

**A COMPANY'S SHARE CAPITAL AND THE ACQUISITION OF ITS OWN SHARES:
A CRITICAL COMPARISON BETWEEN THE RELEVANT PROVISIONS OF THE
COMPANIES ACT 61 OF 1973 AND THE COMPANIES ACT 71 OF 2008**

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I declare that "A Company's Share Capital and the Acquisition of its own shares: A critical comparison between the relevant provisions of the Companies Act 61 of 1973 and the Companies Act 71 of 2008" is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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1. SUMMARY

The Companies Act 71 of 2008 (“2008 Companies Act”) will have far reaching effects on the manner in which a company is formed and operated under South African company law and in particular entrenches the procedure that must be followed by a company when acquiring its own shares. The radical amendment of the capital maintenance rules by the introduction of the solvency and liquidity tests to the Companies Act 61 of 1973 has been carried forward under the 2008 Companies Act. These tests impose an obligation on a company to ensure that the company is both solvent and liquid at the time of the acquisition of its own shares and for a stated period thereafter. The 2008 Companies Act further brings the duties and liabilities of the directors in line with their current fiduciary duties in terms of common law.

Key terms: share acquisition, Companies Act of 2008, Companies Act of 1973, solvency and liquidity tests, capital maintenance rules, acquisition by subsidiaries, purchase of shares, protection of shareholders, protection of creditors.

2. INTRODUCTION

The Companies Act¹ (hereinafter referred to as “the 2008 Companies Act”) was promulgated on 9 April 2009 and is due to come into operation on 1 April 2011.² It will have far reaching effects on the manner in which a company³ is formed and operated under South African company law⁴ and in particular entrenches the procedure that must be followed by a company when acquiring its own shares. Schedule 5 of the 2008 Companies Act will regulate the changeover from the current

¹ 71 of 2008.

² See General Notice 421 in *Government Gazette* 32121 of 9 April 2009. Also see a formal communication released by the Department of Trade and Industry dated 28 September 2010 headed “The new Consumer Protection Act and Companies Act to come into force on 1 April 2011”.

³ The 2008 Companies Act defines a company as a juristic person incorporated in terms of the Act, or a juristic person that immediately before the effective date was registered in terms of the 1973 Companies Act (other than an external company) or the Close Corporations Act 69 of 1984. The 2008 Companies Act therefore applies not only to companies as they existed under the 1973 Companies Act, but now also to close corporations previously registered under the Close Corporations Act. Item 2 of Schedule 5 of the 2008 Companies Act further provides for the continued existence of pre-existing companies.

⁴ South African company law is currently governed in terms of the Companies Act 61 of 1973, as well as the common law.

regime to that of the new regime.

There are currently two types of companies that may be incorporated under South African law, namely a company having a share capital⁵ and a company not having a share capital.⁶ Although not defined in the Companies Act,⁷ (hereinafter referred to as “the 1973 Companies Act”) the share capital of a company, in broad terms, reflects the consideration paid to or due to a company in exchange for the shares it issues.⁸ A company having a share capital may elect to issue par value shares,⁹ no par value shares¹⁰ or a combination of both.¹¹ The issuing of shares provides a company with the ability to raise the capital necessary to conduct its business. It also plays a part in apportioning the rights and interests of its members and was once seen as a method of protecting a creditor’s exposure in terms of credit given by it to the company.¹² In protecting the creditor’s exposure, the basic approach followed by our courts was the protection of the contributed (paid-up) capital of a company, being the fund to which the creditors of the company had recourse for satisfaction of their claims against the company. The decision handed down in *Trevor v Whitworth*¹³ set out this principle of capital maintenance and held that a company was prohibited from purchasing its own shares.¹⁴ The prohibition on companies from acquiring their own shares remained part of our law until 30 June 1999, when the 1973 Companies Act was amended by the

⁵ Section 19(2) of the 1973 Companies Act. A company having a share capital is either a public or a private company. Also see Meskin PM (formerly edited by The Late Hon Mr Justice PM), edited by Jennifer A Kunst *et al Henochsberg on the Companies Act* 5th ed (looseleaf) (LexisNexis Butterworths Durban 1994) at 36.

⁶ Section 19 of the Companies Act 61 of 1973. See Cilliers HS *et al Corporate Law* 3rd ed (LexisNexis Butterworths Durban 2000) at 31. A company not having a share capital is also termed a company limited by guarantee and limits the liability of its members in terms of its memorandum of association. See s 19(1)(b) of the 1973 Companies Act. Also see Meskin *Henochsberg on the Companies Act* op cite note 9.

⁷ 61 of 1973.

⁸ Van der Linde KE *Aspects of the Regulation of Share Capital and Distribution to Shareholders* (LLD-thesis University of South Africa June 2008) at 2.

⁹ Par value shares are shares of a fixed amount (nominal value).

¹⁰ No par value shares are shares which are fixed in number. See Cilliers *et al Corporate Law* op cite note 2 at 222.

¹¹ In practice, the option of having no par value shares is rarely exercised by companies. See McLennan JS “Time for the abolition of the par-value share” 2002 (119) *SALJ* at 39.

¹² Van der Linde Kathleen “Par-value shares or no-par-value shares – is that the question?” 2007 (19) *SA Merc LJ* at 473. Also see Van der Linde Kathleen “The regulation of conflict situations relating to share capital” 2009 (21) *SA Merc LJ* at 35.

¹³ (1887) 12 App Cas 409 (HL) at 416.

¹⁴ Also see Pretorius JT *et al Hahlo’s South African Company Law through the cases* 6th ed (Juta & Co Ltd, Lansdowne 1999) at 123.

Companies Amendment Act.¹⁵

With this amendment, company law moved from relying on the capital maintenance rules to applying a new dual approach comprising the solvency and liquidity tests.¹⁶ Section 86(1) of the 1973 Companies Act imposes a possible joint and several liability on directors to repay the company any amount paid and not otherwise recovered by the company, for any failure by the directors of a company to adhere to the provisions of s 85(4).¹⁷

One of the central concerns surrounding the acquisition of shares by a company is the risk of unfair treatment of shareholders, especially where a company only selectively acquires shares from shareholders.¹⁸ To prevent possible abuse, a very detailed procedure for acquisition of shares by a company is set out in s 87, which governs not only the acquisition of shares by way of market purchases,¹⁹ but also off-market purchases.²⁰

Section 89 provides that where subsidiary companies acquire shares, such subsidiary may, subject to the provisions of this section, only acquire shares in their holding company to a maximum of 10 percent in the aggregate of the number of issued shares of the holding company.²¹

Sections 48(2) and 48(3) of the 2008 Companies Act will govern acquisitions by a company and its subsidiaries' from 1 April 2011. A company may acquire its own

¹⁵ 37 of 1999. Also see Van der Linde Kathleen "A company's purchase of its own shares" 1999 (7) *Juta's Business Law* at 68.

¹⁶ Van der Linde 2007 (19) *SA Merc LJ* op cite note 15 at 475. Section 85(4) of the 1973 Companies Act limits the application of s 85 by requiring compliance with the solvency test and liquidity test.

¹⁷ Section 86(1) of the 1973 Companies Act. Subsection (6) provides that for the purposes of s 86 "... 'director of a company' includes any director of a holding company of such company". Also see Van der Linde 1999 (7) *JBL* op cite note 59 at 69; Cassim 2005 (122) *SALJ* op cite note 21 at 288.

¹⁸ Cassim FHI "The reform of company law and the capital maintenance concept" 2005 (122) *SALJ* at 290.

¹⁹ A market purchase is the purchase of shares on a stock exchange within the Republic of South Africa.

²⁰ An off-market purchase is the purchase of shares where the shares are not listed on a stock exchange within the Republic of South Africa. Section 85 of the 1973 Companies Act governs the acquisition by a company of its own shares.

