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School for Advanced Legal Studies

MINOR DISSERTATION

'INCREASE OF SHARE CAPITAL OF PUBLIC COMPANIES UNDER GERMAN AND SOUTH AFRICAN LAW: A COMPARATIVE LAW STUDY.'

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Cape Town, 13 September 2011

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— LIST OF ABBREVIATIONS —

(Pty) Ltd.	Propriety Limited
AC	Law Reports, Appeal Cases (Third Series)
All ER	All England Law Reports
All ER Rep	All England Law Reports Reprint
App. Cas.	Law Reports, Appeal Cases (Second Series)
B.C.C.	British Company Law Cases
B.C.L.C.	Butterworth Company Law Cases
BCLC	Butterworths Company Law Cases
BGH	Bundesgerichtshof (Engl.: Federal Court of Justice of Germany)
BGHZ	Entscheidungssammlung des Bundesgerichtshofes in Zivilsachen (Engl.: Civil Law Reports of the Federal Court of Justice of Germany)
Ch.	Law Reports, Chancery Division (Third Series)
E.R.	English Reports
ed.	edition *or* editor
eds.	editors
et al.	et alia
et seq.	et sequens *or* et sequentes
EUR	Euro
GG	Government Gazette
GN	General Notice
i.e.	id est
ibid.	ibidem
Jr	Junior
JSE	Johannesburg Stock Exchange
King III Report	King III: Report on Governance for South Africa – 2009
Ltd.	Limited
NPD	Natal Provincial Division of the Supreme Court of South Africa
NPV	No par value
OLG	Oberlandesgericht (Engl.: Higher Regional Court)
p.	Page

para.	paragraph
pp.	Pages
s	section
SA	South African Law Report
SCC	Supreme Court Cases, India
ss	sections
subs	subsection
Vol.	Volume
ZAR	South African Rand

— GLOSSARY —

Aktiengesellschaft	German stock corporation
Aktiengesetz	German Stock Corporation Act
Aufsichtsrat	Advisory board
Bundesgerichtshof	Federal Court of Justice of Germany
Bundesgesetzblatt	Federal Law Gazette
Drittelbeteiligungsgesetz	One-Third Participation Act
Gewinnrücklage	Profit reserve
Handelsgesetzbuch	German Commercial Code
Kapitalrücklage	Capital reserve
Mitbestimmungsergänzungsgesetz	Coal and Steel Industry Codetermination Complementary Act
Mitbestimmungsgesetz	Codetermination Act
Montanmitbestimmungsgesetz	Coal and Steel Industry Codetermination Act
Oberlandesgericht	Higher Regional Court
Vorstand	Executive board

— MINOR DISSERTATION —

I INTRODUCTION

The German *Aktiengesetz* (Engl.: Stock Corporation Act) of 6 September 1965 (hereinafter: the Aktiengesetz) and the South African Companies Act, 43 of 1973 (hereinafter: the 1973 Act) provide, or rather provided for a similar approach with respect to the increase of share capital of public companies[1] through the issuance of shares: Both the Aktiengesetz (see § 182 Aktiengesetz[2]) and the 1973 Act (see s 221 of the 1973 Act) basically required an approval of the shareholders, which had to immediately precede the issuance of new shares.

Whereas the Aktiengesetz still adheres to this approach, the new South African Companies Act, 71 of 2008 (hereinafter: the 2008 Act) introduced a completely different concept for the increase of the share capital through the issuance of shares:

It abolishes the concept of shareholder approval in respect of the increase of share capital through the issuance of shares, and it relocates the corresponding competence to the board of directors. Therefore, the 2008 Act only distinguishes between authorised and issued shares. Whereas the Memorandum of Incorporation (hereinafter: MoI) may stipulate that the authorisation of shares must be approved by the shareholders, the issuance of authorised shares always falls within the scope of the board's responsibility. The MoI must only set out the number and classes of shares that may be issued by the board. In other words, the board of directors can resolve to issue shares of the company at any time as long as they act within the provisions of the MoI. Besides this already wide power, the board of directors may, except to the extent that the MoI provides otherwise, also increase or decrease the number of authorised shares of any class of shares, reclassify any classified shares that have been authorised but not issued, or determine the preferences, rights, limitations or other terms of shares in a class subject to determination by the board. In other words, what is crucial here is that the board may increase both the authorised

[1] The term 'public company' refers in this dissertation to both the German Aktiengesellschaft as defined in § 1 Aktiengesetz and the public company as defined in s 1 of the 2008 Act.
[2] German sections are cited according to the common citation in Germany: section = §, sections = §§, subsection = Roman numerals (I, II, III, etc.), sentences = Arabic numerals (1, 2, 3, etc.).

share capital and the issued share capital – unless the MoI provides otherwise.

Furthermore, even if the board arranges the issuance of *un*authorized shares, or if the number of issued shares exceeds the number of authorised shares of any particular class, the issuance of those shares is not void, but may be retroactively authorised by the shareholders.

The 2008 Act brought these fundamental changes to South African company law *inter alia* for the purpose of being more investor-friendly.[3] The Department of Trade and Industry has emphasised in its Guidelines for the Corporate Law Reform that '[t]he mobility of international capital has highlighted the need for domestic laws to be investor friendly and competitive with international trends.'[4] Besides, the Department of Trade and Industry deemed a most liberalized approach to be reasonable by stating 'that companies attain maximum flexibility in creating financing mechanisms. This implies that they should have significant freedom to create financial instruments.'[5]

These two aims – to be investor-friendly and to grant maximum flexibility – lead to the core question of this paper: Does the maximum flexibility lead to an investor-friendly system or does it rather cause the opposite?

