

## INTRODUCTION

The amendments made to the Companies Act 61 of 1973 (hereafter referred to as 'the Act') by the Companies Amendment Act 37 of 1999 made far-reaching changes affecting the share capital of a company. A significant change was the removal of ss 83–90 of the Act, which required a special resolution and, except in limited circumstances, a court's sanction in order for a company to reduce its share capital.

The removal of the reduction provisions in ss 83–90 raises the question whether the reductions of share capital that were permitted in terms of these provisions are still permissible and, if so, subject to what requirements, if any. The old reduction provisions permitted a reduction in any way (other than by paying off capital in instalments or future payments), including the cancellation (write-off) of any paid-up share capital which had been lost or was not represented by available assets, and the paying off of any paid-up share capital which was in excess of the wants of the company (ss 83(1) and 84(1)).

In the old reduction provisions (ss 83–90) a reduction of share capital referred to a reduction of 'paid-up capital' (see ss 84 and 85(1)). However, the fact that the reduction provisions referred, inter alia, to paid-up share capital which had been 'lost or was not represented by available assets' suggests that what was meant was not the amount of capital actually received by the company from the shareholders as the purchase price of the shares issued to them, but the share capital and stated capital accounts reflecting the company's issued share capital. The reduction provisions were made applicable to the share premium account and the capital redemption reserve fund by s 76(1) and s 98(1)(b) respectively.

The question addressed in this note is accordingly whether a company can reduce its share capital account, stated capital account, share premium account and capital redemption reserve fund, whether it be by way of a payment to shareholders or simply by way of a write-off. The question relates to reductions generally, cognizance being taken of the fact that the Act clearly permits reductions where a 'buy-back' takes place (see ss 85(5) and 85(6)) and in other specified circumstances (see ss 76(3), 77(3), and 252(3)).

It is submitted that the answer to this question is that the following considerations indicate that a company does not have the power generally to reduce capital.

CONSIDERATIONS INDICATING THAT THERE IS NO  
GENERAL POWER TO REDUCE SHARE CAPITAL*Shareholders and not only creditors need protection*

It is true that if, as the law now stands, companies are free to reduce their share capital, creditors are afforded some protection. Where the reduction

involves a payment to shareholders creditors are protected because s 90 must be complied with, which requires compliance with the prescribed 'solvency' and 'liquidity' requirements (see s 90(2)(a) and (b)). And where the reduction does not involve a payment to shareholders, creditors require no protection because they are not affected at all. All this is true, but sight must not be lost of the fact that a reduction, whether it involves a payment to shareholders or not, always involves a variation of the rights of the shareholders. This is most dramatically the case where shares are cancelled. It is also the case where the par value of shares is reduced or, in the case of no par value shares, where the stated capital account is reduced. That is to say, a reduction of share capital always involves either the abrogation of the rights of certain shareholders (cancellation) or the variation (a diminution) of rights of the shareholders on winding-up. (This explains why, prior to the 1999 amendments, a company that had lost any or all of its paid-up capital was not, and could not sensibly be, *required* to reduce its capital.) Consequently, when asked to confirm a reduction under the old provisions, the courts always ensured, not only that the company's creditors were protected, but also that the reduction was fair as between the shareholders. As Galgut J put it in *Ex parte Vlakfontein Gold Mining Co Ltd* 1970 (2) SA 180 (T) at 183, one of the duties of the court when asked to confirm a reduction of capital was 'to consider whether the proposed reduction is fair and equitable as between the shareholders and particularly as between different classes of shareholders'. (See M S Blackman R D Jooste G K Everingham *Commentary on the Companies Act* vol 1 at 5–13.)

It is submitted that the fact that the Act now provides no protection for shareholders (they were protected under the old ss 83–90) indicates that a reduction is prohibited. Surely it could not have been the intention of the legislature to disregard the rights of shareholders?