²¹ This section does not apply to situations where a holding company acquires shares in its subsidiary.

shares, if the decision to do so satisfies the requirements of s 46.²²

In this dissertation, a comparison will be drawn between a company's ability to acquire its own shares under the 1973 Companies Act, the 2008 Companies Act and the JSE Listing Requirements.²³ Consideration will further be given to a company's share capital, including the types of shares that may be issued under the 1973 Companies Act compared to the 2008 Companies Act. The rules of capital maintenance as they relate to the prevention of a company to acquire its own shares will then be considered in contrast with the so-called solvency and liquidity tests, which were included under the 1973 Companies Act by the Companies Amendment Act. These tests have since been reiterated in the 2008 Companies Act. The procedures that currently apply under the 1973 Companies Act will be discussed in comparison with the procedures that are prescribed under the 2008 Companies Act and the JSE Listing Requirements and finally, the ability of a subsidiary company to acquire shares in its holding company under the 1973 Companies Act will be evaluated in contrast with the ability of a subsidiary company to acquire shares in its holding company under the 2008 Companies Act and the JSE Listing Requirements.

3. SHARE CAPITAL

As mentioned earlier, the 1973 Companies Act draws a distinction between a company having a share capital and a company not having a share capital. Section 52(2) requires the memorandum of association of a company to state the amount of the share capital with which it is proposed to be registered and the division thereof into shares of a fixed amount, or the number of shares if the company is to have shares of no par value.²⁴ This amount of share capital or the number of shares is known as the authorised share capital of the company.²⁵ The shareholders do not have a legal claim against the company for return of the capital that they contributed

²² Section 46 of the 2008 Companies Act prescribes that 'distributions', as defined in s 1, are subject to the liquidity and solvency test set out in s 4(1).

²³ The JSE Listing Requirements regulate the acquisition of shares insofar as such shares may be listed on the Johannesburg stock exchange.

²⁴ The memorandum of association does not need to deal with the division of the shares into classes, for example ordinary, preference, deferred. The rights attached to the shares may be regulated by the articles of the company. See Meskin *Henoschsberg on the Companies Act* op cite note 1 at 104.

²⁵ Blackman MS *et al Commentary on the Companies Act* (looseleaf) (Juta & Co Ltd, Lansdowne 2002) Vol 1 at 5-1.

and as such, share capital is treated as a notional liability in the accounts of a company.²⁶ Van der Linde provides that according to Gansen,²⁷ the share capital of a company serves three functions, namely: a method of obtaining funds by which the company operates its business; it provides a protective cushion for the creditors of the company; and the interests of the shareholders of the company are placed in comparative ratios.²⁸ Delpont includes a fourth function, namely that the share capital should benefit the company by enhancing its creditworthiness, which in turn increases its attractiveness to investors in reducing the cost of capital.²⁹

While the 1973 Companies Act regulates the share capital structure of a company in considerable detail, the 2008 Companies Act only touches on this topic.³⁰ The concept of authorised capital has been retained in the 2008 Companies Act in the sense that classes of shares and the number of each class of shares that the company is authorised to issue must be recorded in the Memorandum of Incorporation.³¹ Companies are, however no longer referred to as either companies having a share capital or companies not having a share capital. The 2008 Companies Act now provides for the incorporation of two different types of companies, namely profit companies³² and non-profit companies.³³ Profit companies are further divided into state-owned companies,³⁴ private companies,³⁵ personal liability companies³⁶ or

²⁶ Van der Linde *Regulation of Share Capital* op cite note 11 at 3.

²⁷ Gansen Georg *Harmonisierung der Kapitalaufbringung im englischen und deutschen Kapitalgesellschaftsrecht* (1992) at 3-8.

²⁸ Van der Linde *Regulation of Share Capital* op cit note 11 at 3.

²⁹ Delpont Piet "*Capital Rules in South African Company Law*" 1993 De Jure 406 at 407.

³⁰ Van der Linde *Regulation of Share Capital* op cite note 11 at 251.

³¹ Section 38 of the 2008 Companies Act. Section 1 of the 2008 Companies Act defines a Memorandum of Incorporation as the document, as amended from time to time that sets out *inter alia* the rights, duties and responsibilities of shareholders, directors and others within and in relation to the company. This replaces the memorandum of association and articles of association previously required under the 1973 Companies Act.

³² Section 1 of the 2008 Companies Act defines a profit company as a company incorporated for the purpose of financial gain for its shareholders.

³³ Section 8 of 2008 Companies Act. Also see s 1 of the 2008 Companies Act which defines a non-profit company as a company incorporated for a public benefit or object and the income and property of the company is not distributable to its incorporators, members, directors, officers or any persons related to them.

³⁴ Section 1 of the 2008 Companies Act defines a state-owned company as being a company falling within the meaning of a "state-owned enterprise" under the Public Finance Management Act 1 of 1999 or a company owned by a municipality as contemplated in the Local Government: Municipal Systems Act 32 of 2000 or a similar entity.

³⁵ Section 1 of the 2008 Companies Act defines a private company as a profit company that is not a company or a personal liability state-owned company and satisfies the criteria in s 8(2)(b).

public companies.³⁷

One of the distinguishing features of a private company (in contrast with a public company) under the 1973 Companies Act is the restriction placed on the company in its articles of association regarding the transferability of its shares³⁸ as well as the prohibition regarding the offering of any of its shares or debentures to the public.³⁹ The purpose of restricting the transferability of its shares is to enable the shareholders to keep the company in the hands of a closed circle of approved members.⁴⁰ The same restrictions regarding the transferability of shares and public offerings of shares are placed on a private company under the 2008 Companies Act.⁴¹ Only the shares and debentures of a public company may be listed and dealt with on a stock exchange within the Republic of South Africa, and only where the permission of the relevant stock exchange is first obtained.⁴²

A fundamental change in the 2008 Companies Act is the abandonment of the concept of par value shares. As mentioned earlier, the share capital of a company under the 1973 Companies Act may consist of par value shares or no par value shares. One of the most essential differences between a par value share and a no par value share is the presence or absence of an indicator of value.⁴³ Under the 1973 Companies Act, companies are free to choose either type of share, or may elect to have both, although in practice the option of having no par value shares is rarely exercised by companies.⁴⁴ Notwithstanding the fact that the par value concept has been widely

³⁶ Section 1 of the 2008 Companies Act defines a personal liability company as a company whose Memorandum of Incorporation states that the company is a personal liability company as contemplated in s 8(2)(c).

³⁷ Section 1 of the 2008 Companies Act defines a public company as a profit company that is not a state-owned company, a private company or a personal liability company.

³⁸ Section 20(1)(a) of 1973 Companies Act. Table B of Schedule 1 of 1973 Act restricts the transfer of shares by providing for pre-emptive rights in the case of a sale of shares by a shareholder. See also Van der Linde Kathleen "Pre-emptive rights in respect of share issues – misnomer or mistake?" 2008 (20) *SA Merc LJ* at 510.

³⁹ Pretorius JT *et al Hahlo's cases* op cite note 17 at 38; Also see Van der Linde 2008 (20) *SA Merc LJ* op cite note 41 at 510.

⁴⁰ Van der Linde 2008 (20) *SA Merc LJ* op cite note 41 at 510.

⁴¹ Section 8(2)(b) of the 2008 Companies Act specifies the criteria that a private company needs to satisfy, which includes a similar restriction on the transferability of shares.

⁴² Permission is only given where the provisions of the Stock Exchanges Control Act 1 of 1985 are complied with, as well as compliance is given to the rules and regulations of the committee of the stock exchange in question. Also see Cilliers *et al Corporate Law* op cite note 10 at 32.

