares or the holding company's shares if it has inside information.

⁷¹ Van der Linde 2010 *TSAR* 288 288.

depressing the shares' price, for example via misinformation.⁷² Alternatively, the company can inflate its shares' value, by disposing of its shares in terms of an over-valued reacquisition scheme or reacquiring it in the open market.⁷³ This manipulation thereby abuses reacquisitions' resultant change of ownership, as described above.

Since a share reacquisition, which is a transfer of assets, can clearly be made for improper reasons I agree with Cassim that it inherently has the potential for a power abuse by the reacquiring company, acting through its board.⁷⁴ This considerable concern of possible fraud or abuse by a company's directors is not limited to South Africa, but also exists in some jurisdictions in Europe.⁷⁵

2.3.4 Abuse within a group context

Indirect reacquisitions are also not exempted from possible abuse of control. The "troublesome" and "complicated" relationship between group companies, as described by Delport, leads to potential concerns that may exist if a subsidiary purchases shares from its holding company.⁷⁶ This may include, as mentioned as an *obiter dictum*, a subsidiary company using indirect reacquisitions to traffic its shares, by abusing its control over its holding company, or a reduction of capital through "round-tripping".⁷⁷

In light of the above, it is clear that there is a great risk of potential abuse associated with a company reacquiring its own shares or that of its holding company. Both creditors' and shareholders' interests are at stake during such transactions. It is therefore important that a legal system acknowledges such risks and ensures that it adequately regulates same to avoid any abuse of power to the detriment of the buying company's shareholders and creditors. At first glance, it may seem – as advanced by some commentators – that the easiest option to circumvent any potential prejudice for creditors and shareholders associated with share reacquisitions is to prohibit such transactions.⁷⁸ By considering the benefits associated with share reacquisitions

⁷² Yeats (ed) (2018) 2-464.

⁷³ Yeats (ed) (2018) 2-464.

⁷⁴ Cassim 1999 *SALJ* 760 765.

⁷⁵ Hanks "The new legal capital regime in South Africa" 2010 *Acta Juridica* 131 143.

⁷⁶ Delport "Acquisition of shares in a holding company by its subsidiary" 2014 *THRHR* 99 99.

⁷⁷ *Unisec* case 265ff. See also Delport 2014 *THRHR* 99 99, in which it is advanced that the court's reference to a reduction in capital stems from the capital maintenance rule which existed in our law, as described in para 2.2.1 above, and that the same principles regarding the use of capital still applies but is now subject to the liquidity and solvency test.

⁷⁸ See McCable "The Desirability of a share buy-back power" 1991 *Bond LR* 115 138 who promotes an outright ban on share reacquisitions from an international perspective.

hereafter, I will consider whether the statutory requirements in the Act provide adequate protection to the interests of creditors and shareholders.

2.4 The rationale behind share reacquisitions

The benefits share reacquisitions may have, are mainly to the company's and shareholders' advantage, but can include some "knock-on" benefits for the company's creditors.⁷⁹ The latter creditors' advantages flow from the reacquiring company's ability to keep itself "healthy".⁸⁰ This is due to the fact that a company can use a share reacquisition to restructure itself to, for example, prevent hostile takeovers, attain an optimum debt-equity ratio and effect mergers more efficiently.⁸¹ It should be noted, as evident below, that the advantages associated with reacquisitions are not unanimously acknowledged, as some might regard them as disadvantages, and is still a topic of ongoing academic debate.⁸²

The flexibility reacquisitions provide to companies to fulfil their commercial aims while still providing creditors with the necessary protection was firstly advanced as one of the share reacquisitions' advantages in the Memorandum on the Objects of the Companies Amendment Bill, 1999.⁸³

The Memorandum to the Bill furthermore advanced that share reacquisitions give a manner by which a shareholder or a deceased shareholder's estate can find a new shareholder if a company is not listed.⁸⁴ The latter is an important advantage, especially in the case of small private companies that often struggle to find a purchaser for a shareholder's shares who died or retired.⁸⁵ From a financial management perspective, if a shareholder is desirous of selling its shares, a reacquisition, specifically a selective offer, gives the company an opportunity to purchase it instead of an "unfriendly investor".⁸⁶

⁷⁹ Bradstreet 2012 *SALJ* 736 753.

⁸⁰ Bradstreet 2012 *SALJ* 736 753.

⁸¹ Bradstreet 2012 *SALJ* 736 753.

⁸² Van der Linde 2009 *SA Merc LJ* 33 46. See Bourne "Purchase by a Company of Its Own Shares" 1981 *New LJ* 387 387. See also Fox "Companies Purchasing Their Own Shares" 1981 *JBL* 271 274 is generally supportive of reacquisitions. See however Clark *Corporate Law* (1986) 627, which critically considers the so-called advantages to reacquisitions.

⁸³ B17D-99 (hereafter the "Memorandum to the Bill") 28.

⁸⁴ The Memorandum to the Bill 28. See also Yeats (ed) (2018) 2-467.

⁸⁵ Van der Linde 1999 *JBL* 68 68.

⁸⁶ Parrino (2017) 17-9.

Share reacquisitions enable a company to purchase shares from a previous employee, which was held as part of an employee share scheme.⁸⁷ It is however possible that a previous employee's shares can be held in trust and that the trustee's reacquisition of the shares can be financed by the company.⁸⁸ With private companies, reacquisitions are also a method by which family control within the company can be ensured.⁸⁹

Another purpose behind a reacquisition, mentioned in the Memorandum to the Bill, is the fact that it provides companies with a vehicle to avoid hostile take-overs.⁹⁰ As mentioned above, these reacquisitions however encapsulate a potential prejudice for shareholders, as the consideration for such share reacquisitions can be described as a "bribe" and embeds the existing management's control.⁹¹ A share reacquisition is furthermore beneficial for a company to buy out a dissident shareholder.⁹² This is mostly however also regarded as a bribe, paid out of the company's funds, to the particular shareholder to convince it to sell its shares.⁹³

Lastly, the Memorandum to the Bill mentions, as an advantage to a company's ability to reacquire its shares, that by doing so it can support its shares' market.⁹⁴ It has been advanced that this purpose refers to a listed company's ability to affect its shares' market price because it thinks it is undervalued.⁹⁵ A company can therefore utilise reacquisitions to provide a shield of protection against unscrupulous speculators who manipulates the company's market share prices.⁹⁶ A company's intention with such reacquisition will however lead to a distortion of the market and the creation of a lottery, from a shareholder's perspective.⁹⁷ Furthermore, if a company's directors decide to reacquire its shares while having inside information – information that would

⁸⁷ The Memorandum to the Bill 28. See also Van der Linde 1999 *JBL* 68 68.

⁸⁸ Yeats (ed) (2018) 2-468. See also s 44 of the Act.

⁸⁹ Van der Linde 2009 *SA Merc LJ* 33 46.

⁹⁰ The Memorandum to the Bill 28.

⁹¹ Yeats (ed) (2018) 2-476.

⁹² Yeats (ed) (2018) 2-468.

⁹³ Yeats (ed) (2018) 2-468. See para 2.3.2 above.

⁹⁴ The Memorandum to the Bill 28.

⁹⁵ Yeats (ed) (2018) 2-474. See also Delpont *et al Henochsberg on the Companies Act 71 of 2008* (2022) 205.

⁹⁶ Van der Linde 1999 *JBL* 68 68; Butler "n Maatskappy se nuwe statutêre bevoegdheid om sy eie aandele te verkry: 'n Vertrekpunt" 1999 *Stell LR* 284 285.

⁹⁷ Yeats (ed) (2018) 2-475.

have likely materially affected the value or price of the company's shares – they will find themselves guilty of market manipulation and insider trading.⁹⁸

In light of the benefits of share reacquisitions, highlighted above, and the purpose such transactions can fulfil, I do not believe that a blanket prohibition against share reacquisitions in our law is to be preferred. I do however agree with van der Linde who stresses the need that our company law should regulate distributions – which includes reacquisitions – to safeguard creditors' rights against endangerment and ensure that no disproportionate payments are made between shareholders.⁹⁹ Instead of banning share reacquisitions as a whole, I believe that the answer rather lies in properly addressing and regulating the risks associated with the different types of share reacquisitions. I think that such adequate regulation should not only include proper rules that a buying company should adhere to during share reacquisitions, but also safeguards that ought to be available to shareholders and creditors of the said company protecting them against potential prejudice.

2.5 Conclusion

In conclusion, legal systems such as the Act, which allow share reacquisitions, biggest strength compared to our pre-1999 capital maintenance regime, is the flexibility they afford companies to achieve their commercial objects. There are numerous advantages for South African companies which flow from such flexibility like avoiding a hostile take-over or supporting their shares' market. The weakness of the aforementioned system is however that it opens the door to potential prejudice being suffered by the reacquiring company's creditors and shareholders as a result of such share reacquisition. It is therefore imperative that share reacquisitions are adequately regulated in terms of the Act and that the shareholders and creditors are armoured with sufficient protective measures to shield them against any risk of a power abuse. An evaluation of the former will hereafter follow.

⁹⁸ Yeats (ed) (2018) 2-475. See also fn 70 above. For additional share reacquisition advantages see Cassim (ed) (2021) 388.

⁹⁹ Van der Linde "The regulation of distributions to shareholders in the Companies Act 2008" 2009 *TSAR* 484 484.

CHAPTER 3

THE REGULATION OF SHARE REACQUISITIONS IN TERMS OF THE ACT

3.1 Introduction

Section 48 of the Act covers two types of transactions namely direct reacquisitions, when a company reacquires its own shares, and indirect reacquisitions.¹⁰⁰ The latter refers to the acquisition of a holding company's shares by its subsidiary. In this chapter the current regulation of both types of reacquisitions, by the different recognised types of companies, will be evaluated. This will include highlighting the uncertainties and challenges in the interpretation of section 48 of the Act and other relevant sections. Lastly, the interrelationship between section 48 and section 114 of the Act will be considered.

3.2 The regulation of direct reacquisitions

Both direct and indirect reacquisitions are authorised by section 48(2) of the Act. The last-mentioned sub-section however qualifies this authorisation, by subjecting both types of reacquisitions to sections 48(3) and (8).¹⁰¹ Section 48(2) of the Act also requires the decision by the board, to acquire the company's shares, to satisfy the requirements of section 46 of the Act. I agree with Van der Linde that this reference to section 46 in section 48(2) of the Act is "unnecessary and confusing", as the consideration given by the company in exchange for acquiring its shares is already included in a distribution's definition, in section 1 of the Act, and therefore regulated by section 46 regardless of such reference.¹⁰² The legislature's choice of subjecting the "decision" to section 46, and not the consideration for the reacquired shares, is also questionable as the former section prescribes the requirements for "distributions" – not decisions – and requires in itself decisions to be made.¹⁰³

¹⁰⁰ Delpont 2014 *THRHR* 99 101.