As far as the share premium account is concerned, prior to the introduction of a provision governing the share premium account (in England in 1948, in South Africa in 1952), share premium constituted part of the distributable surplus, which the company, if it so wished, could distribute to its shareholders by way of dividend. The reason why a provision was introduced equating the share premium with share capital as far as reductions were concerned was given by Walton J in *Shearer (Inspector of Taxes) v Bercain Ltd* [1980] 3 All ER 295 at 300–301, namely, that the purpose of the provision was to protect shareholders who had paid a premium for their shares: to ensure that the premiums they had paid were not paid away in dividends to other shareholders. Although this reasoning, it is submitted, is fallacious, at least where the shares are standing at a premium in the market (see Blackman et al op cit 5–21), if it is accepted that the reasoning is valid, it will be recognized that if a company is now free to reduce its share premium this need for protection will not be provided for. Surely, again, this could not have been the intention of the legislature, indicating that the reduction of the share premium account is not permitted.

*Section 90 is not a reduction provision*

Section 90 of the Act does not expressly or impliedly permit a reduction of capital. As has been stated:

‘Section 90 puts an end to the capital maintenance rule. A company may now distribute (make ‘payments’ of) all its net assets to its shareholders. The section draws no distinction between distributions of profits and distributions out of capital; and all such ‘payments’, regardless of whether or not they involve payment out of capital, leave the company’s share capital and its capital accounts unaffected. Thus, s 90 puts an end to the rule that ‘dividends’, in the sense of any payment or benefit given by a company to its shareholders *qua* shareholders, cannot be paid out of capital. It permits ‘payments’ out of capital without a reduction of the company’s share capital (and, of course, without the consent of the company’s creditors and the confirmation of the court). Hence, what it permits is not the reduction of share capital, but, rather, the payment of capital funds to shareholders *without a reduction of share capital*. It should be noted that a reduction of share capital coupled with a distribution of capital funds constituted a *return* of capital funds to the shareholders concerned. Strictly speaking, s 90 does not authorize a *return* of capital funds. The shareholders’ rights to return of their capital on winding-up remain intact. What s 90 permits the company to do is to make payments to the shareholders out of capital funds.’ (Blackman et al op cit 5–112.)

*A company’s powers are statutory*

A company is a creature of statute and as such has only such powers as are expressly or impliedly conferred upon it by the Companies Act. As Lord Halsbury said in *Ooregum Gold Mining Co of India v Roper* [1892] AC 125 (HL) at 133: ‘[T]he whole structure of a limited company owes its existence to the Act of Parliament, and it is to the Act of Parliament one must refer to see what are its powers, and within what limits it is free to act.’

A company, accordingly, derives no powers from the common law and any power it has must be provided for by the Act. With the removal of the old reduction provisions and no enactment of new reduction provisions it follows that the power does not exist.

It is true that art 31(g) of Table A and art 30(g) of Table B still provide that the company may by special resolution ‘reduce its share capital, stated capital, any capital redemption reserve fund or any share premium account, in any manner and with, and subject to, any incident authorized, and consent required by the law’. The purpose of this article was to provide the necessary authorization required by the Act for the exercise of the power to reduce share capital in terms of the old ss 83 and 84 — both these provisions empowered the company to reduce its share capital ‘if so authorized by its articles’. An authorization in terms of the articles to reduce its share capital cannot confer on a company a power to do so that is not conferred by the Act.

Regarding the statutory nature of a company’s power to reduce its capital it is to be noted that our Companies Act’s origins can be traced back to the 1862 English Companies Act, which, as enacted, made no provision for the reduction of share capital. In 1867 the Act was amended (Companies Act 1867, 30 and 31 Vict c 131) to empower a company to reduce its share capital (a special resolution and court confirmation were required) and our legislature later followed suit. As Lord Herschell explained in relation to that amendment: ‘Experience appears to have shown that circumstances might

occur in which a reduction of the capital would be expedient. Accordingly, by the Companies Act, 1867, provision was made enabling a company under strictly defined conditions to reduce its capital.' (*Trevor v Whitworth* (1887) 12 App Cas 409 at 415–416; [1886–90] All ER Rep 46 at 50 (HL).) He said also: 'Nothing can be stronger than these carefully-worded provisions [governing reduction of share capital] to show how inconsistent with the very constitution of a joint-stock company, with limited liability, the right to reduce its capital was considered to be' ((1887) 12 App Cas 409 at 416; [1886–90] All ER Rep 46 at 50 (HL)). It follows that by removing the reduction provisions the legislature has reverted to the original position.