⁴³ Van der Linde *Regulation of Share Capital* op cite note 11 at 262.

⁴⁴ Although companies are free to choose to have both par value shares and no par value shares, it is a provision of s 74 of the 1973 Companies Act that all ordinary shares and all preference shares must consist of either par value shares or of no par value shares.

criticised as potentially misleading,⁴⁵ companies have not been deterred from using par value shares to the almost exclusion of using no par value shares. The reason for the issuing of no par value shares being unpopular has still not been established.⁴⁶

The 2008 Companies Act proposes a system of compulsory no par value shares, subject to item 6 of Schedule 5.⁴⁷ This item provides that despite the provisions of s 35(2), any shares of a pre-existing company that were issued with a nominal or par value, and are held by a shareholder immediately before the effective date, will continue to have the nominal or par value assigned to them when issued, subject to any regulations made in terms of subitem (3).

In December 2009, draft Regulations to the 2008 Companies Act were released by the Department of Trade and Industry for public comment.⁴⁸ The draft Regulations at this stage provide that every share of a pre-existing company must be converted to a share having no par value within five years of the effective date.⁴⁹ Such conversion must be proposed by the board of directors, distributed to the shareholders and approved by special resolution.⁵⁰ By implication, a pre-existing company shall not be entitled to authorise any new par value shares after the 2008 Companies Act comes into operation,⁵¹ so within five years from the effective date only no par value shares should be held by companies governed under the 2008 Companies Act.

⁴⁵ McLennan 2002 (119) *SALJ* op cite note 14 at 43, footnote 3.

⁴⁶ McLennan 2002 (119) *SALJ* op cite note 14 at 43.

⁴⁷ Section 35(2) of the 2008 Companies Act. Also see Van der Linde *Regulation of Share Capital* op cite note 11 at 317. Section 1 of the 2008 Companies Act defines shares as one of the units into which the proprietary interest in a profit company is divided.

⁴⁸ *Government Gazette* 32832 of 22 December 2009. Section 223 of the 2008 Companies Act provides that the Minister will be required to make the Regulations available for public comment before such Regulations are made in terms of the 2008 Companies Act. It is envisaged that the final Regulations will be promulgated early 2011 and will become effective on the effective date of the 2008 Companies Act, being 1 April 2011.

⁴⁹ Regulation 35(4) of the draft Regulations published in *Government Gazette* 32832 of 22 December 2009.

⁵⁰ Regulation 35(7) of the draft Regulations published in *Government Gazette* 32832 of 22 December 2009. See also Anon "New Companies Act 2008 regulations finally published!" http://www.deneysreitz.co.za/index.php/news/new_companies_act_2008_regulations_published [Date of use: 29 March 2010]; and Anon "Release of draft Regulations under the new Companies Act 2008" <http://www.polity.org.za/article/release-of-draft-regulations-under-the-new-companies-act> [Date of use: 29 March 2010].

⁵¹ Section 35(2) of the 2008 Companies Act provides that the shares of a company recognised in terms of the 2008 Companies Act do not have a nominal or par value.

4. THE CAPITAL MAINTENANCE RULES & THE SOLVENCY AND LIQUIDITY TESTS

The capital maintenance rules were aimed at protecting the share capital of the company by restricting the freedom of the company from returning the funds to the shareholders, which were originally subscribed for its shares, during the existence of the company, except as prescribed by legislation. It encompassed the following capital maintenance rules:⁵² rules relating to the raising of capital; a restriction on dividends being paid out of capital,⁵³ a restriction against a company giving financial assistance for the purchase of or subscription of its own shares,⁵⁴ and the rule against a company purchasing its own shares.⁵⁵ In this dissertation I will only deal with the rule that a company could not purchase its own shares.

This rule was intended to protect the creditors of the company, but has over the years received serious criticism for being overly rigid, unnecessarily complex and falling short of providing the creditors with the desired protection.⁵⁶ In fact, there are a number of advantages to allowing a company to purchase its own shares. These include the ability of a company to protect itself against speculators who manipulate share prices in the financial markets⁵⁷ and facilitate “family enterprises” with the transfer of shareholdings in private companies where a shareholder dies or retires.⁵⁸

As stated earlier, the restriction on a company’s ability to purchase its own shares

⁵² Van der Linde *Regulation of Share Capital* op cite note 11 at 21.

⁵³ The common law rule that dividends may not be paid out of capital was amended in 1999 by s 90 of the 1973 Companies Act, which now enables a company to make payments even out of capital or to pay dividends out of capital or to return capital to its members, provided that the company is authorised to do so by its articles of association. The solvency and liquidity test must further be complied with. Also see Cassim FHI 2005 (122) SALJ op cite note 21 at 285.

⁵⁴ Section 38 of the 1973 Companies Act. Also see Cassim FHI 2005 (122) SALJ op cite note 21 at 285.

⁵⁵ The rule that a company may not purchase its own shares was originally laid down in *Trevor v Whitworth* (1887) 12 App Cas 409 (HL) at 416. See also *The Unisec Group Ltd & Others v Sage Holdings Ltd* 1986 (3) SA 259 (T); and *Capitex Bank Ltd v Qorus Holdings Ltd and Others* 2003 (3) SA 302 (W).

⁵⁶ A main disadvantage surrounding the capital maintenance rule is the complexity in identifying and managing the extent of the share capital. See Van der Linde *Regulation of Share Capital* op cite note 11 at 26. The capital maintenance rule was not only an imperfect way of protecting the creditors of the company, but was also notorious for being imprecise and uncertain. See Cilliers *et al Corporate Law* op cite note 10 at 322; Van der Linde Kathleen “A company’s purchase of its own shares” 1999 (7) *JBL* at 68.

⁵⁷ See Anon “Share buybacks” http://www.deneysreitz.co.za/index.php/news/share_buybacks [Date of use: 1 December 2009].

⁵⁸ Van der Linde 1999 (7) *JBL* op cite note 59 at 68.

remained part of South African law until 30 June 1999, when the 1973 Companies Act was amended by the Companies Amendment Act.⁵⁹ Sections 85 to 89 of the 1973 Companies Act prescribe the manner in which a company may now acquire their own shares.

Sections 85(4)(a) and (b) of the 1973 Companies Act set out the solvency and liquidity tests that a company is required to comply with, when purchasing its own shares.⁶⁰ The solvency and liquidity tests prescribe that a company shall not be allowed to make any payment⁶¹ to acquire its own shares if there are reasonable grounds for believing that the company is, or would after such acquisition of the shares, be unable to pay its debts as they become due in the ordinary course of business (“the liquidity test”) or that the consolidated assets of the company, fairly valued, would after the payment for such acquisition of the shares, be less than the consolidated liabilities of the company (“the solvency test”).⁶²

The solvency test requires that the assets of the company exceed the liabilities after payments for the shares have been taken into account. This means that these payments may only be made out of the net assets of the company. Van der Linde believes that this test recognises the ultimate priority that the creditors enjoy over the shareholders in circumstances where the company is dissolved, while the liquidity test addresses the fundamental expectation of a creditor to be paid on time.⁶³ The liquidity test does not however refer to a specific time period for which a company is required to remain liquid after the repurchase of its shares.⁶⁴

⁵⁹ Section 9 of the Companies Amendment Act. Notwithstanding the amendments made by the Companies Amendment Act, certain capital maintenance rules still remain. These include the restrictions on the issue of shares at a discount, the payment of interest on share capital (s 79) and the requirements in respect of redeemable preference shares (s 98). See Pretorius *et al Hahlo's cases* op cite note 17 at 122. Also see Cassim 2005 (122) SALJ op cite note 21 at 284.

⁶⁰ These tests were included to provide the creditors with the protection they previously enjoyed under the rules relating to the reduction of capital. See Anon “Share buybacks” op cite note 60.