¹⁰¹ See paras 3.3 and 3.5 below regarding the scope of ss 48(3) and (8) of the Act, respectively.

¹⁰² See Van der Linde 2009 *TSAR* 484 492; Yeats (ed) (2018) 2-479.

¹⁰³ Van der Linde 2009 *TSAR* 484 492. See also Delpont *et al* (2022) 206; Delpont 2014 *THRHR* 99 101; Van der Linde (LLD thesis 2008 UNISA) 477-478.

A company's MOI can impose additional requirements for share reacquisitions, in light of section 15(2)(a)(iii) of the Act, as long as they are more onerous than those prescribed by section 48(2),¹⁰⁴ which is an unalterable provision.¹⁰⁵

3.2.1 Scope of regulation

Before considering the requirements of reacquisitions an understanding of the exact ambit of section 48 of the Act, is essential. Firstly, the term "acquisition" used in section 48(2) of the Act is a "misnomer" because it implies that the reacquiring company is the holder of its own shares, post-transaction, which is not possible.¹⁰⁶ Section 35(5) of the Act specifically provides that the status of reacquired shares is equal to those that are authorised but unissued. A company is therefore disallowed to directly purchase treasury shares,¹⁰⁷ except under certain circumstances through its subsidiaries.¹⁰⁸

Additionally, redeemable securities issued in terms of section 37 of the Act, and redeemed by the company according to their terms, are expressly excluded from section 48's ambit.¹⁰⁹ Such a redemption is however still a distribution and accordingly subject to section 46's requirements.¹¹⁰ This redemption should also be distinguished from redeemable securities which are "acquired" – redeemed otherwise than per its terms – which triggers section 48 of the Act's application.¹¹¹ The legislature's reference to sections 46 and 48 of the Act in section 37(5)(b),¹¹² is confusing as it could be interpreted, in contradiction to section 48(1)(b), that redemptions are share reacquisitions.¹¹³ I however agree with Yeats that the legislature's failure to amend

¹⁰⁴ Cooke 2012 *SA Merc LJ* 371 383.

¹⁰⁵ See the definition of an "unalterable provision" in s 1 of the Act.

¹⁰⁶ Jooste 2009 *SALJ* 627 636. See also Yeats (ed) (2018) 2-480; Cassim (2021) 394.

¹⁰⁷ See Cassim "The repurchase by a company of its own shares: the concept of treasury shares" 2003 *SALJ* 137 137, in which treasury shares are defined as fully paid issued shares of a company that are reacquired by that company, but instead of cancelling those shares upon reacquisition the company is allowed to resell them at their market value.

¹⁰⁸ Jooste 2009 *SALJ* 627 636; Yeats (ed) (2018) 2-486. See para 3.3 below, regarding the circumstances under which treasury shares may be purchased. See however ss 724 and 732 of the UK Companies Act, 2006 (the "UK Act"), which interestingly allows treasury shares in the UK. This is an example where our law and the UK followed different approaches over the years as both originally forbidden treasury shares. See Morse *et al Palmer's Company Law* (2021) 6.862.

¹⁰⁹ S 48(1)(b) of the Act.

¹¹⁰ Delpont *et al* (2022) 206.

¹¹¹ Delpont *et al* (2022) 206. See also Yeats (ed) (2018) 2-478.

¹¹² See s 37(5)(b) of the Act which gives a company's MOI the authority to provide for shares which are redeemable, but states that those shares are subject to ss 46 and 48 of the Act's requirements.

¹¹³ Yeats (ed) (2018) 2-478.

section 37(5)(b) when it inserted section 48(1)(b) by amendment is likely an oversight, as reacquisitions and redemptions are two different transactions.¹¹⁴ The former is a voluntary transaction between a shareholder and the company which comes into existence with an offer and an acceptance.¹¹⁵ With the latter, the company can force the securities' redemption in terms of their conditions. Nevertheless, the effect is the same – as both are distributions – the obligatory procedure however differs.¹¹⁶

Section 48(1)(a) of the Act also excludes from its regulation, the exercise of a shareholder's appraisal right or a company's payments to its shareholder in terms of section 164 of the Act.¹¹⁷

3.2.2 Requirements of a distribution

All distributions – including reacquisitions unless specifically excluded – must comply with the three requirements prescribed in section 46 of the Act. Sub-section (1)(a) of the Act firstly requires an initiating board resolution authorising the reacquisition. Section 46(1)(b) of the Act obligates a confirmation that it “reasonably appears” that the company will pass the solvency and liquidity test, envisaged in section 4 of the Act, after the share reacquisition. The last requirement, in terms of section 46(1)(c) of the Act, is an effecting resolution by the board in which they acknowledge the company's application of the aforementioned test and that it will be complied with immediately after the reacquisition.¹¹⁸

After the board's compliance with section 46(1)(a)-(c) of the Act, the distribution must be completed within 120 business days, failing which a new acknowledgment by the board is required.¹¹⁹ Based on the wording of section 46(2),¹²⁰ it appears that a company is obliged to continue with a reacquisition, even if it is not solvent and liquid immediately after the distribution, if the directors made the required acknowledgment

¹¹⁴ Yeats (ed) (2018) 2-478.

¹¹⁵ Delpont *et al* (2022) 208(2).

¹¹⁶ Delpont *et al* (2022) 206.

¹¹⁷ See para 3.6.3 below for a discussion of the *Capital* case, in which the appraisal remedy's application in the context of share reacquisitions was considered.

¹¹⁸ It has been held that s 46(1)(b) of the Act is unnecessary and that sub-s (1)(c) could have sufficed since no company will call for the passing of the effecting resolution without first successfully applying the s 4 test. See Cooke 2012 *SA Merc LJ* 371 373; Van der Linde 2009 *TSAR* 484 494.

¹¹⁹ S 46(3) read with s 46(2) of the Act.

¹²⁰ See s 46(2) of the Act which provides that: “When the board of a company has adopted a resolution contemplated in subsection (1)(c), the relevant distribution must be fully carried out...”.

within the 120 days.¹²¹ This renders section 46(1)(b) of the Act without effect. I agree with Van der Linde that companies should rather be prohibited to continue with share reacquisitions if it will place them in an insolvent and/or illiquid position.¹²² It is submitted that allowing a company to proceed with a reacquisition in the latter position is against the solvency and liquidity test's object, of protecting creditors during certain transactions which affect a company's capital.¹²³ I also agree with Cooke that the 120-day period invites potential abuse and uncertainty as it might lead to a company prolonging a distribution's completion to the shareholders' detriment.¹²⁴ It is submitted that a requirement that a distribution must be made "immediately" or as the company's next financial transaction, would be more desirable.¹²⁵

In light of the above, it is further noteworthy that there is no requirement that reacquisitions offered by a company must be *pro-rata* offers or made to all shareholders.¹²⁶ The regulation of the different types of reacquisitions – namely *pro-rata* offers, selective- and general reacquisitions – are also identical, as they should all comply with the same above-mentioned statutory requirements.

3.3 Regulation of "indirect" reacquisitions

3.3.1 Requirements

In respect of indirect reacquisitions, section 48(2)(b) of the Act requires the board of a subsidiary company – who wishes to acquire shares from its holding company – to take such a decision per section 46 of the Act. In other words, are subject to the three requirements, and their accompanied uncertainties described above.¹²⁷ This decision by the subsidiary's board is, by section 48(2), also subject to sections 48(3) and (8) of the Act.¹²⁸

¹²¹ Van der Linde 2009 *TSAR* 484 494.

¹²² Van der Linde 2009 *TSAR* 484 494.

¹²³ See para 4.3.1 below, for an evaluation of the protection offered by the solvency and liquidity test.

¹²⁴ Cooke 2012 *SA Merc LJ* 371 376-378.

¹²⁵ Cooke 2012 *SA Merc LJ* 371 376-378. See however s 694(5) of the UK Act which requires public companies, but not private companies, to stipulate a time period, between the resolution and the actual reacquisition, which does not exceed five years.

¹²⁶ Delpont *New entrepreneurial law* (2020) 105.

¹²⁷ See para 3.2.2 above.

¹²⁸ This is in contrast with a complete prohibition of indirect reacquisitions, which is endorsed by Van der Linde (LLD thesis 2008 UNISA) 506 and, save for certain exceptions, is seen in the UK. See s 136 of the UK Act.

3.3.2 Limitations

Section 48(2)(b)(i) of the Act limits the number of shares which may be held by all the subsidiaries after an indirect reacquisition, to 10% of all the holding company's issued shares of any class. Furthermore, no subsidiary may, in terms of section 48(2)(b)(ii) of the Act, exercise any voting rights attached to "indirectly" acquired shares while being a subsidiary of the holding company. These limitations play an important part to prevent any "mischief" by subsidiaries, and their holding companies.¹²⁹ An example of such misbehaviour is where the aforementioned companies increase their distributions through the "round-tripping" of dividends.¹³⁰

Delpont highlights two clear omissions by the legislature, namely section 48's failure to address the unintended effect that indirect reacquisitions have on the remaining shareholders' shareholding and the potential consequential change in control.¹³¹ The latter section does not regulate the possibility that a subsidiary may acquire its own shares in a manner that is not provided for in the Act.¹³² For example, a holding company can declare a dividend *in specie* in the form of shares to its subsidiary, which includes shares it holds in the subsidiary.¹³³ This would lead the subsidiary – as the holding company's shareholder – to obtain shares in itself. I believe that the legislature should provide clarity in this regard, as proper regulation of "direct reacquisitions" will become superfluous if a company can circumvent the anti-abuse statutory provisions by acquiring its holding company's shares in such a manner that is not regulated by the Act.

Another limitation to share reacquisitions, provided in section 48(3) of the Act, is that no indirect, or direct reacquisitions may be made if it will result in all the issued shares being held by only the company's subsidiaries or are redeemable or convertible

¹²⁹ Kleitman *et al* "Can a subsidiary company ever hold more than 10% of the issued shares in its holding company?" 2020 *Without Prejudice* 45 46; Jooste 2009 *SALJ* 627 638.