Therefore, I will compare the South African law with German law, because under the Aktiengesetz on the other hand, a stock corporation (i.e. public company) may primarily increase its share capital with the approval of the shareholders. To be sure, the Aktiengesetz also provides for increase of share capital by 'contingent capital' (§§ 192 to 201 Aktiengesetz) and 'authorised capital' (§§ 202 to 206 Aktiengesetz), but the main concept of the Aktiengesetz is the increase of share capital with the immediately preceding approval of the shareholders. Thus, this type of increase of share capital is also called 'regular increase of share capital' (§§ 182 to 191

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[3] See Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (GN 1183 of 2004, published in GG Vol. 468 No. 26493 of 23June 2004) at 13.

[4] Ibid.

[5] Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (GN 1183 of 2004, published in GG Vol. 468 No. 26493 of 23June 2004) at 32.

Aktiengesetz). The other types of increase of share capital are subject to very strict restrictions and especially the increase of capital through authorised capital may not exceed the currently existing share capital by more than 50 % and the authorisation is only valid for 5 years or less.

The minor dissertation is to examine whether the German or the South African approach should be preferred. Therefore, I will shortly introduce the fundamental parallelisms and differences of public companies under German and South African law (chapter II), and then describe the South African law in detail (chapter III), namely the provisions of the old Act and of the new Act as well as the policies of legislation. Following this, I will examine the provisions under the German Aktiengesetz (chapter IV).

In chapter V, I will reveal the advantages and disadvantages of both sets of rules and contrast my findings. Conclusively, chapter VI is to contain my opinion and proposals in respect of, for instance, mechanism and judicial means that could be adequate in order to avoid misuse of the increased power of the board of directors in South Africa and suggestions to the German legislative, how to improve the current system.

II FUNDAMENTAL PARALLELISMS AND DIFFERENCES OF PUBLIC COMPANIES UNDER GERMAN AND SOUTH AFRICAN LAW

Before I can analyse the South African and the German law with respect to the increase of share capital it is important to outline the most important parallelisms and distinctions between public companies under German law and under South African law.

The crucial parallelism is that the 'share capital' of both the German public company (hereinafter: Aktiengesellschaft) and the South African public company is,

as its name implies, divided into shares,[6] and that these shares are, in general, freely transferable.[7] Also, under both jurisdictions the MoI and the *Satzung*, which is the name of the statutes of an Aktiengesellschaft, may provide for a restriction on the transferability of shares.[8]

Besides, the further common, structural features of a German Aktiengesellschaft as well as a South African public company are as follows: they are legal persons with a legal personality that is separate from its members and thus, its shareholders are basically not personally liable for the company's liabilities.[9]

Finally, public companies in Germany and in South Africa are free to have their shares listed on a security exchange or to trade them through the unorganized capital market.

On the other hand the structural differences between a public company and an Aktiengesellschaft are particularly decisive for the following examination.

1. Board structure

Unlike South African law, which follows the concept of unitary boards,[10] the Aktiengesetz requires a two-tier board consisting of an *Aufsichtsrat*, which translates as supervisory board, and a *Vorstand* (Engl.: executive board),[11] which is involved with the day-to-day business. However, since the practice and Principle 2.18 of the King III Report[12] – but not the 2008 Act itself – also distinguish between executive and non-executive directors, there is rather a difference in the *modus operandi* than

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[6] Re German public companies: see Uwe Hüffer *Aktiengesetz* 9th ed. (2011) at § 1 marginal No. 1; re South African public companies: see Maleka Femida Cassim 'Types of Companies' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 62 at 67.

[7] Re German public companies: see Dirk Solveen in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 68 marginal No. 9; re South African public companies: see Maleka Femida Cassim 'Types of Companies' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 62 at 67.

[8] Re German public companies: see § 68 II Aktiengesetz; re South African public companies: see Maleka Femida Cassim 'Types of Companies' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 62 at 76.

[9] Re German public companies: see Uwe Hüffer *Aktiengesetz* 9th ed. (2011) at § 1 marginal No. 1; re South African public companies: see s 19(1)(b) of the 2008 Act; *Airport Cold Storage (Pty) Ltd v Ebrahim and Others* 2008 (2) SA 303 (C) para 6.

[10] See Rehana Cassim 'Corporate Governance' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 433 at 439.

[11] Translations adopted from: Rehana Cassim 'Corporate Governance' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 433 at 439.

[12] Read with Annexes 2.2 and 2.3.

in the tasks that they perceive: The Aufsichtsrat fulfils broadly the same functions as non-executive directors do according to the definition of non-executive directors in Annex 2.3 of the King III Report, and the members of the Vorstand are comparable to executive directors and their functions contemplated in Annex 2.2 of the King III Act.