⁶¹ “Payment” is not defined, but seems to include not only the giving of money but also the giving of property, whatever its form, as payment for shares. See Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-70.

⁶² Also see Van der Linde 1999 (7) JBL op cite note 59 at 69; Cassim FHI “The new statutory provisions on company share repurchases: A critical analysis” 1999 (116) SALJ at 761.

⁶³ Van der Linde *Regulation of Share Capital* op cite note 11 at 27.

⁶⁴ Section 85(4) is silent on the period for which a company is required to remain liquid and solvent, after the share repurchase. Van der Linde Kathleen “The solvency and liquidity approach in the Companies Act 2008” 2009 (2) TSAR at 229.

Section 85(4) prohibits a company from making any payment for the purchase of any shares issued by the company, if there are “reasonable grounds” for believing that the company would not be liquid, before or after the acquisitions of the shares, or where the making of such payments would result in the company being insolvent, after the payments for such shares. It is therefore not necessary to prove that the company was in fact liquid and solvent.

The question whether the common law prohibition on the purchase by a company of its own shares has been abolished entirely was discussed in *Capitex Bank Ltd v Qorus Holdings*.⁶⁵ In its decision, the court stated that although the capital maintenance rule and the perceived protection that it afforded a company’s creditors had dramatically been amended by the Companies Amendment Act, the rule nevertheless continued to have residual application in South African law. The court further confirmed that s 85(1) of the 1973 Companies Act, as amended, had the effect of repealing the common law rule laid down in *Trevor v Whitworth* and that a company was now entitled to acquire its own shares. Only a payment in contravention of the dual tests of solvency and liquidity would result in the illegality of a share-repurchase agreement.⁶⁶

In terms of the 2008 Companies Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonable financial circumstances of the company at the time, the fairly valued assets of the company⁶⁷ are equal to or exceed the fairly valued liabilities of the company⁶⁸ (“the solvency test”)⁶⁹ and it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of either twelve months after the date on which the test is applied,⁷⁰ or in the case of a distribution, twelve months following that distribution

⁶⁵ *Capitex Bank Ltd v Qorus Holdings Ltd and Others* 2003 (3) SA 302 (W) at 3081-J. Also see Meskin *Henoschsberg on the Companies Act* op cite note 1 at 179.

⁶⁶ Also see Larkin MP and Cassim FHI “Company Law (including Close Corporations)” 2003 *Annual Survey South African Law* at 595.

⁶⁷ Section 4(1)(a) of the 2008 Companies Act is extended to include not only the assets of the company to whom the test is applied, but also, if the company is a member of a group of companies, the aggregate assets of the company.

⁶⁸ Section 4(1)(a) of the 2008 Companies Act is extended to include the aggregate liabilities of the company where the company is a member of a group of companies.

⁶⁹ The solvency test, also sometimes referred to as the balance sheet test, recognises the preference given to creditors over shareholders on dissolution of a company by preventing a company from favouring its shareholders through a partial liquidation. See Van der Linde 2009 (2) *TSAR* op cite note 68 at 226. Section 4(1)(b)(i) of the 2008 Companies Act.

⁷⁰ Section 4(1)(b)(i) of the 2008 Companies Act.

(“the liquidity test”).⁷¹ Section 1(a) of the 2008 Companies Act defines a distribution as being a direct or indirect transfer of money or other property by a company, to or for the benefit of the shareholders of the company or of another company within the same group of companies in consideration for *inter alia* the acquisition by the company of its own shares or by any company within the same group of companies of any shares of a company within that group of companies. The payment for the acquisition of share is therefore a distribution, as defined and is therefore subject to all the requirements pertaining to distributions.

It is also evident that while the 1973 Companies Act is silent on the time period for which a company is required to remain liquid after the repurchase of its shares, the 2008 Companies Act provides that the company must be able to pay its debts for a twelve month period after the payment for shares.⁷²

Unlike the 2008 Companies Act, the 1973 Companies Act does not contain any specific guidelines as to which assets, liabilities and debts should be taken into account when applying the solvency and liquidity tests. The 2008 Companies Act offers guidance in that it provides that when considering the financial information concerning a company, accounting records that satisfy the requirements of s 28 and financial statements satisfying the requirements of s 29 must be used. Section 4(2)(b) further provides that a company must consider a fair valuation of the company’s assets and liabilities in conjunction with any reasonably foreseeable contingent assets and liabilities and may consider any valuation of the company’s assets and liabilities that are reasonable in the circumstances.⁷³ In addition, s 4(2)(b)(ii) provides that the board or other person applying the test “may consider any other valuation of the company’s assets and liabilities that is reasonable in the circumstances”.

⁷¹ The liquidity test addresses the fundamental expectation of creditors of the company that their debts will be paid when they become due. The determination of the liquidity of a company entails not only the application of a balance sheet test, but also an analysis of the company’s cash flow forecast. A company’s cash flow will indicate its ability to pay its debtor when the debtor’s claim becomes due (i.e. whether the company is liquid or not). See Van der Linde *Regulation of Share Capital* op cite note 11 at 27; Van der Linde 2009 (2) *TSAR* at 226

⁷² Section 4(1)(b) of the 2008 Companies Act. While the inclusion of a time period may assist the directors when they authorise a distribution, it may disadvantage the creditors of the company that have foreseeable longer term commitments that are not payable within the twelve months. See Van der Linde 2009 (2) *TSAR* op cite note 68 at 299.

⁷³ A person applying the solvency and liquidity tests is required to disregard as a liability any amount that would be required, if the company were to be liquidated at the time of the distribution, to satisfy the preferential rights of shareholders whose preferential rights are, on liquidation, superior to those preferential rights of the parties receiving the distribution, at the time of liquidation. Section 4(2)(c) of the 2008 Companies Act.

5. A COMPANY'S ACQUISITION OF ITS OWN SHARES

5.1 INTRODUCTION

The procedure for the acquisition of shares differs depending on whether the shares are to be acquired by way of a market purchase (i.e. on an exchange) or an off-market purchase.⁷⁴ A company is required to comply with the provisions of s 87(1) to (5) of the 1973 Companies Act, where the shares are acquired by way of an off-market purchase. Where the shares are acquired by way of a market purchase the rules and listing requirements of the relevant exchange are to be complied with, over and above the provisions of the 1973 Companies Act.⁷⁵ Once effective, s 48 of the 2008 Companies Act will govern the acquisition of shares, with the listing requirements of the relevant exchange providing further requirements in respect to market purchases.

5.2 THE 1973 COMPANIES ACT

Section 85(1) of the 1973 Companies Act provides that a company may acquire⁷⁶ its own shares, if such acquisition is authorised by the articles of association of the company⁷⁷ and is approved by special resolution.⁷⁸ The special resolution may be a general approval or a specific approval for a particular acquisition.⁷⁹ Where a company gives a general approval, the approval is valid until the next annual general meeting unless it is varied or revoked by special resolution prior to such subsequent

⁷⁴ An off-market purchase is a purchase of shares where the shares are not listed on the stock exchange. See Van der Linde 1999 (7) *JBL* op cite note 59 at 70.

⁷⁵ Section 87(2)(b), read together with s 87(6) of the 1973 Companies Act.

⁷⁶ The term "acquire" and/or "acquisition" is not defined in s 85(1) of the 1973 Companies Act, but is intended to include both a purchase of the shares of a company and the subscription for the shares of the company. See Cassim 1999 (116) *SALJ* op cite note 66 at 763.

⁷⁷ Eilis Magner justifies the requirement of authorisation as "the power in question undeniably has great potential for altering the nature of the company and therefore the shareholders as a body should be required to consider whether they want it to be available to the company." See Cassim 1999 (116) *SALJ* op cite note 66 at 764 (footnote 16).