¹³⁰ The "round-tripping" of dividends is used by holding and subsidiary companies to hide, from minority shareholders and creditors, the fact that the additional dividends declared forms part of the original distributable income and is not additional income. See Bhana "The company law implications of conferring a power on a subsidiary to acquire the shares of its holding company" 2006 *Stell LR* 232 241-242.

¹³¹ For e.g., if company X has 50 issued shares and shareholder Y holds 5 of those shares. Shareholder Y has accordingly 10% of the company X's votes. If subsidiary Z purchases 5 of company X's shares (which will be without any voting rights as per s 48(2)(b)(ii) of the Act), shareholder Y's votes will change to 11% (5 out of 45 shares). See Delpont (2020) 104.

¹³² Delpont (2020) 104. See also Kleitman *et al* 2020 *Without Prejudice* 45 45.

¹³³ See Delpont (2020) 104-105.

shares. The latter limitation regarding redeemable or convertible shares is questionable since any other shares can, post the reacquisition, be converted to such types of shares.¹³⁴ I also agree with Delpont¹³⁵ and Van der Linde¹³⁶ that the former exception regarding the shares that subsidiaries may hold is redundant, as the Act already limits the shares to be held by subsidiaries to 10%, as described above.

3.4 The enforceability of reacquisition agreements and consequences of non-compliance with regulating provisions

3.4.1 The enforceability of reacquisition agreements

An agreement by a company to acquire its shares is, in terms of section 48(4) of the Act, enforceable against such a company.¹³⁷ It is noteworthy that the aforementioned contract need not be available for inspection, contrary to other jurisdictions' legislation such as the UK Act.¹³⁸ If a company alleges that it will not be able to meet its duties under the reacquisition agreement, it may per section 48(5), apply for a just and equitable court order as to when payment should be made. The court will make such an order while having regard to the company's other financial obligations but which still ensures that the seller receives its payment as soon as possible.¹³⁹

3.4.2 Consequences of non-compliance with regulating provisions

If a company fails to comply with sections 46 or 48 of the Act, the reacquisition agreement or resolution will not be, in terms of section 218(1) of the Act, void unless a court makes such a declaration. A company is however obliged to apply for a court order reversing a direct or indirect reacquisition, in non-compliance with sections 46 or 48, within two years.¹⁴⁰ The court may then order that the selling shareholder must return the consideration paid by the company and the company must issue to such

¹³⁴ Delpont (2020) 105.

¹³⁵ Delpont (2020) 105.

¹³⁶ Van der Linde (LLD thesis 2008 UNISA) 478.

¹³⁷ The reason for the distinction between direct and indirect reacquisitions is not clear. See Delpont 2014 *THRHR* 99 106; Cassim (ed) (2021) 400; Jooste 2009 *SALJ* 627 644. See also Van der Linde 2009 *TSAR* 484 494 regarding s 48(4)'s interpretational issues.

¹³⁸ See ss 696(2) and 702.

¹³⁹ See Van der Linde (LLD thesis 2008 UNISA) 485, suggesting that the scope of s 45(5) be widened to include court orders which, for example, forces an increase in a company's shares, an issue of shares to non-subsidiary shareholders or demands that the board reconsiders the solvency and liquidity test. See also para 4.3.2 below.

¹⁴⁰ S 48(6) of the Act.

shareholder shares equal to those previously acquired.¹⁴¹ Directors may also incur, under certain circumstances, liability for reacquisitions contrary to sections 46 or 48.¹⁴²

3.5 Share reacquisitions requiring additional requirements

3.5.1 Listed companies

A company listed on the JSE Stock Exchange must comply, over and above the aforementioned requirements in the Act, with certain requirements provided for in the JSE Limited Listings Requirements if it wishes to reacquire its shares.¹⁴³ For instance, as a general rule, both specific and general reacquisitions need to be authorised by the shareholders of the reacquiring company via a special resolution.¹⁴⁴ This prior approval required from shareholders is in my opinion a positive requirement, as holders of listed securities are still susceptible to a reacquiring company's abuse of power and therefore also require safeguards during reacquisitions.

3.5.2 Shares acquired from directors, prescribed officers, or related persons

Certain types of reacquisitions of shares are subject to section 48(8) of the Act. Sub-section (8)(a), in addition to the aforementioned obligations,¹⁴⁵ requires the board's decision to reacquire the company's shares, to be approved by a special resolution if the seller is a director, prescribed officer, or a related person to such persons. The main purpose of this additional requirement is to prevent directors' abuse of power to benefit themselves.¹⁴⁶

3.5.3 Share reacquisitions exceeding the 5%-threshold

The decision by the board to reacquire the company's shares is also, in terms of section 48(8)(b) of the Act, subject to the "requirements of sections 114 and 115" if 5% or more of a specific class of shares are reacquired. This raises the question of whether a transaction within the latter sub-sections' scope should be regarded as a

¹⁴¹ There are various interpretational issues associated with s 48(6) of the Act. See for example Delpont *et al* (2022) 208(1); Cassim (ed) (2021) 401; Delpont 2014 *THRHR* 99 105-106; Jooste 2009 *SALJ* 627 645-646.

¹⁴² See para 4.4.1 below.

¹⁴³ See paras 11.23-11.25, 5.69(b) and 5.68, 5.72, 11.26-11.27 of the JSE Limited Listings Requirements which deals with the requirements of selective and general reacquisitions, respectively. See paras 5.67-5.81 regarding share reacquisitions in general.

¹⁴⁴ Paras 5.69(b) and 5.72(c) of the JSE Limited Listings Requirements. See also Steenkamp & Wesson "The relationship between share repurchases and share-based remuneration of South African CEOs: an explanatory study 2020 *Management Dynamics* 2 4.

¹⁴⁵ See para 3.2.2 above.

¹⁴⁶ Cassim (ed) (2021) 396.

scheme of arrangement or is merely subject to such an arrangement's requirements, provided for in sections 114 and 115 of the Act.¹⁴⁷

3.6 Interrelationship between sections 48 and 114 of the Act

3.6.1 Introduction

The interrelationship which exists between sections 48 and 114 of the Act is important as this determines the procedure and approvals a company ought to abide by before implementing such reacquisition transactions. An evaluation of this issue will accordingly hereafter follow, starting with a brief overview of section 114 of the Act.

3.6.2 Overview of section 114 of the Act

Part A of Chapter 5 of the Act governs fundamental transactions. These transactions are not defined in the Act but have been described as specific actions by a company for which particular requirements are prescribed, and include schemes of arrangement.¹⁴⁸ The last-mentioned arrangement, which is between a company and its shareholders, or a class thereof, can only be proposed by its board and can be implemented, *inter alia*, by way of a re-acquisition of securities per section 114(1)(e) of the Act.¹⁴⁹

Companies proposing a scheme of arrangement must appoint an independent expert, which complies with section 114(2) of the Act's requirements, to draft a report regarding such a proposed arrangement. This report must include the particulars set out in section 114(3) of the Act and should be furnished to the directors and circulated between the company's securities holders. Section 114(4) furthermore provides that section 48 of the Act applies to a scheme of arrangement contemplated in section 114, to the extent that it would lead to a company reacquiring formerly issued securities.

Section 115 of the Act, in addition, prescribes the implementation procedure of fundamental transactions, including schemes of arrangement. Section 115(2)(a) of the Act, and similarly section 115(2)(b) in the case of indirect reacquisitions, requires

¹⁴⁷ See para 3.6.2 below, for an overview of ss 114 and 115.

¹⁴⁸ Delpport (2020) 203. See *Capital* case para 15; Latsky "The fundamental transactions under the Companies Act: a report back from practice after the first few years" 2014 *Stell LR* 361 361. See also ss 112 and 113 of the Act governing the other two fundamental transactions, namely a proposal to dispose all or most of a companies' assets or undertakings, and mergers or amalgamations, respectively.

¹⁴⁹ Delpport (2020) 210.

a special resolution to be passed by the securities holders entitled to vote on the matter. Section 115(2)(c) of the Act, provides for instances when a court's approval of the fundamental transaction is required. Lastly, section 115(8) gives dissenting shareholders, during the latter transactions, an appraisal right, as contemplated in section 164 of the Act.¹⁵⁰ The aforementioned right is triggered if such a shareholder notifies the company that it intends to oppose the special resolution approving a fundamental transaction and then at the meeting votes against it.¹⁵¹

3.6.3 Potential overlap between sections 48 and 114 of the Act

A company is accordingly empowered to reacquire its shares in terms of section 114(1)(e) of the Act, as a scheme of arrangement. Such a transaction will in terms of section 114(4) also be subject to section 48 read with section 46 of the Act. If the reacquisition is a reacquisition as contemplated in section 48(8)(b) of the Act it is also subject to the "requirements of sections 114 and 115" of the Act, being the regulating provisions of schemes of arrangement. This overlap between sections 48 and 114 and the failure in the Act to draw a clear distinction between the two types of share reacquisitions is problematic as it creates uncertainty and an arbitrage opportunity.¹⁵² This interrelationship between sections 48, 114, and 115 of the Act was considered by the SCA in the recent *Capital*¹⁵³ case.

3.6.3.1 The Capital case

(a) The facts

In the *Capital*¹⁵⁴ case, a circular was issued by Capital Appreciation Ltd,¹⁵⁵ to its shareholders, including First National Nominees (Pty) Ltd,¹⁵⁶ which held just over 18 million shares in the Appellant. In terms of the circular shareholders were notified of the Appellant's intention to reacquire 245 million of its shares for R196 million from particular shareholders.¹⁵⁷ The Appellant informed the shareholders that the proposed

¹⁵⁰ An appraisal right is a dissenting shareholder's right to have its shares be purchased by the company at their market value when certain triggering events occurs. See Yeats (ed) (2018) 7-24. See also s 164 of the Act for the procedure which ought to be followed by the respective parties.

¹⁵¹ S 115(8) of the Act.

¹⁵² Cassim (ed) (2021) 398.

¹⁵³ See *Capital* case paras 12-29.

¹⁵⁴ *Capital* case para 3.

¹⁵⁵ Hereafter the "Appellant".

¹⁵⁶ Hereafter the "First respondent".