Generally, the Aufsichtsrat consists of three to twenty-one members depending on the Satzung and the size of the company, see § 95 Aktiengesetz, where the members are either only shareholders or a combination of shareholders and employees: Whether or not the members of the Aufsichtsrat must also be recruited from the personnel, depends on the number of employees who work for the company concerned and the industry of the company.[13] The Vorstand runs the day-to-day business of the company and is advised and supervised by the Aufsichtsrat. The Aufsichtsrat inter alia appoints the members of the Vorstand, may remove them, and determines the salary of the members of the Vorstand. Hence, there is slight difference in the mode of appointment of the members of the Vorstand and the executive directors. While executive and non-executive directors must generally be elected by the persons entitled to exercise voting rights in such an election (unless they are first directors or unless the MOI provides otherwise[14]), the Vorstand of an Aktiengesellschaft is always appointed by the Aufsichtsrat.[15] However, like under South African law the Aufsichtsrat is to be elected by the shareholders too, unless the law provides for participation of employees.[16] In this case, the representatives of the employees are elected by them.[17]

2. Minimum capital to form a company

Another fundamental difference between South African law and German law is the requirement of a minimum capital to form a company. Whereas neither the 1973 Act nor the 2008 Act contained any requirements regarding a minimum amount of

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[13] See § 1 I No. 1 Drittelbeteiligungsgesetz [One-Third Participation Act] of 18 Mai 2004; § 5 1 Montanmitbestimmungsergänzungsgesetz [Coal and Steel Industry Codetermination Complementary Act]; § 4 1 Montanmitbestimmungsgesetz [Coal and Steel Industry Codetermination Act]; § 7 I, II Mitbestimmungsgesetz [Codetermination Act] of 4 May 1976.
[14] See s 68(1) read with s 66(4)(i) or (ii) of the 2008 Act.
[15] See § 84 1 1 Aktiengesetz.
[16] See § 101 I Aktiengesetz.
[17] Ibid.

authorised and/or issued share capital to form or to run a public company,[18] the Aktiengesetz requires that the minimum nominal[19] amount of share capital totals EUR 50,000.00 (≈ ZAR 500,000.00), see § 7 Aktiengesetz.

3. Purpose of the share capital

The aforementioned different approach of South African and German law is based on different convictions with regard to the purpose of the share capital:

As is in Germany, the whole continental European company law is traditionally characterized by the concept of creditor protection through the share capital.[20] The need of a certain mandatory amount of share capital is considered to be the compensation for the fact that only the company itself as a legal person and its assets, respectively, but not the shareholders personally, are liable for the company's debts.[21] Just recently, the European Commission confirmed that it considers the minimum legal capital approach and thus, the protection of companies' creditors through the share capital to be reasonable[22] – even though the High Level Group of Company Law Experts proposed an amendment of the Second Council Directive 77/91/EEC of 13 December 1976 to the effect that EU member states would have a choice whether they prefer to stick to a minimum legal capital regime or whether they want to introduce an alternative regime which would not be based on the concept of legal capital.[23]

Albeit the creditors of German companies do not enjoy an absolute financial protection through this system, the legislation seeks to protect the so called *Haftkapital* (Engl.: liable capital) by the *Prinzip der Kapitalaufbringung* (Engl.:

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[18] See Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 46.

[19] In this regard 'nominal share capital' means the issued share capital as compared to paid-up share capital: Whereas the minimum amount of issued share capital must total EUR 50,000.00, the minimum amount of paid-up capital, i.e. that part of the total amount called up by the company on the shares issued, which has already been paid up by the shareholders, only has to amount to 25 per cent of the issue price, unless the consideration for the shares is non-cash, see § 36a I, II Aktiengesetz.

[20] See Karsten Heider in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 1, 3rd ed. (2008) at § 1 marginal No. 96.

[21] See Karsten Heider in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 1, 3rd ed. (2008) at § 1 marginal No. 95.

[22] See Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006.

[23] See Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward, COM/2003/0284 final.

principle of capital raising) and by the *Prinzip der Kapitalerhaltung* (Engl.: principle of capital maintenance). The complete raising of capital is especially ensured through the obligation of the incorporators to acquire all the shares (see §§ 23 I No. 2, 29 Aktiengesetz) and to pay up the called-up issue price (see §§ 36 II, 36a Aktiengesetz) as well as through the general prohibition of the issue (a) of par value shares at a discount to their nominal value, i.e. below par value, or (b) of no-par value shares below their calculated proportion of the capital (see § 9 I Aktiengesetz), and the prohibition of successive formation[24] (see § 2 Aktiengesetz). Furthermore, these substantial obligations and prohibitions are flanked by the duty to have the formation reviewed independently (see § 33 Aktiengesetz), by strict provisions regarding the valuation of non-cash contributions (see §§ 27, 32 et seq. Aktiengesetz) and by the personal liability of the founders with regard to obligations implied by the formation (see §§ 46 et seq. Aktiengesetz).

However, the protection of creditors would be undermined, if the Aktiengesetz did not provide for several prohibitions regarding the maintenance of the capital: Thus, it is prohibited to re-transfer capital contributions (see § 57 Aktiengesetz), to exempt the shareholders from paying up their shares (see § 66 Aktiengesetz), to acquire own shares (see §§ 71 to 71e Aktiengesetz) and to distribute a dividend that is in excess of the amount of balance sheet profit (see § 58 IV Aktiengesetz) or that has to be used by law as a reserve (see § 150 Aktiengesetz read with §§ 266 IIIA, 272 *Handelsgesetzbuch*, Engl.: German Commercial Code). These statutory provisions are complemented by that fact, that German courts treat loans from those shareholders, who are also creditors of the company, to the company like liable capital, if *inter alia* the loan was granted at a time when the company was financially distressed.[25] Also, even though § 27 III Aktiengesetz is slightly mitigated as compared with its former wording in conjunction with the so-called theory of hidden non-cash contributions, which was originated by German courts and German

[24] 'Successive formation' means that shares are already issued before the actual formation takes place, see Peter Doralt and Christoph Diregger in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktienrecht*, Volume 1, 3rd ed. (2008) at § 2 marginal No. 50.