⁷⁸ Section 85 of the 1973 Companies Act. The fundamental protection that is afforded the shareholders of the company is the requirement that a special resolution be passed prior to the repurchase of any shares by the company.

⁷⁹ Section 85(2) of the 1973 Companies Act. The main distinction between a general approval and a specific approval is whether the approval is or is not "for a particular transaction". If the approval is specific to a particular transaction, then it is a 'specific approval', if not, then the approval is a general approval. A general approval would then be a general discretion of the directors to repurchase the shares of the company. See Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-68.

annual general meeting.⁸⁰

In terms of s 87(1), a company that wishes to purchase its own shares is required to deliver or mail a copy of the written offering circular, in the prescribed form, to each registered shareholder of the company,⁸¹ as at the date of the offer.⁸² The purpose of this requirement is to ensure equal treatment of each shareholder of the company.⁸³ The offering circular⁸⁴ is to be given in such manner as is provided in terms of the company's articles for the sending of any notice of a meeting of shareholders, stating the number and class or kind of its issued shares which the company proposes to acquire and specifying the terms and reasons for such offer.⁸⁵ Some authors are of the view that only the remaining shareholders should be entitled to vote on the special resolution for the repurchase of shares and that the shareholders who intend selling their shares (hereinafter referred to as "leaving shareholders") should be excluded from the decision.⁸⁶ Nothing in s 85 however prevents leaving shareholders from participating in voting on the special resolution for the repurchase of the shares. Failure to comply with s 87(1) constitutes a criminal offence punishable by a fine, imprisonment for a period not exceeding three months, or both.⁸⁷

In terms of s 87(1)(b) a company is required to lodge a copy of the offering circular

⁸⁰ Section 85(3) of the 1973 Companies Act. Also see Cilliers *et al Corporate Law* op cite note 10 at 324.

⁸¹ The registered shareholders of the company are those shareholders who are recorded in the register of shareholders at the time of the proposed purchase.

⁸² Section 87(1) does not apply in circumstances where the shares are acquired by special resolution passed in terms of s 85(1) and the approval by such special resolution is a specific approval as contemplated in s 85(2) and in cases where a company whose shares are listed on a stock exchange within the Republic.

⁸³ Van der Linde Kathleen "Share repurchases" 2002 (10) *JBL* at 27.

⁸⁴ It would seem that a written offering circular may only be delivered or mailed to its shareholders once the necessary approvals set out in s 85 are given. Section 199(1) provides however that a notice of a general meeting to be held to pass a special resolution must specify "... the intention to propose the resolution as a special resolution, the terms and effect of the resolution and the reasons for it." Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-64.

⁸⁵ Section 87(1)(a) of the 1973 Companies Act. As the shareholders are given the opportunity to decide whether or not to accept the company's offer to repurchase its shares, this procedure distinguishes a share repurchase from a reduction of the company's issued share capital where a shareholder may be deprived of his shares without his consent. See Cassim 1999 (116) *SALJ* op cite note 66 at 773.

⁸⁶ This view was expressed by Prof LCB Gower, a research adviser on company law to the Department of Trade report in the article, "*The Purchase by a Company of its Own Shares. A Consultative Document* (1980) Cmnd 7944, para 44. See also Blackman *et al Commentary on the Companies Act* at op cite note 28 at 5-65 (footnote 4).

⁸⁷ Section 21 of the Companies Amendment Act, read together with s 287 of the 1973 Companies Act.

with the Registrar within 15 days of the date that it is delivered or mailed to the shareholders of the company.

Where a company has proposed the repurchase of its own shares and in response to such proposal the shareholders propose selling a greater number of shares than what the company originally offered to acquire, then the company is obliged to acquire from all the shareholders who offered to sell *pro rata* their shares, as nearly as possible disregarding fractions.⁸⁸

No provision exists in the 1973 Companies Act, or in the later 2008 Companies Act, requiring the directors to repurchase the shares of the company at the lowest price at which the shares are obtainable. It is, however, trite law that the common law fiduciary duties of a director and in particular the duty of a director to act in good faith and for the benefit of the company would require the directors to consider the repurchase price carefully.⁸⁹

Sections 85(5) to 85(9) set out the effect of share acquisition (relating to par value shares and no par value shares) on the share capital of the company. Once a company has acquired shares issued by it, such shares are cancelled as issued shares and are restored to the status of authorised shares of the company.⁹⁰ No “treasury shares” are therefore permitted in South African company law.⁹¹ As the reacquired shares are restored to the status of authorised share capital, these shares do not carry any voting or dividend rights in the hands of the company, but the company may reissue them.⁹² The company is required to notify the Registrar within thirty days of the date of the acquisition of the date, number and class of shares that it has acquired.⁹³

In the case of an acquisition by a company of its par value shares, s 85(5) provides that the issued capital must be decreased by an amount equal to the par value of the

⁸⁸ Section 87(4) of the 1973 Companies Act. Those members who opt to sell their shares will participate on an equal basis with other such shareholders. Each shareholder will have an equal opportunity to sell his shares in response to the offering circular. See Cassim 1999 (116) SALJ op cite note 66 at 773. Section 87(4) does not apply to the acquisition of shares listed on a stock exchange within the Republic (provision to s 87(4)).

⁸⁹ Cassim 1999 (116) SALJ op cite note 66 at 773.

⁹⁰ Section 85(8) of the 1973 Companies Act.

⁹¹ “Treasury shares” are repurchased shares that have not been cancelled. See Cassim 1999 (116) SALJ op cite note 66 at 761.

⁹² Cassim 1999 (116) SALJ op cite note 66 at 761.

⁹³ Section 87(5) of the 1973 Companies Act.

shares acquired. This is the necessary consequence of the cancellation of the par value shares as required in terms of s 85(8).⁹⁴ Acquisition of no par value shares issued by the company results in the stated capital of the class of shares acquired being decreased by an amount derived from multiplying the number of shares of that class acquired with the amount arrived at by dividing the stated capital contributed by issued shares of that class by the number of issued shares of that class.⁹⁵ The repurchase of shares therefore always operates as a reduction of the company's share capital.⁹⁶

In terms of s 85(9), after the acquisition of company shares there must still remain shares in issue other than convertible or redeemable shares. The purpose of this requirement is to prevent a company from acquiring all of its own shares or prevent a company from being in a position to convert or redeem all of its remaining issued shares. If a company was allowed to acquire all of its shares, it would be able to informally liquidate itself.⁹⁷

5.3 THE 2008 COMPANIES ACT

Unlike the 1973 Companies Act, the 2008 Companies Act applies the same financial restrictions to all distributions⁹⁸ and does not regulate the effect of distributions on the share capital accounts of the company.⁹⁹

Subject to s 48(3),¹⁰⁰ a company may acquire its own shares, if the decision to do so

⁹⁴ Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-71.

⁹⁵ Section 85(6) of the 1973 Companies Act.

⁹⁶ Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-72.

⁹⁷ Van der Linde 1999 (7) *JBL* op cite note 59 at 69.

⁹⁸ The 1973 Companies Act regulates four different payments which are essentially distributions, namely payments to shareholders for the acquisition of their shares by the company, payment to shareholders on the redemption of their shares, payments to shareholder as interest on their shares and payments to shareholders by reason of their shareholding. Different financial restrictions apply to these different types of distributions as they have different effects on the share capital accounts of the company. Payments to shareholders for acquisition of their shares and payments to shareholders by reason of their shareholding are both distributions which are subject to the solvency and liquidity tests. The other two payments, however, continue to be regulated as exceptions to the capital maintenance principle. See Van der Linde Kathleen "The regulation of distributions to shareholders in the Companies Act 2008" 2009 (3) *TSAR* at 484.