¹⁵⁷ *Capital* case para 3.

reacquisition was subject to sections 48, 114, and 164 of the Act because it would lead to a reacquisition of its issued shares over the 5%-threshold and that the passing of a special resolution, per section 115 of the Act, was therefore required.¹⁵⁸ Notwithstanding the First respondent's objection to the aforementioned resolution, it was passed by the Appellant's shareholders.¹⁵⁹ Relying on section 164 of the Act, the First respondent subsequently demanded the Appellant to reacquire its shares.¹⁶⁰ The First respondent was however not satisfied with the Appellant's purchase price offered for its shares and accordingly brought a court application, in terms of section 164(14) of the Act, for a determination of its shares' fair value.¹⁶¹

The Appellant argued that section 164 of the Act did not find application as dissenting shareholders' appraisal right is only triggered upon the occurrence of the circumstances described in section 164(2)(a) and (b).¹⁶² Sub-section (2)(b), according to the Appellant, only includes share reacquisitions envisaged in section 114 and not share reacquisitions contemplated in section 48 of the Act.¹⁶³

(b) The High Court judgment

The High Court in the *HC Capital* case found that reacquisitions envisaged in section 48(8)(b) are not *per se* schemes of arrangement and that they only require compliance with the requirements in sections 114 and 115 of the Act.¹⁶⁴ The High Court held that because the reacquisition contemplated by the Appellant exceeded the 5%-threshold in section 48(8)(b) of the Act, the requirements in sections 114 and 115 were triggered.¹⁶⁵ This in turn gave the First respondent the right to apply to the court to determine its shares' fair value in terms of section 164 of the Act, regardless of whether such a transaction was a scheme of arrangement.

(c) The judgment of the Supreme Court of Appeal

The Appellant appealed to the SCA, which found after providing a summary of the relevant law, that a share reacquisition above the 5%-threshold envisaged in section

¹⁵⁸ *Capital* case para 3.

¹⁵⁹ *Capital* case para 4.

¹⁶⁰ *Capital* case para 4.

¹⁶¹ *Capital* case para 4.

¹⁶² *First National Nominees (Pty) Limited v Capital Appreciation Limited* 2021 4 SA 516 (GJ) (hereafter the "*HC Capital* case") para 9.

¹⁶³ *HC Capital* case para 18.

¹⁶⁴ *HC Capital* case para 30.

¹⁶⁵ *HC Capital* case para 32.

48(8)(b) is “regarded as a fundamental transaction”.¹⁶⁶ Without explicitly confirming that such reacquisition is a scheme of arrangement, it arguably, therefore, did so implicitly as such schemes are commonly seen as one of the three fundamental transactions provided for in Part A of Chapter 5 of the Act. The SCA further held that there is a “direct connection” between sections 48(8)(b) and 164, and accordingly to the First respondent’s contended appraisal right, through sections 114 and 115 of the Act.¹⁶⁷ The court however concluded that since the First respondent complied with “the *procedural requirements* of section 115 and section 164” it is entitled to receive its shares’ fair value from the Appellant.¹⁶⁸ The appeal was accordingly dismissed.

3.6.3.2 Evaluation of the *Capital* case

(a) The need for the protection distinction between sections 48(8)(b) and 114(1)(e) of the Act

In my opinion, to be able to properly evaluate the *Capital*¹⁶⁹ case, the distinction between a reacquisition above the 5%-threshold, contemplated in section 48(8)(b), and one in terms of section 114(1)(e) of the Act, should first be considered. The first-mentioned type of reacquisition refers to merely an offer by a company to reacquire its shares and is not a compulsory acquisition; a shareholder cannot be forced to sell its shares based on the provisions of section 48 of the Act.¹⁷⁰ There is accordingly no risk for the dissenting shareholder that it will be coerced into selling its shares. The last-mentioned reacquisition per section 114(1)(e) of the Act, on the other hand, is a scheme of arrangement in terms of which a company reacquires its shares from its shareholder(s), but as the High Court rightfully, in my opinion, pointed out includes an element of coercion.¹⁷¹ The latter type of compulsory reacquisition provides, compared to the former, a different vehicle at the company’s disposal to effect a reacquisition with the necessary majority’s support when, for example, some shareholders did not respond to the company’s general offer to acquire their shares.¹⁷² Schemes of arrangement are therefore an alternative to reacquisitions – which can be achieved by independent agreements as envisaged in section 48(8)(b) – and cannot

¹⁶⁶ *Capital* case para 27.

¹⁶⁷ *Capital* case para 29.

¹⁶⁸ Own emphasis added. *Capital* case para 29.

¹⁶⁹ See *Capital* case paras 27-29 for the conclusion reached by the SCA.

¹⁷⁰ Delpont *et al* (2022) 208(2). See also Latsky 2014 *Stell LR* 361 382; Delpont (2020) 105.

¹⁷¹ *HC Capital* case para 18.

¹⁷² Latsky 2014 *Stell LR* 361 380.

be used to substitute a mandatory procedure as prescribed in section 48 of the Act.¹⁷³ Given the aforementioned described characteristics it is also clear that a reacquisition based on section 114(1)(e) holds a greater potential for an abuse of power for the reacquiring company's shareholders and creditors compared to a section 48(8)(b) consensual reacquisition.

Authors, such as Jooste, have furthermore argued, prior to the *Capital* case, that voluntary reacquisitions contemplated in section 48(8)(b) of the Act are not necessarily schemes of arrangement.¹⁷⁴ The words "subject to the requirements of section 114 and 115" in sub-section (8)(b) mean that only the requirements in the latter provisions must be met.¹⁷⁵ Delpont shares this view and opines that if the legislature intended that the reacquisition contemplated in section 48(8)(b) is a scheme of arrangement by definition, then the aforementioned quoted phrase could have excluded the words "the requirements".¹⁷⁶ Latsky agrees based on the fact that share reacquisitions via a private treaty, envisaged in section 48 of the Act, does not share a scheme of arrangement's characteristics.¹⁷⁷

(b) Reacquisition of shares as a fundamental transaction

The SCA in the *Capital* case held, as mentioned above, that a reacquisition above the 5%-threshold in terms of section 48(8)(b) of the Act should be regarded as a fundamental transaction; thereby arguably implying that such reacquisition is a scheme of arrangement.¹⁷⁸ However, the SCA subsequent confirmation of the required compliance with only "the procedural requirements of section 115",¹⁷⁹ directs in my opinion to a contrary argument. Namely that the latter type of reacquisition is

¹⁷³ Delpont *et al* (2022) 414. See also *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T); *Ex parte Natal Coal Exploration Co Ltd* 1985 4 SA 279 (W) and Latsky 2014 *Stell LR* 361 381 which compares a 311 scheme under the 1973 Act's purpose to an arrangement in terms of s 114 of the Act, as a means to affect the security holders and the company's rights and obligations *inter se* in a manner which conveniently cannot be reached by an independent contract between such parties. See also the cross-reference to s 48 in s 114(4) of the Act, which supports the principle that a scheme of arrangement's procedure in ss 114 and 115 of the Act cannot be used to circumvent s 48. This is important, as the passing of the solvency and liquidity test is for example not a requirement in terms of either s 114 or the Takeover Regulations, which means that a company proposing a scheme of arrangement could avoid compliance with such test in the absence of the cross-reference in s 114(4).

¹⁷⁴ Cassim (ed) (2021) 398.

¹⁷⁵ Cassim (ed) (2021) 398.

¹⁷⁶ Delpont *et al* (2022) 208(2A).

¹⁷⁷ Latsky 2014 *Stell LR* 361 381.

¹⁷⁸ See *Capital* case para 27.

¹⁷⁹ See *Capital* case para 29.

not per definition a scheme of arrangement but is only subject to the procedure set out in sections 114 and 115 of the Act, as advanced in the *HC Capital* case, and by the above authors. This line of argument is furthermore strengthened by the SCA decision to cite, in the conclusion, an author who submitted that the wording of section 48(8)(b) of the Act “simply means that ‘ss 114 and 115 must be complied with’”.¹⁸⁰ The SCA’s reference to a “fundamental transaction” – which is not defined in the Act – perhaps highlights the fact that reacquisitions contemplated in section 48(8)(b) lead to a fundamental change to a company’s share capital and therefore require additional requirements to be met,¹⁸¹ than those provided for in sections 46 and 48 of the Act.

In light of the above, I agree with the above authors that the legislature’s intention was to only subject reacquisitions envisaged in section 48(8)(b) of the Act to the requirements in sections 114 and 115 of the Act and not the substantive requirements regarding the nature of schemes of arrangement. I believe it prescribed different requirements and procedures – and an overlap where needed – for the two respective types of reacquisitions for a reason; being the different degrees of potential abuse for the company’s stakeholders which necessitates different safeguards. In addition, if the contrary is accepted and a reacquisition above the 5%-threshold is *per se* a scheme of arrangement, it means that if a regulated company¹⁸² – for example the Appellant – wishes to execute such a transaction it will be regarded as an affected transaction.¹⁸³ This will then require compliance with, in my opinion, unnecessary time-consuming, and costly additional approval and reporting requirements,¹⁸⁴ which in some cases will even not be possible to apply, if it is simply a mutual agreement between the company and a single or a few shareholders.¹⁸⁵

¹⁸⁰ See *Capital* case para 27.

¹⁸¹ The requirements are the passing of a special resolution, obtaining an independent expert report, while the dissenting shareholders have access to their appraisal right and a review by the court.

¹⁸² See s 117(1)(i), read with s 118(1) and (2), of the Act which describes a regulated company to include, *inter alia*, all public companies, state-owned companies except if they enjoy exemption in terms of s 9 and private companies under certain circumstances.

¹⁸³ The definition of an “affected transaction” includes, *inter alia*, in terms of s 117(1)(c)(iii) of the Act, a scheme of arrangement as provided for in s 114 between the shareholders of a regulated company and itself.

¹⁸⁴ The additional requirements may include procuring a fair and reasonable opinion, the formation of an independent board and providing the shareholders with a circular which sets out the information with the Takeover Regulations requires. See the Takeover Regulations 90 and 106; Latsky 2014 *Stell LR* 361 381; Luiz 2012 *PELJ* 102 126.

¹⁸⁵ See Latsky 2014 *Stell LR* 361 383.

I coincide with Bidie’s comments regarding the High Court’s non-engagement, in the *HC Capital* case with section 114(1)(e) of the Act and can in my opinion be applied equally to the SCA judgment in the *Capital* case.¹⁸⁶ I believe that the latter judgment, with respect, would have been more complete and helpful if it fully evaluated a scheme of arrangement contemplated in section 114(1)(e)’s scope and section 114 interrelationship with section 48 of the Act. It is submitted that the SCA’s focus on whether the First respondent could exercise its appraisal right resulted, in my view, in a missed opportunity to provide clarity on the above-considered question, given the facts before it.