[25] BGH, decision of 26 March 1984 – II ZR 171/83 – published in *Neue Juristische Wochenschrift* 1984, 1893 at 1895.

researchers,[26] it enhances the protection of both the share capital and the creditors. § 27 III Aktiengesetz does, in fact, stipulate that a cash contribution is considered unpaid in case both the shareholder concerned and the company have agreed on an (immediate) subsequent handover of an object against payment. The Aktiengesetz alleges in that case that the parties actually intended to agree on a share issuance against non-cash contribution and hence, one would have had to adhere to the strict provisions regarding non-cash contributions.[27]

On the other hand, as is in the United States of America and most of the members of the Commonwealth of Nations,[28] neither the 1973 nor the 2008 Act provide for a statutory requirement of a minimum amount of issued share capital.[29] However, the 1973 Act in conjunction with common law followed the concept of capital maintenance.

This concept seeks to protect the issued share capital in a quite similar way as in Germany. Hence, capital of a public company is not regarded to be ‚a debt owing by it to its shareholders, and if the capital is lost, the company is under no legal obligation either to make it good, or, on that ground only, to wind up its affairs.'[30] In fact, the basis of the concept of capital maintenance is the assumption that the issued share capital is to serve as a ‚permanent fund or guarantee fund intended for the payment of the claims of the company's creditors.'[31]

The concept of capital maintenance consists of various principles, such as the prohibition against a company issuing shares at a discount,[32] the rule that dividends

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[26] See, for instance, BGH, decision of 11 May 2009 – II ZR 137/08 – published in *Neue Zeitschrift für Gesellschaftsrecht* 2009, 747 at 747; Welf Müller 'Abgesang und Auftakt für die verdeckte Sacheinlage' in *Neue Juristische Wochenschrift* 2009, 2862 at 2862-2863.

[27] See above. A similar protection of the share capital gives § 27 IV Aktiengesetz which applies if the shareholder and the company have agreed on a service etc that cannot be considered to be an object.

[28] See s 761(2) in conjunction with s 763(1) of the UK Companies Act 2006. The United Kingdom as a member of the European Union had to enact such a requirement (minimum amount of issued share capital) according to Article 6(1) of the Second Council Directive 77/91/EEC of 13 December 1976.

[29] See Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 46.

[30] *Verner v General and Commercial Investment Trust* [1894] 2 Ch. 239 at 265.

[31] Farouk HI Cassim 'Introduction to the New Companies Act: General Overview of the Act' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 1 at 10.

[32] See *Ooregum Gold Mining Co. of India Ltd. v Roper* [1982] AC 125 (HL) at 125.

may not be paid out of capital;[33] the rule that a company may not purchase its own shares;[34] and the prohibition on the granting by companies of financial assistance for the purchase of or subscription for its own shares.[35]

The concept of capital maintenance, which was not only case law but also integrated in the 1973 Act, has been modified by various amendments of the 1973 Act and finally, partly jettisoned by the Companies Amendment Act 37 of 1999.[36] Since the Companies Amendment Act 37 of 1999 only abandoned some but not all principles of the concept of capital maintenance and introduced the twins tests of liquidity and solvency in other respects, a "strange and a curios ambivalence"[37], i.e. a mixture of two different and in fact, contrary approaches, occurred.

Accordingly, the 2008 Act commendably replaces the whole concept of capital maintenance by the solvency and liquidity test. According to s 4 of the 2008 Act, the test will be satisfied

> 'at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time— *(a)* the assets of the company or, in the case of a holding company, the consolidated assets of the company, as fairly valued, equal or exceed the liabilities of the company or, in the case of a holding company, the consolidated liabilities of the company, as fairly valued; and *(b)* 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— (i) 12 months after the date on which the test is considered; or (ii) in the case of a distribution contemplated in paragraph *(a)* of the definition of 'distribution' in section 1, 12 months following that contribution.'

Since the liquidity and solvency test is to replace the concept of capital

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[33] See *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706.
[34] See *Trevor and Another v Whitworth and Another* (1887) L.R. 12 App. Cas. 409 at 423-424.
[35] See John Armour 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' in (2000) 63 *The Modern Law Review*, No. 3, 355 at 368-369.
[36] See Farouk HI Cassim ,The Reform of Company Law and the Capital Maintenance Concept' in (2005) 122 *The South African Law Journal*, Issue 2 p 283 at 284.
[37] Farouk HI Cassim and Rehana Cassim 'The Capital Maintenance Concept and Share Repurchases in South African Law' in (2004) 15 *International Company and Commercial Law Review* 188 at 188.

maintenance, it is to be applied in those instances where the rules of the concept of capital maintenance were applicable previously: Thus, the liquidity and solvency test is to be considered by the board in case of financial assistance for the subscription of securities, s 44(3)(b) of the 2008 Act, in case of loans or other financial assistance to directors, see s 45(3)(b) of the 2008 Act, in case of distributions, see s 46(1)(c) of the 2008 Act, in case of resolving to offer a cash payment in lieu of awarding a capitalisation share, see s 47(2) of the 2008 Act, in case of repurchases of shares, see s 48(2) of the 2008 Act, and in case of amalgamations or mergers, see s 113(1) of the 2008 Act.