⁹⁹ Van der Linde 2009 (3) *TSAR* op cite note 104 at 485.

¹⁰⁰ Section 48(3) restricts the ability of a company to acquire its own shares where, if as a result of such acquisition, there would no longer be any shares of the company in issue other than

satisfies the requirements of s 46.¹⁰¹ Distributions must be authorised by the board of directors.¹⁰² The only exception to this requirement is where a distribution is to be made in compliance with a court order or pursuant to an existing obligation of the company.¹⁰³ The authorisation by the board can be given at any stage before the distribution.¹⁰⁴ The 2008 Companies Act does not prescribe the form of the authorisation or approval of the distributions that needs to be given by the shareholders. The company's Memorandum of Incorporation may, however, impose such requirements to which the directors would then need to comply, for all and/or any distributions to be made by the company.¹⁰⁵

Section 4 requires that the company must be able to pay its debts as they become due in the ordinary course of business for twelve months following the share repurchase and not more than ten percent, in the aggregate, of the number of issued shares of any class of the shares of the company may be held by, or for the benefit of, all the subsidiaries of the company.¹⁰⁶ In addition to s 46, a company must comply with the requirements set out in s 48.¹⁰⁷

Prior to effecting a distribution,¹⁰⁸ the board of directors must acknowledge that the

shares held by one or more of the company's subsidiaries or convertible or redeemable shares.

¹⁰¹ Section 48(2) of the 2008 Companies Act.

¹⁰² Section 46(1)(a)(ii) of the 2008 Companies Act.

¹⁰³ Section 46(1)(a)(i) of the 2008 Companies Act.

¹⁰⁴ Section 1 of the Companies Act 71 of 2008 defines a "distribution" to include a direct and indirect "...incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares of that company or of another company within the same group of companies...". The term "distribution" is used to refer to payment made to shareholders either as a return on share capital or as a return of share capital. See Van der Linde 2009 (2) *TSAR* at 484, 492.

¹⁰⁵ Van der Linde 2009 (3) *TSAR* op cite note 104 at 492.

¹⁰⁶ When determining whether the solvency and liquidity tests have been applied, a subjective test is used in that the Board must be satisfied that the company is actually solvent and that it appears that it will be liquid (including the following 12 (twelve) months. If the company becomes insolvent or illiquid after the Board has applied these tests, it will not affect the transaction or the liability of the directors. See Benade ML *et al Entrepreneurial Law, incorporating The New Companies Act Manual* special ed (LexisNexis Durban 2009), Delpont P *The New Companies Act Manual* at 32.

¹⁰⁷ A share repurchase entails not only the reorganization of the capital of the company, but also a distribution to the extent that the company gives consideration. The distributional aspects of the transaction are therefore regulated in one provision, while the reorganisational aspects are dealt with in another. See Van der Linde 2009 (3) *TSAR* op cite note 104 at 492.

¹⁰⁸ This may be acknowledged at any time prior to the distribution, however if the distribution has not been finalised within 120 business days of the acknowledgement, a new assessment must be done. Section 46(3) of the 2008 Companies Act.

solvency and liquidity tests¹⁰⁹ have been applied and that they have reasonably concluded that the company will satisfy the tests immediately after completion of the proposed distribution.¹¹⁰ The directors of a company may be personally liable (jointly and severally with the company) if they are present at a meeting when the board approved a share repurchase or participated in the decision and failed to vote against such decision, despite knowing that the distribution made would be contrary to s 46.¹¹¹

A similar provision to s 85(9) of the 1973 Companies Act is included in the 2008 Companies Act. Section 48(3)(b) of the 2008 Companies Act provides that after the acquisition of company shares there must still remain shares in issue other than convertible or redeemable shares.¹¹²

5.4 THE JSE LISTING REQUIREMENTS

Where the shares of a company are listed on the JSE¹¹³ such shares are dealt with in terms of the provisions of the 1973 Companies Act and the Listing Requirements of the JSE Ltd (hereinafter referred to as “the JSE Listing Requirements”),¹¹⁴ which primarily ensure proper disclosure.¹¹⁵ It is interesting to note that while s 87(6) of the 1973 Companies Act provides that a stock exchange may determine further requirements with which a company whose shares are listed on such exchange shall comply prior to such company acquiring its own shares, no such provision has been included under the 2008 Companies Act. It would therefore appear that only the provision of the 2008 Companies Act need to be complied with. It is my view however that irrespective of whether the 2008 Companies Act prescribes this as a requirement or not, the JSE will surely still require compliance, as a requirement to being listed on the JSE.

¹⁰⁹ Compliance with the solvency and liquidity tests as set out in s 4 of the 2008 Companies Act is required for all distributions.

¹¹⁰ Section 46(1)(c) of the 2008 Companies Act.

¹¹¹ Section 46(6)(b) of the 2008 Companies Act.

¹¹² Section 48(3)(b) of the 2008 Companies Act.

¹¹³ The JSE Ltd is licensed as an exchange under the Securities Services Act, 2004 and is the only stock exchange in South Africa.

¹¹⁴ Listing Requirements of the JSE 2nd ed Service Issue No. 13. Johannesburg, LexisNexis Durban - [online] <http://jse.co.za/How-To-List-A-Company/Main-Board/Listing-requirements/JSE-listing-requirements.aspx> [Date of use: 28 June 2010].

¹¹⁵ Van der Linde Kathleen “Share repurchases” 2002 (10) *JBL* at 28.

The JSE Listing Requirements¹¹⁶ prescribe the information that must be contained in the circular to the shareholders in the case of a specific repurchase, namely an offer approved in a general meeting in respect of a particular repurchase, as well as a general repurchase, namely a general approval by the giving of a renewal mandate, which is valid until the company's next annual general meeting or fifteen months from the date of resolution, whichever is shorter.¹¹⁷ This information includes the details of the offer, notice of the general meeting to be held and the authority¹¹⁸ that will be sought for the acquisition of the shares.¹¹⁹

The general repurchase of shares by way of a market purchase is subject to stricter limits than specific repurchases with regards to the volumes of shares that may be acquired and the price that may be paid.¹²⁰ Section 5.69(b) of the JSE Listing Requirements provides that, where a specific repurchase is sought, the authorisation must be given in terms of a special resolution passed by the company shareholders, excluding any shareholder and its associates that are participating in the repurchase.

6. ACQUISITION OF A COMPANY'S SHARES BY ITS SUBSIDIARIES

6.1 INTRODUCTION

Both the 1973 Companies Act and the 2008 Companies Act differentiate between a subsidiary company and a holding company based on the degree of control that one company has over another. The relationship between a subsidiary company and a holding company exists where one company, as a holding company, has either on its own or with its subsidiaries, or only via its subsidiaries a certain degree of control.¹²¹

The 1973 Companies Act defines a holding company with reference to another

¹¹⁶ Section 11.1 of the JSE Listing Requirements.

¹¹⁷ Section 5.67 (a) and (b) of the JSE Listing Requirements.

¹¹⁸ Section 5.72 and s 11.1 prescribes the information that must be given where a general authority will be sought at an annual general meeting for repurchases on the exchange, and for additional information where approval is to be sought at a general meeting other than an annual general meeting.

¹¹⁹ Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-65.

¹²⁰ Section 5.68 of the JSE Listing Requirements prescribes that the general repurchase by a company of its own securities shall not, in the aggregate in any one financial year, exceed 20% of that company's share capital of that class in any one financial year.