3.6.3.3 Effect of the proposed amendments of section 48(8)(b)

It is important to note that the proposed changes to section 48(8) by the Companies Amendment Bill, 2021¹⁸⁷ will change the above position. It proposes to repeal section 48(8) and replace it firstly with section 48(8)(a); which reads materially the same as the current sub-section (8)(a) of the Act. The new proposed section 48(8)(b) however requires the company’s board decision, to acquire any of its shares, to be approved by its shareholders via a special resolution unless it is a *pro rata* offer or a reacquisition of listed shares.¹⁸⁸

Bidie points out as a positive consequence of the above-proposed amendments, that it eliminates the aforementioned uncertainties created by the 5%-threshold in the current section 48(8)(b).¹⁸⁹ The proposed changes are arguably reasonable as they ought to “streamline” the approval procedure of reacquisitions by shareholders and it also concisely separates share reacquisitions proposed in terms of sections 114 and 48 of the Act, respectively.¹⁹⁰ I agree with Bidie that the proposed amendments to section 48(8) of the Act are commendable as it removes the necessity of answering the question of whether a reacquisition exceeding the 5%-threshold is a scheme of arrangement. Removing the prescription of compliance with sections 114 and 115’s requirements in section 48(8)(b) of the Act, however, means that an important shareholder safeguard is deleted.¹⁹¹ The Companies Amendment Bill, 2021 also does

¹⁸⁶ See Bidie 2022 *SA Merc LJ* 52 79.

¹⁸⁷ GG 41913 dated 1 October 2021.

¹⁸⁸ See s 12 of the Companies Amendment Bill, 2021 GG 41913 dated 1 October 2021.

¹⁸⁹ Bidie 2022 *SA Merc LJ* 52 85.

¹⁹⁰ Bidie 2022 *SA Merc LJ* 52 85.

¹⁹¹ See para 4.2.3 below for a further evaluation.

not propose to amend section 114(4) of the Act, including its cross-reference to section 48. The uncertainties relating to the interrelationship between sections 48 and 114, studied above, will thus in my opinion to some degree continue to exist notwithstanding the Companies Amendment Bill, 2021's proposed replacement of the wording of section 48(8)(b).

3.7 Conclusion

In light of the above, the accuracy of Delpont's statement that section 48 is a "minefield" is clear.¹⁹² The Act does not distinguish between the different types of share reacquisitions and requires, as a rule, all such distributions to comply with the requirements in sections 46 and 48 of the Act. There are however many difficulties associated with the latter sections, such as inconsistent use of terminologies and confusing and unnecessary cross-referencing. One important aspect, considered above, is also whether a reacquisition contemplated in section 48(8)(b) is a scheme of arrangement *per se* or merely subject to sections 114 and 115's requirements. Although the SCA in the *Capital* case shed some light on the former sections' interrelationship, some existing uncertainties were unfortunately not addressed by the latter court. This makes the Companies Amendment Bill, 2021's proposed amendment of section 48(8) desirable. A significant question, which will be considered hereafter, is however what effect such proposed amendments will have on shareholders' and creditors' protection, and whether the Act's current protective measures are adequate.

¹⁹² Delpont 2014 *THRHR* 99 108.

CHAPTER 4

SHARE REACQUISITIONS AND THE PROTECTION OF SHAREHOLDERS AND CREDITORS

4.1 Introduction

The need for a legal system that “carefully” regulates distributions – including share reacquisitions – in a manner that shareholders’ and creditors’ interests are adequately protected has been recognised by authors, such as Jooste.¹⁹³ Bradstreet echoes this notion, with regard to creditors, and highlights the legislature’s responsibility to protect creditors sufficiently to encourage their participation in the corporate environment.¹⁹⁴ Section 7 of the Act, includes as objectives, the balancing of shareholders’ interests and the directors within the company, as well as promoting investments in our markets.¹⁹⁵ Section 5(1) read with section 158(b) requires that the Act be interpreted and applied to give effect to the objectives stated in section 7.¹⁹⁶ Whether the Act adequately protects company stakeholders, specifically against the potential prejudice associated with share reacquisitions, will be evaluated in this chapter. This will be done by comparing the legal protection afforded by the Act to the protection mechanisms which applied under the 1973 Act and which apply in the UK’s legal system during the reacquisition of shares.

4.2 The protection of shareholders

4.2.1 General

If a company wishes to reacquire its shares, sections 48 and 46 of the Act, as mentioned above,¹⁹⁷ only require the board of directors’ approval. It is only share reacquisitions contemplated in section 48(8) of the Act which also prescribes shareholder approval.¹⁹⁸ Cassim highlights the importance of safeguards, such as a shareholders’ resolution, to prevent the abuse of the share reacquisition power and

¹⁹³ Jooste 2009 *SALJ* 627 627.

¹⁹⁴ Bradstreet 2015 *J AFR L* 121 121.

¹⁹⁵ See s 7(c) and (j) of the Act. See also Cassim (2021) 5.

¹⁹⁶ See *Swart v Beagles Run Investments 25 (Pty) Ltd* 2011 5 SA 422 (GNP) paras 18, 41; *Welman v Marcelle Props* 193 CC 2012 JOL 28714 (GSJ) paras 16, 25; *Employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd* 6418/2011 8 May 2012 (GNP) para 12; *Mouritzen v Greystone Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) para 18.

¹⁹⁷ See para 3.2.2 above.

¹⁹⁸ Share reacquisitions pursuant to a court order or current legal obligation, contemplated in s 46(1)(a)(i) of Act, is another exception which do not require a board or shareholders’ resolution.

unequal treatment between shareholders.¹⁹⁹ The exclusion of shareholders from the decision-making process, whether to proceed with a general reacquisition, has been questioned given that both creditors' and shareholders' interests are at stake.²⁰⁰ The exclusion of shareholders stands in contrast with the 1973 Act.²⁰¹ Section 85(1) of the 1973 Act specifically required the passing of a special resolution. Dissimilar to the *status quo* the 1973 Act also required the circulation of a prescribed circular between the reacquiring company's shareholders when an off-market reacquisition offer was made.²⁰² The Act currently, as a general rule,²⁰³ does not oblige a company to provide its shareholders with certain information, regarding the merits of its off-market share reacquisition offer.²⁰⁴ This disclosure requirement omission during off-market reacquisitions is problematic since it can be a valuable shareholders' safeguard that facilitates other remedies, for example, the right to object to a court, which in turn may discourage unfair reacquisitions.²⁰⁵

4.2.2 The provisions of section 48(8)

Section 48(8) of the Act offers a degree of shareholders' protection, as it prescribes a special resolution to be passed if a company proposes one of the two types of reacquisitions described in this sub-section, in addition to the other abovementioned requirements.²⁰⁶

¹⁹⁹ Cassim "The reform of company law and the capital maintenance concept" 2005 *SALJ* 283 287-288. See also Delpont *et al* (2022) 205, in which concern is expressed over the absence of a shareholders' resolution to "effect" a reacquisition, as this is seen as an "abuse of control" element.

²⁰⁰ See Jooste 2009 *SALJ* 627 637. Also see Mongoato "Start worrying about inadequate share buyback protection for shareholders" 2010 *Without Prejudice* 14 14-15.

²⁰¹ Interestingly, a company with a share capital in the UK is authorised under section 690(1) of the UK Act to reacquire its shares by either following the statutory procedure for off-market-, as defined in s 693(2), or market reacquisitions. S 694(1) and (2) of the UK Act requires for an off-market reacquisition the passing of an ordinary shareholders' resolution, which authorises the share reacquisition agreement's terms. This authorising resolution will however be ineffective, per s 696(2) of the UK Act, if the proposed agreement or memorandum stipulating the reacquisition's terms is not made available for the shareholders' inspection. On the other hand, market reacquisitions, arguably due to their nature, are not subject to the contract approval procedure but require per s 701 of the UK Act authorisation via an ordinary resolution. See also Morse *et al* (2022) 6.832.

²⁰² See s 87 of the 1973 Act. See also Cassim 1999 *SALJ* 760 772; Van der Linde 1999 *JBL* 68 70.

²⁰³ Exceptions to this rule is if the reacquisition is a scheme of arrangement in terms of s 114 or an affected transaction by a regulated company. See paras 3.6.2 and 3.6.3.2 above, respectively, for a further discussion of the requirements for both these types of transactions.

²⁰⁴ Jooste 2009 *SALJ* 627 638.

²⁰⁵ Van der Linde 2010 *TSAR* 288 305.

²⁰⁶ Delpont *et al* (2022) 208(2B).

4.2.2.1 Reacquisitions by directors

The aforementioned special resolution requirement applies when directors' shares are reacquired.²⁰⁷ This protects shareholders against a possible conflict of interests, and since it is, as a rule, only the directors' decision to reacquire the company's shares.²⁰⁸

4.2.2.2 Share reacquisitions exceeding 5%

Furthermore, subjecting share reacquisitions that exceed the 5%-threshold, as contemplated in section 48(8)(b) of the Act, to sections 114 and 115's requirements, facilitates a positive consultative procedure.²⁰⁹ The latter prerequisite is also, as highlighted by Bidie, a central minority shareholder safeguard.²¹⁰ If it is a reacquisition by a regulated company in terms of section 48(8)(b) of the Act, which is in light of the *Capital* case a scheme of arrangement,²¹¹ it will be an affected transaction that will afford such company's shareholders additional protection.²¹² This is due to the company's required compliance with certain added approval and reporting requirements.²¹³ These shareholder protection mechanisms will however be removed if the amendments to section 48(8), set out in the Companies Amendment Bill, 2021²¹⁴ are accepted into our law.

4.2.3 The Companies Amendment Bill, 2021

4.2.3.1 Regulatory bias for pro rata offers

The proposed amendments to section 48(8) of the Act,²¹⁵ are from a shareholders' protection perspective commendable. It is submitted given that it promotes *pro rata* reacquisition offers that invite less abuse and unequal treatment between

²⁰⁷ S 48(8)(a) of the Act.

²⁰⁸ Luiz 2012 *PELJ* 102 118.

²⁰⁹ Bidie 2022 *SA Merc LJ* 52 86.

²¹⁰ Bidie 2022 *SA Merc LJ* 52 86.