III SOUTH AFRICAN LAW

1. The Companies Act of 1973

As mentioned before, the 1973 Act required shareholder approval for the alteration of the *authorised* share capital. The core provisions for the increase of share capital were contemplated in s 75(1)(a), (b) and (d) of the 1973 Act, whereupon a company having a share capital, if so authorised by its articles, was allowed by special resolution to alter its share capital and shares as follows: It could—

> '(a) increase its share capital by new shares of such amount, or increase the number of its shares having no par value, as it thinks expedient;
> (b) increase its share capital constituted by shares of no par value by transferring reserves or profits to the stated capital, with or without a distribution of shares;
> ...
> (d) increase the number of its issued no par value shares without an increase of its stated capital'.

(a) General conditions for an increase of share capital

At first, it is important to note, that the authority vested by s 75 of the 1973 Act to alter the share capital was subject to three conditions: (1) the measure had to comply with ss 56 and 102 of the 1973 Act, where s 56 of the 1973 Act dealt inter alia with

the entrenchment of the special rights attaching to a class of shares and s 102 of the 1973 Act dealt with the variation of the rights of different classes of shareholders, (2) it had to be provided for by the company's articles, and (3) it could only be taken by a special resolution, i.e. by a shareholders' resolution passed at a general meeting of that company in the manner provided for by s 199 of the 1973 Act.[38]

It is also to be emphasized that s 75 of the 1973 Act only provided for the *authorisation* of shares but not for the *issue* of authorised shares. Ordinarily, the authorised share capital has not been increased until all authorised shares had been issued. But neither the 1973 Act nor the courts prohibited increasing the authorised share capital, even though the authorised shares had not yet been issued completely.[39] But the board – except to the extent that the memorandum of association provided otherwise – had no power to issue shares of the company without the prior approval of the company in general meeting. The shareholders were free to grant either a general approval or a specific one in respect of a particular issue. They were also allowed to attach conditions to the issuance or to grant a quasi-blanket authorisation to the directors to make an issue to anyone including the directors themselves.[40] It is submitted that such a general authority to issue shares were only valid until the annual general meeting next succeeding the date of its grant.[41] But also an interim general meeting was allowed to alter the earlier granted general authorisation.[42] It is to be born in mind that the authorisation to issue shares under s 221 of the 2973 Act is to be distinguished from the authorisation or approval of an increase of (authorised) share capital under s 75 of the 1973 Act. The shareholders had thus to approve the increase of the share capital on the one hand and to approve the issue of such shares on the other hand. Nevertheless, the authorisation of shares and the issuance of shares were closely linked to each other under the 1973 Act, since both needed the approval of the shareholders and the general authorisation to issue shares was valid one year at the longest. As it will be seen, the regime of the 1973 Act was thus, in principle, very akin to the Aktiengesetz.

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[38] See s 1 of the 1973 Act.
[39] See Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 148.
[40] See s 221(2) of the 1973 Act.
[41] See s 221(3) of the 1973 Act; Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 425.
[42] Ibid.

However, back to the provisions for the authorisation of shares: The first condition of s 75(1) of the 1973 Act was at first a formal one. S 56(1) of the 1973 Act[43] regulated that the clauses contained in the memorandum of association regarding the share capital could (only) be altered by special resolution. In addition, s 56(5) of the 1973 Act, which had to be read with ss 102 and 252 of the 1973 Act,[44] provided for further requirements to be met in case the increase of share capital affected existing shareholders' rights. Since that could only be the case if the company had different classes of shares or sought to issue shares of a different class as compared to the existing shares, I will get back to those requirements in the following subchapter.

The second condition of s 75(1) of the 1973 Act – 'if so authorised by its articles' – merely required that the articles of association of the company expressively state that an alteration of the share capital was permissible. Since Articles 30 and 31 of Table A of Schedule 1 of the 1973 Act contained the necessary authorisations, this condition was also just a formal requirement: Either the articles of association already contained Articles 30 and 31 of Table A of Schedule 1 or the company would have had to alter its articles of association before it could increase its capital. But it must be born in mind that the specifications listed in s 75(1) of the 1973 Act regarding the alteration of the share capital and the shares were exhaustive. In other words, a company was not allowed – even if its articles of association seem to permit it – to alter its share capital and shares in a way that was not contemplated in s 75(1) of the 1973 Act.[45]

The core meaning of the third condition of s 75(1) of the 1973 Act was that the general meeting of the company was not allowed to delegate its power to resolve to alter the share capital to the board of directors. Such a resolution would have been ineffective as conflicting with the provisions of this section,[46] and explicitly with s 221(1) of the 1973 Act, too. The only possible way to remedy the lack of shareholder approval was to apply to the Court in order to have the invalid resolution validated through an order of the Court – provided that the Court was 'being satisfied

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[43] Read with s 75(1) of the 1973 Act.
[44] See M S Blackman et al. (eds.) *Commentary on the Companies Act Volume 1* at 4-97.
[45] See M S Blackman et al. (eds.) *Commentary on the Companies Act Volume 1* at 5-5.
[46] See Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 147.

that in all the circumstances it is just and equitable to do so.'[47] As a side note it should be mentioned that the notice convening the meeting to authorise the proposed increase had to specify its amount.[48]

However, a company arranging an alteration of its capital had not only to obey the sections of the Act and the case law but also the provisions of its articles – provided that they were not inconsistent with the Act: In case a company sought to bring an alteration of its capital into effect without adhering to the provisions of its articles, the alteration would have failed since the corresponding resolution was 'null and void.'[49]

(b) Ways to increase share capital

(i) Increase of share capital by new shares

The 1973 Act basically provided for two types of increasing the share capital: First, according to subs (1)(a) of s 75 of the 1973 Act a company could 'increase its share capital by new shares of such amount, or increase the number of its shares having no par value, as it thinks expedient;' and secondly, according to subs (1)(b) of s 75 of the 1973 Act a company could also 'increase its share capital constituted by shares of no par value by transferring reserves or profits to the stated capital, with or without a distribution of shares'.