*Why are other alterations specifically dealt with?*

Section 75 of the Act empowers a company, subject to certain requirements (including a special resolution), to make various alterations (not reductions) to its share capital and shares, eg increasing share capital and cancelling authorized but unissued shares. If a reduction of share capital is permitted and as there is nothing in the Act prescribing any special requirements to achieve it, it means that a reduction can be achieved far more easily than 'harmless' alterations, eg the cancellation of authorized but unissued shares. This is illogical.

*Amendments to ss 76(1) and 98(1)(b)*

Prior to an amendment in 2001 (see s 9 of the Companies Amendment Act 35 of 2001) s 76(1) provided that 'the provisions of the Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the share premium account were paid-up share capital of the company'. When the provisions of the Act relating to reduction of share capital (ss 83–90), which were the provisions referred to, were removed by the 1999 amendment, the legislature, through an oversight, failed to amend s 76(1) accordingly. The position was rectified to an extent by the amendment in 2001 referred to above. Section 76(1) now provides that 'the provisions of this Act relating to the share capital of a company shall, except as provided in this section, apply as if the share premium account were paid-up share capital of the company'. The reference to any reduction provisions in the Act has thus been removed, the logical implication being that there are no longer any provisions enabling a company to reduce its share capital. (It is not clear what the meaning is of the new wording. What are the provisions of the Act relating to share capital that now apply to the share premium account?)

There was a similar oversight relating to the capital reserve fund provided for by s 98(1)(b) of the Act. Section 98(1)(b), prior to its amendment in 2001, contained the same wording, quoted above, that was contained in s 76(1) of the Act. Section 98(1)(b) too, through an oversight, was not amended in 1999 and, as in the case of s 76(1), removal of the reference to the old reduction provisions only came about in 2001 (see s 12 of the Companies

Amendment Act 35 of 2001). The 2001 amendment has the same logical implication as the amendment to s 76(1), namely, that the Act no longer contains provisions which empower a company to reduce its share capital.

*Reductions using s 56(4)*

Section 52(2) provides that the memorandum of a company with a share capital shall 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' (s 52(2)(a)(i)) and 'the number of shares if the company is to have shares of no par value' (s 52(2)(a)(ii)). These provisions accordingly provide for the so-called 'authorised share capital' of the company.

Any changes to the authorized share capital in the memorandum require a special resolution (s 56(4)).

Could it be argued that herein lies the machinery enabling a company to reduce its issued share capital? If a reduction of issued share capital does not involve a reduction of authorized share capital no alteration of the company's memorandum is necessary, in fact no reduction is possible. If, however, the reduction does involve a reduction of authorized share capital, does this mean that the reduction can be achieved by a special resolution in terms of s 56(4)? Thus if a company wishes to cancel issued shares or to reduce the par value of issued shares, can this be achieved through an alteration to the memorandum by special resolution in terms of s 56(4)?

This argument is questionable in a number of respects. First, it does not cater for all reductions. For example, it does not provide the means whereby a company can reduce its stated capital without a reduction in the number of no par value shares. Secondly, it is illogical in that it only permits a company to reduce its share capital if it is prepared to go the extra step of amending its memorandum. For example, it can only cancel issued shares if it also reduces the number of authorized shares. Thirdly, if the legislature wished to replace a means of reduction of share capital which has previously been specifically and comprehensively provided for, surely it would not do so in such an obscure and incomplete way. Why expressly single out less innocuous alterations of share capital, as has been done in s 75, and leave an important alteration such as a reduction (which can seriously impact on shareholders' rights) to be dealt with in such an obfuscated way?