²¹¹ See para 3.6.3 above.

²¹² See *Capital* case para 27, in which the SCA implied that a share reacquisition above the 5%-threshold is *per se* a scheme of arrangement. See also para 3.6.3.1 above; Delpont *et al* (2022) 208(2B).

²¹³ See para 3.6.3.1 above; Delpont *et al* (2022) 208(2B).

²¹⁴ GG 41913 dated 1 October 2021. See s 12.

²¹⁵ See para 3.6.3.3 above.

shareholders.²¹⁶ Such regulatory bias in support of *pro rata* offers is a powerful shareholders' safeguard.²¹⁷

4.2.3.2 Special resolution requirement

The Companies Amendment Bill, 2021's proposed new wording of section 48(8)(b), which subjects even share reacquisitions below the 5%-threshold, except *pro rata* offers and those of listed shares, to a special resolution will provide much needed protection to shareholders. The latter amendment will provide shareholders with more power of control, since it enables them to participate in deciding whether or not the company ought to continue with a proposed reacquisition. The inclusion of shareholders in the last-mentioned decision is, I believe arguably a rectification of the legislature's omission to include this safeguard,²¹⁸ in the original section 48 of the Act.

4.2.3.3 Reacquisitions above the 5%-threshold

On the other hand, I believe reacquisitions above the 5%-threshold, which is currently subject to the requirements of a scheme of arrangement, will be less protected if the proposed wording of section 48(8)(b) of the Companies Amendment Bill, 2021 is passed. Shareholders in such a case currently have the right to, for example, an independent expert report which provides them with the necessary information to vote on a proposed share reacquisition.²¹⁹ Removing such a right, in my opinion, places the shareholders in a less favourable position to make an informed decision regarding a proposed reacquisition, in comparison with the *status quo*.

4.2.3.4 Reacquisitions of listed shares

The Companies Amendment Bill, 2021's removal of the shareholders' required consent and the compliance requirement with sections 114 and 115 of the Act, in the case of on-market reacquisitions above the 5%-threshold, is also questionable. I do not agree that holders of listed shares should completely be excluded from the

²¹⁶ Cassim 1999 SALJ 760 772; Delpont *et al* (2022) 205.

²¹⁷ See Van der Linde 2010 TSAR 288 305. See also the UK Act, which uses this method by prescribing more lenient procedural conditions in the case of *pro rata* offers.

²¹⁸ The resolution safeguard can be seen in the UK Act and was included in the 1973 Act. See fn 201 and para 4.2.1 above.

²¹⁹ See para 3.6.2 above.

decision-making procedure, as they are still susceptible to abuse, although to a lesser extent given the market mechanism.²²⁰

In light of the above, from a shareholder's perspective, I am of the opinion that the Act does not sufficiently regulate share reacquisitions, due to its inadequate shareholders' protection offered, and I agree with Bidie that the proposed changes to section 48(8) are a "disservice" to minority shareholders and their protection.²²¹ Shareholders are afforded some additional protection during a share reacquisition, if it is also a scheme of arrangement in terms of the Act. Not all reacquisitions however fall within the ambit of such a type of fundamental transaction. It is submitted that all selective reacquisitions should be subject to a special resolution, due to their associated pronounced potential prejudice, and an ordinary resolution should be peremptory for all other reacquisitions. In addition, the Act should in my opinion oblige the disclosure to shareholders of information regarding the transaction when an off-market reacquisition offer is made, as required by the 1973 Act,²²² and the UK Act.²²³ The requirement of a shareholders' resolution was acknowledged by the Memorandum to the Bill as a protective mechanism when the prohibition against reacquisitions was originally lifted.²²⁴ I am of the view that this is an indication of our law's recognition of the need to properly regulate reacquisitions and provide adequate shareholders' protection, in exchange for allowing such transactions. It is submitted that South Africa's share reacquisition regulation should be evaluated from this perspective again.

4.3 Creditors' protection during share reacquisition

4.3.1 The solvency and liquidity test

A company's creditors are not part of any inhouse decision-making regarding a company's proposed distributions and do not share shareholders' interests.²²⁵ The shareholders' safeguards considered above will accordingly not necessarily provide a company's creditors with the required protection, as their interests and position differ

²²⁰ Delpont *et al* (2022) 208(2B).

²²¹ Bidie 2022 *SA Merc LJ* 52 87.

²²² See s 87 of the 1973 Act.

²²³ See s 696(2) of the UK Act.

²²⁴ Memorandum to the Bill 28.

²²⁵ Bradstreet 2015 *J AFR L* 121 125-126, in which four types of conflict of interests between shareholders and creditors are discussed.

from those of the shareholders. A widely accepted manner to protect creditors' interests – and is preferred over the old capital maintenance regime – is a solvency and liquidity standard which is used as a distribution benchmark.²²⁶ The solvency and liquidity test is premised on the assumption that as long as the test is satisfied creditors will not suffer any prejudice due to a company's capital not being used for its normal business purposes.²²⁷ The former creditors' safeguard was introduced into our law by the 1999 amendments to the 1973 Act, which subjected share reacquisitions to the liquidity and solvency requirements.²²⁸ The Act however extended the scope of the last-mentioned requirements' application and is now a protection measure for a broad array of transactions that affect creditors' rights.²²⁹

An example of a transaction that must be preceded by a conclusion by the board that the company would satisfy the solvency and liquidity test, is a share reacquisition.²³⁰ The latter test prohibits a company from making a distribution if it is financially "unhealthy".²³¹ The test prescribed in section 4 of the Act has two elements, namely a solvency, and a liquidity requirement. The last-mentioned test imposes a positive duty on the company, contrary to the 1973 Act's negatively stated test.²³²

The first element, namely the solvency benchmark, demands factual solvency at a particular moment.²³³ This balance sheet test, in terms of section 4(1)(a) of the Act, requires the assets of the company at a specific time – centred on all reasonable anticipated financial considerations – to exceed its liabilities. The rationale behind the solvency requirement is to preserve the creditors' preference at a company's

²²⁶ Bradstreet 2015 *JAFRL* 121 122.

²²⁷ Delpont *et al* (2022) 33.

²²⁸ *Qorus* case para 8; S 85(4) of the 1973 Act.

²²⁹ Van der Linde 2009 *TSAR* 224 225.

²³⁰ See s 46(1) read with s 48(2) of the Act; para 3.2.2 above. Examples of other transactions which require the solvency and liquidity test to be satisfied include, *inter alia*: (i) the provision of financial assistance by a company for the acquisition of its securities in terms of s 44; (ii) the giving of financial assistance by a company to its directors and intra-group loans in terms of s 45; (iii) any distribution in terms of s 46; and (iv) mergers or amalgamations in terms of s 113 of the Act.

²³¹ Bradstreet 2015 *JAFRL* 121 134. This formal solvency confirmation is in line with the UK which, per s 714(3)(a) of the UK Act, requires an auditors' report and director's statement that acknowledges the continued solvency of the private company if the company would have reacquired its shares by means of a payment out of its capital.

²³² In terms of ss 85(4) and 90(2) of the 1973 Act, it was rather an insolvency and illiquidity test. In principle payment was allowed, unless reasonable grounds existed that the company was either not able to pay its debts, or it was insolvent. In contrast, the Act requires the board, before a distribution can be made, to consider and apply the solvency and liquidity test. See Delpont *et al* (2022) 33; Van der Linde 2009 *TSAR* 224 237.

²³³ Delpont *et al* (2022) 33.

dissolution, by avoiding a partial liquidation that would favour its shareholders at its creditors' expense.²³⁴ Comparing the last-mentioned element of the test with the capital maintenance rule, Bradstreet contends that the former standard does not offer creditors more protection than the latter doctrine.²³⁵ This is because the solvency requirement relies on a company's accounting integrity and the assumption that the applicable accounting standards will be applied in a manner that shows a reliable representation of the company's financial position.²³⁶

Secondly, the liquidity element entails the company, in light of all reasonably foreseeable financial circumstances, to be in a position to pay its liabilities payable in the normal course of business for the subsequent twelve months; known as commercial solvency.²³⁷ The reason behind this requirement is to recognise creditors' expectation to be paid timeously.²³⁸ The twelve months' time threshold in section 4(1)(b) of the Act,²³⁹ has been criticised as it is arguably to the disadvantage of creditors whose long-term debts are due and payable beyond the twelve months.²⁴⁰ I agree with Bradstreet that a possible solution, from a creditors' perspective, is to create a presumption that the company failed the liquidity test if it is liquidated within a certain period after a reacquisition, as this will relieve creditors from the evidentiary burden if the board's application of the test is challenged.²⁴¹ The liquidity standard however once again depends heavily on the relevant accounting standards' integrity and the board's capability to accurately make a future prediction.²⁴²

Given the wording of section 4(1) of the Act – namely that the above requirements must “appear” to have been met based on the “reasonably foreseeable financial circumstances” – the solvency and liquidity test is arguably an objective test and not a factual enquiry.²⁴³ In the case of a distribution, including a reacquisition, the test is however not purely objective as a consideration of the skill and knowledge of the board

²³⁴ Van der Linde 2009 *TSAR* 224 226. See also Van der Linde 2009 *SA Merc LJ* 33 49.

²³⁵ Bradstreet 2015 *J AFR L* 121 135.

²³⁶ Bradstreet 2015 *J AFR L* 121 135.

²³⁷ See s 4(1)(b) of the Act.

²³⁸ Bradstreet 2015 *J AFR L* 121 136; Van der Linde 2009 *TSAR* 224 226; *Ex parte De Villiers: In re Carbon Developments (Pty) Ltd (in liquidation)* 1993 1 SA 493 (A) 504.

²³⁹ See s 714(3)(b) of the UK Act, which has also included the twelve months' time threshold.

²⁴⁰ Van der Linde 2009 *TSAR* 224 229; Bradstreet 2015 *J AFR L* 121 136.

²⁴¹ Bradstreet 2015 *J AFR L* 121 136. See also para 4.4.1 below.

²⁴² Bradstreet 2015 *J AFR L* 121 136.