Increasing the share capital through the issue of new shares is usually the way by which a company can raise 'fresh' money. On the other hand, a company can also decide to broaden its financial basis, i.e. its equity, through the capitalisation of profits or reserves. Besides the effect, that the liable capital increases, the object of such an issue is to bring the nominal capital into better relationship with the value of the assets and their earning power. The effect on existing holders of ordinary shares is accordingly relatively small. What changes is only the saleability: it increases. Since – after the capitalisation of profits or reserves – the new market value of one share is nearer to its nominal value and thus, its actual value, a potential investor will

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[47] S 97(1) of the 1973 Act.

[48] See *MacConnell v E Prill & Co Ltd* [1916] 2 Ch. 57 at 61.

[49] See *Trustees Emma Smith Trust v Illovo Sugar Estates, Ltd., and Registrar of Deeds* (1926) 47 NPD 370 at 371.

be more willing to buy shares.[50] He, she (or it) then knows that the value of the share corresponds with the amount of money he, she (or it) spends.

(ii) Issuance of preference shares

Once a company sought to issue preference shares it would have had to consider the existing shareholders' rights resulting from s 56(5) of the 1973 Act and the memorandum of association. Or more specifically, there were two situations where the existing shareholders' rights influenced the procedure of increasing the share capital: First, when a company already having different classes of shares sought to issue shares, and secondly, when a company did not have different classes of shares yet but sought to issue shares preferential as compared to the existing shares.

The opportunity to have preference shares arose from s 56 of the 1973 Act. S 56 of the 1973 Act generally permits to entrench 'special rights of any classes of members', where 'classes of members' is to be understood as 'class of shares' if the company concerned is a public company.[51] However, s 56(5) of the 1973 Act also provides that such 'special rights' may only be altered or abrogated if and in the manner the memorandum of association provides for such an alteration or abrogation. Thus, the structuring of the memorandum of association determined the existence of rights of existing shareholders regarding an intended increase of share capital as well as the actual content thereof.[52] In other words, an increase is only possible either if it does not affect the classes of shares at all or if such affection is permissible according to the memorandum of association and the affected shareholders give permission in the prescribed manner. The memorandum of association could, for instance, provide for 'a special resolution of [the] particular class of shareholders [affected], or that they be afforded an opportunity to attend and vote at the meeting of the company called to pass the resolution for the increase [...], or their written consent as involving a variation of their rights'[53].

However, the existing shareholders did not have to approve any variation of their

[50] Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 148.
[51] More generally spoken: if the company has got a share capital. See *Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd* [1987] Ch. 1 at 18; M S Blackman et al. (eds.) *Commentary on the Companies Act Volume 1* at 4-97.
[52] See s 56(5) of the 1973 Act.
[53] Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 148.

rights and they did not have any further rights if the proposed variation was not an 'alteration or abrogation' in terms of the 1973 Act. Especially a mere reduction in the commercial value of a share was not an 'alteration or abrogation' within the meaning of the 1973 Act. Instead, shares were only 'altered or abrogated' when not merely their 'enjoyment'[54] but rather 'their literal form is altered.'[55]

Hence, the jurisdiction has developed different case groups, where there was no 'alteration or abrogation' within the meaning of the 1973 Act: (1) In case a company resolved to subdivide one part of its ordinary shares – with the effect that the voting power of the shareholders holding the other part of the ordinary shares got relatively diluted – there was basically no alteration within the meaning of the law.[56] However, there might have been an alteration of the rights of the shareholders caused by the dilutive effect if the balance of voting power was protected in an applicable agreement.[57] (2) The rights of preference shareholders were also not altered neither when the company issued additional preference shares nor when it issued additional ordinary shares.[58] (3) The last case group to mention is actually no reduction 'at all'[59] of capital and thus, consequently no alteration, either. For the sake of completeness I will briefly explain it regardless: The cancellation of a particular class of shares and the return of capital did not – under two conditions – constitute an alteration of the rights attaching to the shares: First, the company had to be a going concern, and secondly, the return of capital had to be made strictly in accordance with those rights on a winding up.[60] Such a cancellation of a class of shares was not considered to be an alteration of rights, because '[t]he liability to prior repayment on a reduction of capital, corresponding to their right to prior return of capital in a winding-up [...] is part of the bargain between the shareholders and forms an integral part of the definition or delimitation of the bundle of rights which make up a preference share. Giving effect to it does not involve the variation or abrogation of any right attached to such a share.'[61] But even in this case group, it could be an alteration of the rights of