¹²¹ Delport PA "Company Groups and the Acquisition of Shares" 2001 (13) SA Merc LJ at 121.

company being its subsidiary,¹²² which in turn is defined in s 1(3). The definitions set out in subsec (3) are based on the control that a holding company has over its subsidiary and provides that a subsidiary or holding company relationship exists in a number of different circumstances as set out in this subsection.¹²³

From s 3 of the 2008 Companies Act, it is clear that the determination of whether a company is a subsidiary of another entity or not, also depends on forms of control. Firstly the ability of the juristic person in question to directly or indirectly exercise or control the exercise of a majority of voting rights associated with the issued securities of that company and secondly the right to appoint or elect such number of directors as control a majority of the votes at a board meeting.¹²⁴ The manner of determining whether a person controls all or a majority of the general voting rights associated with issued securities of a company is set out in subsec (2).

6.2 THE 1973 COMPANIES ACT

In terms of s 1(5) of the 1973 Companies Act, a subsidiary is deemed to be a wholly owned subsidiary of another company if it has no members except that other company and a wholly owned subsidiary of that company and its or their nominees.¹²⁵

Section 85(1) provides that prior to a company being able to acquire its own shares, a special resolution needs to be passed. No exception is made with regards to a wholly owned subsidiary. A wholly owned subsidiary is therefore also required to pass a special resolution prior to it being able to acquire its own shares. This would appear to be superfluous as the main purpose of acquiring the special resolution is the

¹²² Section 1(4) of the 1973 Companies Act.

¹²³ Cilliers *et al Corporate Law* op cite note 10 at 434. The relationship between a holding company and a subsidiary company is important in company law, as at the moment that a degree of control comes into existence, two major consequences follow regarding these companies. Firstly, the holding company must prepare annual financial statements and secondly the 'abuse of control' provisions of the 1973 Companies Act come into operation. This notwithstanding, the principles remain clear that a company in a group is and remains a separate legal entity, with its own rights and obligations.

¹²⁴ Etienne Swanepoel "New Companies Act: who is related to whom and why?" <http://www.busrep.co.za/index.php?fSectionId=558&fArticleId=5060712> [Date of use: 28 June 2010].

¹²⁵ The 2008 Companies Act has a similar definition in that it defines a wholly owned subsidiary as being a company where all the general voting rights associated with issued securities of the company are held or controlled, alone or in any combination, by the persons contemplated in s 3(1)(a).

protection of the shareholders, which in the case of a wholly owned subsidiary would be the holding company. There would therefore be no need to protect the shareholder (being the holding company) in this circumstance.¹²⁶

Prior to the amendment of the 1973 Companies Act by the Companies Amendment Act, s 39 prohibited, subject to certain exceptions, shareholding by the subsidiary company in its holding company.¹²⁷ This provision was intended to exclude the indirect purchase of its own shares by the holding company and the subsequent artificial increase in dividends, as was illustrated in *The Unisec Group Ltd & Others v Sage Holdings Ltd*.¹²⁸ The artificial increase in dividends occur when the dividends paid to the wholly owned subsidiary are paid back as dividends to the holding company. The holding company then distributes the dividends again to the shareholders and the whole process of dividend round-tripping starts over again as the dividend that the subsidiary receives is again paid as dividends to the holding company.¹²⁹

With the amendment of the capital maintenance rule, the erstwhile s 39 required amendment. The result was that s 89 now empowers subsidiaries to acquire shares of their holding company. This section now permits the acquisition of shares up to a maximum of ten percent if made *mutatis mutandis* in accordance with ss 85, 86, 87 and 88.¹³⁰ This limitation of ten percent applies to the joint shareholding of all the subsidiaries of a particular holding company.¹³¹ The provisions of s 89 do not apply to the acquisition of shares by a holding company in a subsidiary of itself and further do not regulate or restrict the acquisition of shares by one subsidiary company of the shares of another subsidiary company. Where a subsidiary company is also the subsidiary of the acquiring company, no problems arise with regards to possible abuse surrounding the acquiring of shares. Where this is not the case, however the power to acquire shares can be abused. Not only is the trafficking in the shares of the group possible, but also a purchase of the holding company's shares in a fellow

¹²⁶ Delpont 2001 (13) SA Merc LJ op cite note 126 at 124.

¹²⁷ Before its amendment by the 1999 Amendment Act, s 39(1) prohibited a company or its nominee from being a member of its holding company and rendered void any allotment, issue or transfer of shares of a company to its subsidiary. See Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-97.

¹²⁸ 1986 (3) SA 259 (T) at 265-266.

¹²⁹ Delpont 2001 (13) SA Merc LJ op cite note 126 at 124.

¹³⁰ Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-98.

¹³¹ Van der Linde 1999 (7) JBL op cite note 59 at 70.

subsidiary is, in effect, a return to the holding company of its investment in the subsidiary acquiring the shares.¹³²

The words *mutatis mutandis* in s 89 require that a subsidiary that wishes to acquire shares in its holding companies must comply with the requirements for a company acquiring its own shares in so far as these requirements can, with the necessary changes, be applied to the situation.¹³³ This means that the subsidiary company's articles must authorise the acquisition of shares in the holding company and a special resolution must first be passed. The tests of solvency and liquidity also apply to the subsidiary's acquisition of shares. If the solvency and liquidity tests are not complied with by the subsidiary, not only the directors of the subsidiary will be liable, but also the directors of the holding company.¹³⁴ The shareholders or former shareholders of the holding company may also be held liable to return the consideration they received, to the subsidiary company.¹³⁵

In terms of s 39, a subsidiary will not be able to vote on the shares that it acquires, since the voting rights attached to such shares may not be exercised while the shares are being held by the subsidiary.

The provisions of s 85(8), which require the cancellation of shares once acquired, do not apply to acquisitions in terms of s 89. In addition to the non-cancellation of the shares, the capital accounts are not adjusted where the subsidiary acquires shares in its holding company.¹³⁶ The legislature therefore effectively permits an indirect holding (to a maximum of ten percent of the issued shares of the holding company) of what is effectively a type of treasury share (as the subsidiary does not cancel the acquired shares), whilst it expressly prohibits any direct holding of treasury shares.¹³⁷

The sections in the JSE Listing Requirements governing the acquisition by a company of its own shares also govern the purchase by a subsidiary of shares in its holding

¹³² Blackman *et al Commentary on the Companies Act* op cite note 28 at 5-99.

¹³³ Van der Linde 1999 (7) *JBL* op cite note 59 at 70.

¹³⁴ Section 86(6) of the 1973 Companies Act.

¹³⁵ Section 86(3) of the 1973 Companies Act. See also Van der Linde 1999 (7) *JBL* op cite note at 71.

¹³⁶ Cassim FHI "The repurchase by a company of its own shares: The concept of treasury shares" 2003 (120-1) *SALJ* at 137.

¹³⁷ The 1973 Companies Act prohibits the direct holding of 'treasury shares' by requiring the cancellation of the shares on their acquisition (s 85(8)) Also see Bhana Deeksha "The company law implications of conferring a power on a subsidiary to acquire the shares of its holding company" 2006 (17) *Stellenbosch Law Review* at 248.

company.¹³⁸ In terms of s 5.76 of the JSE Listing Requirements, an issuer must obtain approval from its shareholders, in accordance with s 5.69 or s 5.72 before any subsidiary of the listed company undertakes to purchase shares in its holding company. Also, where an issuer wishes to use repurchased shares, held as treasury shares by a subsidiary of the issuer, such use must comply with the JSE Listing Requirements as if such use was a fresh issue of shares.¹³⁹

6.3 THE 2008 COMPANIES ACT

Section 48 of the 2008 Companies Act regulates the acquisition of shares by the subsidiary in the holding company.¹⁴⁰

In terms of s 48(2), a subsidiary of a company may acquire shares of that company provided that not more than ten percent, in the aggregate, of the number of issued shares of any class of shares of the company may be held by, or for the benefit of, all the subsidiaries of that company taken together.¹⁴¹ In addition to the percentage restriction, a further restriction provides that the company may not acquire its own shares, and a subsidiary of a company may not acquire shares of that company if, as a result of such acquisition, there would no longer be any shares of the company in issue other than the shares held by one or more subsidiaries of the company, or convertible or redeemable shares.¹⁴²

As set out above, s 85(1) of the 1973 Companies Act requires the passing of a special resolution, prior to any shares being acquired. No exception is made with regards to wholly owned subsidiaries and as such, a wholly owned subsidiary would also be required to pass such special resolution. The position under the 2008 Companies Act is not as clear.