*Why the need for the specific reduction provisions?*

With regard to the reduction of the share premium account, it is noteworthy that s 76(3) specifically permits this account to be 'applied' (a reduction is clearly implied) for various purposes. If reductions of the share premium account were generally permitted, there would be no need for s 76(3). The fact that s 76(3)(d) (which permits the use of its share premium by a company to pay a premium on the acquisition of its shares in accordance with s 85 of the Act) was inserted by the same 1999 Amendment Act that abolished the old ss 83–90 reduction provisions enhances this argument. This addition to

s 76(3) also counters any argument that s 76(3) should have been abolished and its continued presence is as a result of an oversight by the legislature.

Regarding oversights, it is to be noted that there are still provisions in the Act which continue to refer to reductions of capital. Section 75(2) provides that a cancellation of authorized but unissued shares ‘shall not be deemed to be a reduction of capital within the meaning of the Act’ (a ‘reduction of capital’ is nowhere defined in the Act). Section 194(1)(b) provides that preference shareholders whose right to vote has been removed by the articles shall nevertheless have the right to vote ‘in regard to any resolution proposed which directly affects any of the rights attached to such shares or the interests of the holders thereof, including a resolution . . . for the reduction of its capital’.

It is submitted that, based on the arguments set out above, a reduction of capital is not permitted, and the continued existence of these provisions is due to an oversight on the part of the legislature.

Although it is a cardinal rule of interpretation of statutes that a statute should not be interpreted as to render certain provisions redundant (see *Minister of Law and Order v Argus Printing and Publishing Co Ltd* 1990 (1) SA 1058 (A) at 1067 B–C), there is authority that a court may find that the legislature failed to repeal provisions through oversight (see *Fundtrust (Pty) Ltd (In Liquidation) v Van Deventer* 1997 (1) SA 710 (A) at 733G; *R v Correia* 1958 (1) SA 533 (A) at 538B). In *Correia’s* case Fagan CJ accepted that the interpretation of a statutory provision that he favoured rendered it ineffective, because there was never a case to which it could apply. Earlier in his judgment he said: ‘even Parliament may have nodded’ (*Correia* (supra) ??). Also in the *Fundtrust* case Hefer JA remarked: ‘[W]e must bear in mind that faithful avoidance of anomalies is not the lawgiver’s *forte*’ ((supra) ??).

## CONCLUSION

*The Memorandum on the Objects of the Companies Amendment Bill, 1994* (B17D–99) states:

‘The principles of capital maintenance have undergone significant changes in almost all countries. The modern notion of capital maintenance is that companies may reduce capital, including the acquisition of their own shares, but subject to solvency and liquidity criteria. This has the advantage of affording protection to creditors whilst at the same time giving flexibility to companies to achieve sound commercial objectives. These aspects of flexibility and achievement of sound commercial objectives have become extremely important since South Africa’s re-entry into the global markets.’

This statement does, it is conceded, indicate an intention to permit reductions of capital and a desire to allow for far greater flexibility in the regulation of what a company can do with its shares and share capital. And this is borne out by the 1999 amendments, which, inter alia, abolished the capital maintenance rule by lifting the prohibition on the acquisition by a company of its own shares (s 85) and the payment of dividends out of share capital.

Despite the new approach reflected in the Explanatory Memorandum and evidenced by the 1999 amendments, it is submitted that the intention to

permit reductions is not borne out by the wording of the Act, and for a court to conclude that it is possible would constitute unacceptable judicial law-making. It is contended that the considerations set out in this note clearly indicate that our company law does not permit a company, other than in the specific instances provided for, to reduce its share capital. There is undeniably a need for a general enabling provision, but this requires legislative intervention, intervention that takes into account that it is not only creditors who need protection but shareholders as well.