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[54] *White v Bristol Aeroplane Co* [1953] Ch. 65 at 74.
[55] M S Blackman et al. (eds.) *Commentary on the Companies Act Volume 1* at 4-98.
[56] See *Greenhalgh v Arderne Cinemas Ltd and Another* [1946] 1 All ER 512.
[57] Ibid.
[58] See *White v Bristol Aeroplane Co* [1953] Ch. 65 at 74 at 80.
[59] See *Re Northern Engineering Industries plc* [1994] 2 BCLC 704.
[60] See *Re Northern Engineering Industries plc* [1994] 2 BCLC 704; M S Blackman et al. (eds.) *Commentary on the Companies Act Volume 1* at 4-98 with further references.
[61] *Re Saltdean Estate Co Ltd* [1968] 3 All ER 829 at 832.

shareholders, if the company's articles of association deemed the cancellation and repayment to be an alteration of rights.[62]

The distinction drawn between an alteration or abrogation within the meaning of s 56 of the 1973 Act and a mere commercial variation was very important with respect to ss 102(1) and 252 of the 1973 Act. Only if there was an alteration or abrogation within the meaning of s 56 of the 1973 Act, which were collectively called 'variation' under s 102(1),(2) of the 1973 Act, an affected shareholder could apply to the Court for an order under s 252 of the 1973 Act,[63] where s 252 of the 1973 Act provided that 'the Court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the future conduct of the company's affairs or for the purchase of the shares of any members of the company by other members thereof or by the company'[64] on condition that the complaint 'appears to the Court that the particular act or omission is unfairly prejudicial, unjust or inequitable, or that the company's affairs are being conducted as aforesaid and if the Court considers it just and equitable'[65]. Nevertheless, it is important to bear in mind that the (minority) shareholder concerned had generally to defer to the majority[66] and could only apply to the Court, if first, he did not consent to or vote in favour of the resolution, and secondly, he was able to prove that the variation was unfairly prejudicial, unjust or inequitable to him.[67]

(iii) Increase of share capital constituted by shares of no par value.

To understand the system of subparagraph (b) one must consider the financial structure of a public company under the 1973 Act. Every public company had to have three separate accounts: a 'stated capital account',[68] a 'share premium account',[69] and a 'share capital account'.[70] The proceeds on the issue of par value shares were to be transferred to the share capital account and the proceeds on the issue of shares having

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[62] See *Re Northern Engineering Industries plc* [1994] 2 BCLC 704.
[63] See Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 203.
[64] S 252(3) of the 1973 Act.
[65] Ibid.
[66] See *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Collieries Ltd: SA Mutual Life Assurance Society and Another Intervening* 1979 (3) SA 713 (W) at 720.
[67] See Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 203.
[68] See s 77(1) of the 1973 Act.
[69] See s 76(1) of the 1973 Act.
[70] See s 76(2) of the 1973 Act.

no par value were to be transferred to the stated capital account.[71] In the event of issuing shares at a price above their par value, i.e. at a so-called premium, the premium was to be transferred to the share premium account.[72]

With this proviso, it is simple to understand how the increase of share capital under subs (1)(b) of s 75 of the 1973 worked: Having no par value shares a company could resolve to increase its capital through the transfer of any reserves or profits to the stated capital account.[73] Such an increase of the number of shares could either result in an increase of the stated capital, i.e. the share capital, or in a mere increase of the number of shares without an increase of the share capital. In order to effect the latter one must read subs 1(b) with subs 1(d) of s 75 of the 1973 Act.

Meskin[74] gave a good example in order to clarify the mechanism:

> '[T]ake the case of a company which has issued 100 000 shares of no par value for an amount of R300 000 but has prospered so substantially that the market price of these shares has reached such heights that it has become desirable to split them and reduce the market value per share (thus making them more accessible to prospective investors) by issuing to members two new shares for each one held. This could be done by using the powers conferred by sub-s (1)(d). The end result would be:

Original Issue	100 000	NPV shares with stated capital per s. 77(1)	R300 000
Issue of two new shares for every one held	200 000	NPV shares with stated capital	[0]
	300 000		R 300 000'

In terms of s 75(1)(b) of the 1973 Act companies could choose to transfer reserves of profits to the stated capital account with or without a distribution of shares. If they had made the transfer *without* issuing shares of no par value simultaneously, they

[71] See Richard Jooste and Jacqueline Yeats 'Shares, Securities and Transfer' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 197 at 198.
[72] See s 76(1),(2) of the 1973 Act.
[73] See Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 149.
[74] Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 149.

would have actually increased their share capital through the transfer of reserves or profits. The value of every no par value share would thereby have attributably increased.

If a company issued capitalisation shares contemporaneously with the transfer of reserves or profits, there would have not been an increase in the company's stated capital account through the issue of capitalisation shares either. Indeed, the transfer of reserves or profits to the stated capital account would have effected the increase of respectively the share capital or the stated capital account.

(c) Fees payable

It should be noted that every increase of share capital triggered the obligation to pay 0.5 per cent of the amount of increase to the Registrar,[75] i.e. the Companies and Intellectual Property Registration Office (CIPRO).

However, it is submitted that the company concerned did not have to pay any fees in the cases just mentioned. Only when a new issue of no par value shares has been made, the proceeds received increasing the stated capital account are intended to attract the fee as contemplated in s 75(3)(b) of the 1973 Act.[76]

If the company increased the number of its shares by the way as contemplated in s 75(1)(b) read with s 75(1)(d) of the 1973 Act, i.e. without issuing shares, there was no fee payable because the share capital was not affected. The same applied in the case where a company transferred its reserves or profits to the stated capital account *without* issuing capitalisation shares simultaneously: There was no fee payable either, because there has not been an increase in the company's share capital through the issue of shares, but rather through the transfer of profits or reserves. And finally, it is submitted that the fees contemplated in s 75(3)(b) of the 1973 Act are not attracted either in case of the mere issuing of capitalisation shares if they represented 'the amount transferred to the stated capital account from reserves or profits'.[77]

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[75] See s 75(3)(a), (b) of the 1973 Act.