²⁴³ Delpont *et al* (2022) 33.

are also required.²⁴⁴ The fact that the board must reasonably conclude via a resolution that the company will satisfy the test before concluding the last-mentioned type of transaction, not only oblige the directors to apply themselves to the test but can serve as evidence when their liability under section 46(6) is challenged.²⁴⁵

4.3.2 Right to apply to court

A further safeguard available to creditors, and shareholders, under the 1973 Act regime was the right to bring a court application for an order reversing an unlawful share reacquisition, specifically when the solvency and liquidity requirements were not met.²⁴⁶ If this application was successful, the court could have ordered, *inter alia*, that the selling shareholder should return its consideration received for the reacquisition.²⁴⁷ Unfortunately, the Act only affords a company with the *locus standi* to apply to a court, in terms of section 48(6), for an order to reverse a reacquisition made in contravention of sections 46 or 48. From a creditor and shareholder's perspective, the legislature's failure to afford the latter stakeholders of such right is in my view undesirable as this could have served as an effective mechanism to discourage companies from concluding unlawful or unfair reacquisitions.²⁴⁸

In light of the above, the solvency and liquidity test is in my opinion in principle an important safeguard for creditors during reacquisitions and an improvement compared to the capital maintenance regime. The former does not however offer much more protection than the latter against the board's possible manipulation of the calculations required by the solvency and liquidity test. An additional protection mechanism is therefore necessary which I believe, in agreement with Jooste, should be a right available to creditors, and even shareholders, to apply to a court to reverse a reacquisition, or another appropriate order, if it was made contrary to the Act.²⁴⁹ Given creditors' inability to participate in the decision-making process of whether to proceed

²⁴⁴ See 46(1)(c) of the Act which requires, *inter alia*, the directors' reasonable conclusion that the company will satisfy the test; Delpont *et al* (2022) 198(4). See also *Trevo Capital Ltd v Steinhoff International Holdings (Pty) Ltd* 2021 4 All SA 573 (WCC) para 61; Jooste 2009 SALJ 627 642.

²⁴⁵ Cooke 2012 SA Merc LJ 371 374. See para 4.4.1 below.

²⁴⁶ S 86(3), read with s 85(4), of the 1973 Act.

²⁴⁷ S 86(3)(a) of the 1973 Act; Jooste 2009 SALJ 627 646. The right to object against a share reacquisition via a court application is also available to shareholders in the UK under certain circumstances. An UK private company's shareholder may for example object against reacquisitions funded out of the company's share capital. See s 721 of the UK Act.

²⁴⁸ See Van der Linde 2010 TSAR 288 305.

²⁴⁹ See Jooste 2009 SALJ 627 650.

with a reacquisition, I contend that this right to retrospectively correct the prejudice suffered, due to an unlawful reacquisition, is a suitable alternative. The effectiveness of the latter safeguard will be enhanced if the Act prescribes as a pre-condition to share reacquisitions, the disclosure of certain related information, as studied above.²⁵⁰

4.4 Other safeguards

4.4.1 Directors' liability

Distributions restrictions – as the above-mentioned solvency and liquidity test – are supplemented with the personal liability directors can incur if a reacquisition was made contrary to the Act.²⁵¹ A director,²⁵² in terms of section 48(7) of the Act, will be liable as provided for in section 77(3)(e)(vii), if he was in attendance at the meeting where the authorising reacquisition resolution was passed and did not vote against same, despite knowing the transaction does not comply with sections 46 or 48.²⁵³ A director's liability is accordingly centred around a subjective evaluation of the knowledge of the director at a specific time.²⁵⁴

A director is in terms of section 77(3)(e)(vii) of the Act, liable for the costs, loss, or damages suffered by the reacquiring company as a result of the noncomplying share reacquisition. The seriousness of the Act's attempt to impose directors' liability has however been questioned by authors, due to the relief and indemnification provisions,²⁵⁵ which the Act simultaneously offers directors under certain circumstances.²⁵⁶ For example, section 77(5) of the Act provides a director or the company with a right to apply to a court to set aside a decision made contrary to sections 46 and 48. Section 77(5)(b) of the Act specifically authorises the court during the aforementioned application to, *inter alia*, make an order that the reacquiring company must provide indemnification to a director, who has incurred liability per section 77. The reason behind the latter order is not easy to grasp, as it is

²⁵⁰ See para 4.2.1 above.

²⁵¹ Van der Linde 2009 *TSAR* 484 495.

²⁵² By virtue of s 77(1) of the Act a "director" for the purposes of s 77 has a wide scope and includes prescribed officers, alternate directors and members of a board or audit committee of a company. It is arguably however only a director in the ordinary sense that can incur liability under s 77(3)(e)(vii) as the person had to participate in the authorising board resolution. See Cassim (ed) (2021) 402.

²⁵³ See s 1 of the Act which extends the definition of "knowing" beyond actual knowledge.

²⁵⁴ Jooste 2009 *SALJ* 627 647.

²⁵⁵ See for example ss 77(5), 77(9) and 77(10) of the Act.

²⁵⁶ See Jooste 2009 *SALJ* 627 648-649; Cooke 2012 *SA Merc LJ* 371 382; Yeats (ed) (2018) 2-498.

questionable why a director should be indemnified if he knew of the share reacquisition's statutory inconsistency, being a prerequisite for his liability.²⁵⁷

4.4.2 General statutory protection mechanisms

4.4.2.1 Claim for damages

Section 48(7) of the Act, described above, however only provides for a director's liability to the reacquiring company; not to shareholders or creditors.²⁵⁸ Section 20(6) of the Act in turn gives a shareholder the right to claim damages against a person who fraudulently, intentionally, or by gross negligence caused the company to act inconsistent with the Act. Contrary to, in my view, a reasonable deduction of the latter section our court in *De Bruyn v Steinhoff International Holdings NV*,²⁵⁹ held that shareholders do not under section 20(6) have a personal right to claim damages for any personal loss they suffered due to a person's – including a director's – misconduct referred to in the aforementioned section. Shareholders can only claim damages in terms of the latter section on the reacquiring company's behalf if the loss was suffered by the company and not by them personally.²⁶⁰ A personal claim will exclusively be possible if a shareholder can prove it suffered a loss separate from the company.²⁶¹ Section 20(6) of the Act is also regrettably only at shareholders' disposal and not creditors'.²⁶²

4.4.2.2 Civil action: sui generis liability

Similarly, section 218(2) of the Act provides that a person incurs liability towards another person for damages suffered by the latter person due to any contravention of the Act. Our courts have however restricted the last-mentioned section's application and found that "the person who can sue to recover loss is the one to whom harm was caused".²⁶³ Therefore, if a non-observation of sections 46 or 48 resulted in the reacquiring company suffering a loss, a shareholder cannot use section 218(2) to

²⁵⁷ Jooste 2009 SALJ 627 648. See however Cassim (ed) (2021) 404.

²⁵⁸ Yeats (ed) (2018) 2-498.

²⁵⁹ 2020 JOL 47482 (GJ) para 232.

²⁶⁰ Cassim (ed) (2021) 405.

²⁶¹ Cassim (ed) (2021) 405.

²⁶² Yeats (ed) (2018) 2-500.

²⁶³ See *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* 2020 5 SA 419 (SCA) para 51.

claim damages for its personal reflective loss incurred due to its position as a shareholder.²⁶⁴

4.4.2.3 Oppression remedy

Section 163 of the Act – the oppression remedy – furthermore provides shareholders with the right to bring a court application for relief, if they can prove that the exercise of the board of directors' power in the case of, for example, a selective reacquisition, was oppressive or unfairly prejudicial to them.²⁶⁵

4.4.2.4 Appraisal remedy

Another general safeguard possibly available to shareholders is the appraisal remedy, as envisaged in section 164 of the Act, if the share reacquisition is a scheme of arrangement or a reacquisition envisaged in section 48(8)(b) of the Act, as confirmed in the *Capital* case.²⁶⁶ The latter remedy is useful in the case of selective reacquisitions, when dissenting shareholders are excluded, but is less protective with proportionate reacquisitions as it only ensures the shares are reacquired at their fair value.²⁶⁷

4.4.2.5 Regulation in terms of a MOI

In addition to the above, a company is at liberty to regulate reacquisitions in its MOI, provided it imposes more onerous requirements than would otherwise apply to such a transaction in terms of the Act.²⁶⁸ Under section 76(3) of the Act, directors must adhere to the company's MOI and they will incur liability towards the company if it suffers any loss due to their non-compliance with the MOI.²⁶⁹ An MOI can therefore prescribe requirements in addition to those in sections 46 and 48 of the Act, for example, the passing of a special resolution before any reacquisition or requiring only *pro rata* reacquisitions to be made, which will provide shareholders with an extra safeguard.²⁷⁰ Naturally, the problem with the last-mentioned protection mechanism is

²⁶⁴ Cassim (ed) (2021) 405.

²⁶⁵ Delpont *et al* (2022) 574(6); Van der Linde 2010 *TSAR* 288 304. See also *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd* 2014 5 SA 179 (WCC) para 53.

²⁶⁶ *Capital* case para 29. See ss 114 and 115 of the Act; para 3.6.3.1 above.

²⁶⁷ Van der Linde 2010 *TSAR* 288 302-303.

²⁶⁸ See s 15(2)(a)(iii) of the Act. See also Cooke 2012 *SA Merc LJ* 371 383; Van der Linde 2010 *TSAR* 288 303; Van der Linde 2009 *TSAR* 484 492.

²⁶⁹ See 77(2)(b)(iii) of the Act.

²⁷⁰ Delpont *et al* (2022) 198(3).

its limited application to only the shareholders of companies that decided to insert it in their MOI and does not provide a general solution to shareholders.

4.5 Conclusion

Cassim described the share reacquisitions safeguards in the 1973 Act as “rudimentary” and “inadequate”.²⁷¹ In retrospect, those provisions in the 1973 Act regulating reacquisitions provided more protection to shareholders and creditors compared to the Act, which currently leaves these stakeholders vulnerable. Creditors and shareholders can rely on the general statutory safeguards, described above. Section 48, read with section 46 of the Act, also provides some form of protection to the aforementioned role-players, especially with share reacquisitions envisaged in section 48(8). However, in light of the potential abuse that creditors and shareholders may suffer in the case of all reacquisitions, but particularly selective reacquisitions, I do not view the Act’s regulation of the aforementioned transactions as adequate given its lack of proper safeguards.

²⁷¹ Cassim 1999 SALJ 760 776.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter contains the conclusions based on the research in the preceding chapters. In this chapter, recommendations will be made for possible legal reform in respect of the reacquisition of shares in terms of the Act.