Section 48 of the 2008 Companies Act can, in my view, be read to mean that a subsidiary of a company may acquire shares subject only to s 48(2)(b) being complied

¹³⁸ The JSE Listing Requirements do not, however, govern transactions entered into on behalf of *bona fide* third parties, either by the company or any other member of its group at arm's length terms.

¹³⁹ Section 5.75 of the JSE Listing Requirements.

¹⁴⁰ A holding company, in relation to a subsidiary, is defined as meaning a juristic person or undertaking that controls that subsidiary. See s 1 of the 2008 Companies Act.

¹⁴¹ Section 48(2)(b)(i) of the 2008 Companies Act.

¹⁴² Section 48(3) of the 2008 Companies Act.

with.¹⁴³ The application of s 46 appears to be connected purely to acquisitions under s 48(2)(a) and not to acquisitions by subsidiaries that are dealt with under s 48(2)(b). With s 46 requiring the passing of a special resolution prior to any shares being acquired, it can therefore be argued that where a subsidiary wishes to acquire its own shares, no special resolution is needed. The passing of the resolution is intended to provide the shareholders with comfort that no shares will be repurchased without such authorisation. The abovementioned interpretation of s 48(2)(a) would therefore lead to an untenable position for the shareholders of the company. It is therefore my submission that the word “and” at the end of s 48(2)(a) should be read to imply that the provisions of s 46 would have application in respect to both acquisitions in terms of s 48(2)(a) and s 48(2)(b). The definition of distribution in s 1 would support this view, as acquisitions by subsidiaries are considered to be distributions within the meaning defined and as such, the provisions of s 46 would apply. If this position is correct, then the same superfluous effect of requiring a special resolution by a wholly owned subsidiary will occur under the 2008 Companies Act as is currently the case under the 1973 Companies Act.

Where a company acquires shares in contradiction to s 46 or s 48, the company may, not more than two years after the acquisition, apply to a court for an order reversing the acquisition, and the court may order the person from whom the shares were acquired to return the amount paid by the company and the company to issue to that person an equivalent number of shares of the same class as those acquired.¹⁴⁴

A director of a company may be liable to the extent set out in s 77(3)(e)(vii)¹⁴⁵ if the director was present at the meeting when the board approved the acquisition of the shares contemplated in s 48, or participated in the making of such decision in terms of s 74 and failed to vote against the acquisition of the shares, despite knowing¹⁴⁶ that

¹⁴³ Section 48(2)(b) of the 2008 Companies Act. Section 48(2)(b) imposes a ten percent limit on the aggregate number of shares that may be acquired and prescribes that the voting rights attached to shares may not be exercised while held by the subsidiary.

¹⁴⁴ Section 48(6) of the 2008 Companies Act.

¹⁴⁵ Section 77(3)(e) of the 2008 Companies Act provides that a director is liable for any loss, damages or costs sustained by the company as a direct or indirect result of the director’s conduct and identifies a number of instances including unlawful distributions and unlawful acquisitions of shares. See also Van der Linde Kathleen “The regulation of share capital and shareholder contributions in the Companies Bill 2008” 2009 (1) *TSAR* at 498.

¹⁴⁶ Section 1 of the 2008 Companies Act defines the terms “knowing”, “knowingly” or “knows” to mean “...the person either (a) had actual knowledge of that matter; (b) was in a position in which the person reasonably ought to have (i) had actual knowledge; (ii) investigated the

the acquisition was contrary to s 48 or s 46.¹⁴⁷

7. CONCLUSION

The main function of the authorised capital of a company is to protect the existing shareholders against possible dilution of their equity interests by the issuing of shares beyond the stipulated limit.¹⁴⁸ The authority therefore given to companies to purchase their own shares has given companies the flexibility to decide on matters directly relating to the share capital of the company.¹⁴⁹

The solvency and liquidity tests set out in s 4 of the 2008 Companies Act provide adequate protection to both creditors and shareholders of the company. These tests, in my view, provide better protection for creditors and shareholders than what was previously afforded under the capital maintenance rules.

As mentioned earlier, the solvency test recognises the ultimate priority that the creditors enjoy over the shareholders of the company on dissolution of the company,¹⁵⁰ while the liquidity test addresses the fundamental expectation of the creditors of the company to be paid on time.

According to Van der Linde provided the solvency and liquidity tests are complied with, the risk of loss to the creditors should be remote.¹⁵¹ I agree with Van der Linde in that although the provisions are not as strong as under the old procedure, which have been criticised as being overly protective, the new provisions of the 2008 Companies Act are adequate in their protection of creditors of the company.¹⁵²

With the personal liability that directors can be exposed to under the 2008 Companies Act, it is absolutely vital that the directors of the company satisfy themselves that the

matter to an extent that would have provided the person with actual knowledge; or (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter.” See s 1 of the 2008 Companies Act.

¹⁴⁷ Section 48(7) of the 2008 Companies Act.

¹⁴⁸ One of the functions of the authorised capital is to determine the maximum number of shares that the company may issue without altering its share capital. The statement of authorised capital therefore protects the existing shareholder’s interests as it limits the potential disturbance of the proportionate interests of the shareholders which could result from the issue of further shares. See Van der Linde *Regulation of Share Capital* at 254.

¹⁴⁹ Van der Linde 1999 (7) *JBL* op cite note 59 at 71.

¹⁵⁰ See Van der Linde *Regulation of Share Capital* op cite note 11 at 27.

¹⁵¹ Van der Linde *Regulation of Share Capital* op cite note 11 at 309.

¹⁵² Van der Linde *Regulation of Share Capital* op cite note 11 at 309.

company can afford to repurchase its shares, prior to the shares being repurchased. Any failure to do so may have extremely serious consequences, including joint liability with the company, for any loss, damages or costs sustained by the company as a direct or indirect result of the director's conduct.¹⁵³

In the 1973 Companies Act, the procedures that must be followed by a company when acquiring its own shares are quite elaborate in contrast with the simple procedure recorded in terms of s 48 of the 2008 Companies Act. I believe that the same procedures that apply to market purchases should be applied to off-market purchases so as to provide consistency relating to the purchase of shares.

The legislature's intention with regards to the permitting of treasury shares needs to be clarified. With allowing subsidiaries to acquire and hold its holding company shares, it appears that our law now permits treasury shares. If this is legislative intention, then I would recommend that this position is clarified in subsequent amendments to the 2008 Companies Act.

The 2008 Companies Act has codified the standards of director's conduct that were previously set out in common law, which require a director to exercise his powers and perform his functions in good faith for a proper purpose, in the best interests of the company and with a reasonable degree of care, skill and diligence. This is particularly important with regards to compliance with the solvency and liquidity tests set out in s 4 of the 2008 Companies Act.¹⁵⁴

¹⁵³ Section 77(3)(e) of the 2008 Companies Act. Also see Anon "Share buybacks" http://www.deneysreitz.co.za/index.php/news/share_buybacks [Date of use: 1 December 2009].

¹⁵⁴ Makwana Edward "Companies Act still not certain" <http://www.saica.co.za/tabid/695/itemid/2449/Companies-Act-still-not-certain.aspx> [Date of use: 22 September 2010]

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