5.2 Conclusions and recommendations

The aim of this mini-dissertation was to critically evaluate share reacquisitions' regulation in terms of the Act. The main focus of the aforementioned evaluation was to determine whether shareholders and creditors enjoy sufficient statutory protection in light of the potential prejudice that these stakeholders can suffer due to such transactions.

5.2.1 Need and purpose of regulating share reacquisitions

Share reacquisitions provide companies with the necessary flexibility to achieve a variety of commercial objectives.²⁷² Reacquisitions may, for example, be used to avoid hostile takeovers or to support a company's shares market. A weakness however of a legal system, such as ours, which allows the aforementioned type of transaction, may be the potential abuse to the detriment of the reacquiring company's creditors and shareholders.²⁷³

5.2.2 Regulation of share reacquisitions

5.2.2.1 Current regime of regulation

As a general rule, the Act regulates direct and indirect share reacquisitions by subjecting it to sections 46 and 48, as such a reacquisition of shares constitutes a distribution by the reacquiring company.²⁷⁴ All the different types of companies recognised in our law – private-, public-, and listed companies – must therefore comply with the requirements set out in sections 46 and 48 of the Act if they wish to reacquire any of their shares. The last-mentioned provisions in the Act are however problematic

²⁷² See para 2.4 above.

²⁷³ See para 2.3 above.

²⁷⁴ See para 3.2.2 above.

due to an inconsistent use of terminology and unnecessary cross-references.²⁷⁵ In respect of indirect share reacquisitions, section 48 of the Act fails to address their unintended effect on the remaining shareholders' shareholding and the potential change in control as a result thereof.²⁷⁶ The last-mentioned section in the Act also omits to regulate the possibility that a subsidiary may acquire its own shares via an indirect reacquisition, not as provided for in the Act.²⁷⁷

If a company that is listed on the JSE Stock Exchange reacquires its own shares it must observe the JSE Limited Listings Requirements in addition to the procedure prescribed by the Act.²⁷⁸

Share reacquisitions above the 5%-threshold must also in terms of section 48(8)(b) of the Act comply with the requirements prescribed in sections 114 and 115.²⁷⁹ An important question, regarding reacquisitions' regulation, that was before the SCA in the *Capital* case, was whether a reacquisition of shares per section 48(8)(b) is a scheme of arrangement *per se* or just subject to the requirements set out in sections 114 and 115 of the Act.²⁸⁰ If the aforementioned position is true, it affects the regulation of reacquisitions by regulated companies, which includes public companies and the majority of state-owned companies. This is because such a reacquisition will then be regarded as an affected transaction that requires the regulated company's compliance with additional reporting and approval requirements.²⁸¹ Although the court in the *Capital* case answered the aforementioned question to a certain extent, its failure to thoroughly address the ambit of section 114(1)(e), as well as sections 48(8)(b) and 114 interrelationship, was, in my opinion, a lost opportunity to give clarity regarding these uncertainties, in light of the facts before the SCA.²⁸²

5.2.2.1 Proposed regulation under the Companies Amendment Bill, 2021

The Companies Amendment Bill, 2021 proposes to replace the current section 48(8)(b) of the Act with a provision that requires the decision by the board to reacquire its shares to be approved by the shareholders via a special resolution unless the

²⁷⁵ See para 3.2 above.

²⁷⁶ See para 3.3 above.

²⁷⁷ See para 3.3 above.

²⁷⁸ See para 3.5.1 above.

²⁷⁹ See para 3.5.3 above.

²⁸⁰ See para 3.6.3 above.

²⁸¹ See para 3.6.3.2 and fn 184 above.

²⁸² See para 3.6.3 above.

contemplated share reacquisition is that of listed shares or a *pro rata* offer.²⁸³ The Companies Amendment Bill, 2021's amendments to section 48(8)(b) will in one respect be welcomed. This is due to its removal of the need to answer the above-mentioned question of whether a reacquisition exceeding the 5%-threshold is per definition a scheme of arrangement. The latter proposed amendment has however arguably a negative effect on shareholders' protection.²⁸⁴

5.2.3 Protection afforded under the regime of share reacquisitions regulation

South Africa's current regulatory regime of share reacquisitions, described above, unfortunately affords creditors and shareholders with limited safeguards which were specifically included in the Act to provide them with protection during such a type of distribution. In the preceding chapters I have identified certain weaknesses in the regulation of reacquisitions in terms of the Act, in light of the protection it affords shareholders and creditors. The aforementioned weaknesses together with my recommendations for possible legal reform, will hereafter follow.

5.2.3.1 Shareholders' protection

(a) General shareholders' exclusion

Save for reacquisitions contemplated in section 48(8) of the Act, the reacquisition of shares as a general rule only requires the authorisation of the reacquiring company's board of directors. This exclusion of shareholders from the company's decision-making procedure has been questioned by many authors since it is regarded as an important shareholder safeguard against the potential prejudice inherent to share reacquisitions.²⁸⁵ The Act also currently does not, generally, require the reacquiring company to circulate between its shareholders relevant information regarding the particular reacquisition offer's merits.

Due to the potential prejudice associated with reacquisitions, I believe the legislature should reconsider section 48 of the Act's wording.²⁸⁶ I recommend that the Act should rather make all reacquisitions subject to the passing of an ordinary shareholders' resolution and have a special resolution be peremptory for selective reacquisitions. In

²⁸³ See para 3.6.3.3 above.

²⁸⁴ See para 4.2.3.3 above and para 5.2.3.1 (b) below.

²⁸⁵ See para 4.2.1 above for a further discussion regarding shareholders' exclusion.

²⁸⁶ See para 3.2 above.

addition, the Act should compel a company to make, at a minimum the terms of the reacquisition agreement available for shareholders' pre-inspection, when an off-market reacquisition offer is made.

(b) Share reacquisitions above 5%-threshold

If it is a reacquisition exceeding the 5%-threshold, as provided for in section 48(8)(b) of the Act, shareholders are afforded some form of protection as such a transaction is subject to sections 114 and 115's requirements.²⁸⁷ If a regulated company reacquires more than 5% of the company's issued shares – which is in light of the *Capital* case arguably a scheme of arrangement²⁸⁸ – it is an affected transaction. In such a case, the reacquiring regulated company's shareholders are afforded additional protection as a result of the added approval and reporting requirements which such company must comply with.²⁸⁹

The Companies Amendment Bill, 2021 however proposes to remove the above-mentioned shareholder protection mechanism, as it subjects all reacquisitions, except *pro rata* offers and listed share reacquisitions, to only a special resolution.²⁹⁰ The Companies Amendment Bill, 2021 accordingly effectively deprives a shareholder, in the case of a reacquisition per section 48(8)(b), of his right to for example an independent expert report which gives him insight into the merits of the contemplated transaction.²⁹¹

In light of the limited risk of prejudice for stakeholders associated with reacquisitions contemplated in section 48(8)(b), compared to schemes of arrangement envisaged in section 114(1)(e) of the Act, the aforementioned type of transaction should only in my opinion be subject to the procedure in section 115 and not be regarded as a fundamental transaction. To mainly remove the uncertainty regarding the interrelationship of reacquisitions in terms of section 48(8)(b) and schemes of arrangement, I agree with Bidie's recommendation, to insert the provisions of section 114(2) and (3) as section 48(9) of the Act, instead of the Companies Amendment Bill, 2021's proposed amendments.²⁹² Section 48(9) will then cater for reacquisitions that

²⁸⁷ See para 4.2.2 above.

²⁸⁸ See para 3.6.3 above.

²⁸⁹ See para 3.6.3.2 above.

²⁹⁰ See paras 3.6.3.3 and 4.2.3 above.

²⁹¹ See para 4.2.3.3 above for a further discussion.

²⁹² Bidie 2022 *SA Merc LJ* 52 87.

are not intended by companies as schemes of arrangement but rather voluntary transactions between the company and its shareholders.

(c) *Reacquisitions of listed shares*

The Companies Amendment Bill, 2021 as mentioned above, also does not require shareholders' approval if it is a reacquisition of listed shares.²⁹³

Given the fact that holders of listed shares are still susceptible to a degree of potential prejudice, I believe, as recommended above, that all reacquisitions including those of listed shares should be subject to at least an ordinary resolution passed by the reacquiring company's shareholders.²⁹⁴

5.2.3.2 *Creditors' protection*

(a) *Solvency and liquidity test*

Creditors, on the other hand, are mainly protected by the Act during reacquisitions by virtue of the solvency and liquidity test described in section 4 of the Act and can be regarded as an improvement to the former capital maintenance rule in our law.²⁹⁵ The last-mentioned test is, however, susceptible to manipulation by the company, acting through its board of directors.²⁹⁶ I am of the opinion that consideration should be given to possibly include an additional safeguard available to creditors during reacquisitions.²⁹⁷

(b) *Right to apply to court*

Unlike the Act's predecessor, the Act does not give creditors, or shareholders, the right to bring a court application for an order reversing an unlawful share reacquisition.²⁹⁸

As an extra protection mechanism to the solvency and liquidity test, I believe the Act should accordingly also provide creditors, and even shareholders, with the *locus standi* to apply to a court to reverse a reacquisition that does not comply with the Act or

²⁹³ See para 4.2.3.4.

²⁹⁴ See para 5.2.3.1 (a) above.

²⁹⁵ See para 4.3.1 above.

²⁹⁶ See para 4.3.1 above.

²⁹⁷ See para 5.2.3.2 (b) below.

²⁹⁸ See para 4.3.2 above.

another appropriate order. This can be a means by which companies are discouraged to conclude unfair or unlawful reacquisitions.

5.2.3.3 Other safeguards

In addition, the Act also provides for general safeguards which creditors and shareholders can employ, under certain circumstances, to protect their interests against the potential prejudice which might flow from a share reacquisition. These protection mechanisms include, *inter alia*, personal liability which directors can incur if a reacquisition does not comply with the provisions of the Act, the regulation of reacquisitions by the reacquiring company's MOI, the oppression remedy and the appraisal remedy, if the share reacquisition is a scheme of arrangement or a reacquisition envisaged in section 48(8)(b) of the Act.²⁹⁹

5.3 Conclusion

In light of the above, I am of the opinion that shareholders and creditors are neither adequately protected under the current regime of the regulation of share reacquisitions nor in terms of the Companies Amendment Bill, 2021's proposed new framework. A legal reform in respect of the reacquisition of shares in terms of the Act is therefore in my view required, as per my recommendations described above.

²⁹⁹ See para 4.4.2 for a discussion of the general statutory safeguards available.

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