[76] See Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 149-150.

[77] See Philip M. Meskin (ed.) *Henochsberg on Companies Law* 5th ed. (last updated 11/2010) at 149-150.

(d) Policy of legislation

The provisions regarding shareholder approval for the issue of shares were introduced on the recommendation of the *Commission of Enquiry into the Companies Act*. The commission emphasised that there was

> 'a strong body of opinion to the effect that directors should not have unlimited powers, whether derived from the articles or a resolution by the company in meeting, to issue shares...[T]he issue by the company of further shares is a matter which directly affects the interests of each holder of shares in that company and is in this respect distinguishable from ordinary managerial acts by the directors performed in carrying on the business of the company. ... [Thus, there] seems to be justification for imposing a curb on unlimited powers of directors in this respect'.[78]

I submit that the provisions regarding the authorisation of shares were also based on this recommendation, so that the South African legislator decided to establish the system for increasing the share capital as described above.

2. The Companies Act of 2008

(a) Structure of the share capital of public companies

As mentioned earlier, the 2008 Act brought significant changes to South African company law. In respect of the structure of the share capital the following aspects are noteworthy:

Companies finance their activities through the issuance of securities, normally in the form of shares, and through borrowings. Although the 2008 Act, unlike the 1973 Act, does not mention the term 'share capital', it describes the financial means raised by a company through the issue of shares. The fact that the 2008 Act does not mention the term does not imply that South African companies do not have share capital. Also unlike the 1973 Act, the 2008 Act does not require a transfer of the proceeds on the issue of shares to certain accounts. Hence, companies do not have to

[78] Commission of the Enquiry into the Companies Act *Main Report RP 45/1970* at para 44.40 and recommendation 101.

set up either a 'share capital account' or a 'stated capital account' or a 'share premium account'.[79]

While the 2008 Act does not limit the opportunities to create most diverse classes of shares, it prohibits the issue of nominal or par value shares, see s 35(2) of the 2008 Act, because they are deemed to be 'largely artificial, arbitrary and detached from economic value.'[80] Existing par value shares remain,[81] but the Minister has made regulations in respect of the conversation of these shares.[82]

(b) Authorisation of shares

The only provision regarding the authorisation of shares to be issued is s 36(1) of the 2008 Act: The company's MoI—

> '(a) must set out the classes of shares, and the number of shares of each class, that the company is authorised to issue;
> (b) must set out, with respect to each class of shares—
> (i) a distinguishing designation for that class; and
> (ii) the preferences, rights, limitations and other terms associated with that class, subject to paragraph (d);
> (c) may authorise a stated number of unclassified shares, which are subject to classification by the board of the company in accordance with subsection (3) (c); and
> (d) may set out a class of shares—
> (i) without specifying the associated preferences, rights, limitations or other terms of that class;
> (ii) for which the board of the company must determine the associated preferences, rights, limitations or other terms; and
> (iii) which must not be issued until the board of the company has determined the associated preferences, rights, limitations or

[79] See above.
[80] Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (GN 1183 of 2004, published in GG Vol. 468 No. 26493 of 23June 2004) at 33; see also: James J Hanks, Jr 'The new legal capital regime in South Africa' in 2010 *Acta Juridica* 131 at 142.
[81] See item 6(2) of Schedule 5 of the 2008 Act.
[82] See s 31of Regulation 31 of Companies Regulations, 2011.

other terms, as contemplated in subparagraph (ii).'

Subsections (2), (3) and (4) deal with facilities for alteration of those provisions of the MoI, which set out the authorisation and the classification of shares, the numbers of authorised shares of each class, and the definitions of each class of shares: Such an amendment may only be made by special resolution of shareholders,[83] or – except to the extent that the MoI provides otherwise – by the board of directors.[84] In other words, the board of directors is free to increase even the authorised capital at any time, unless the MoI does expressly state that the board may not.

In the event that the board of directors increases the authorised share capital the company merely has to file a Notice of Amendment of its MoI, setting out the changes effected by the board.[85] It has also to do so when the board decreases the number of authorised shares, reclassifies classified shares or classifies unclassified shares, which have been authorised but not issued, and defines a class of shares.[86] That means *argumentum e contrario* that – provided the MoI does not provide otherwise – there is only two things the board may not do: First, the board may not reclassify classified shares that have already been issued, and secondly, the board may not classify unclassified shares that have already been issued, either. Therefore, the company would need a special resolution by the shareholders.

Thus, one can say that the board and the shareholders 'have concurrent jurisdiction'[87] in respect of the authorisation of shares and the classification of (unissued) shares.

(c) Issuance of shares

The issue of shares on the contrary may principally only be induced by the board of directors.[88] According to s 38(1) of the 2008 Act, the board may do so 'at any time, but only within the classes, and to the extent, that the shares have been authorised by or in terms of the company's Memorandum of Incorporation, in

[83] See s 36(2)(a) of the 2008 Act.
[84] See s 36(2)(b) read with s 36(3) of the 2008 Act.
[85] See s 36(4) of the 2008 Act.
[86] See s 36(3)(a) to (d) of the 2008 Act.
[87] Piet Delport *The New Companies Act Manual* (2009) at 18.
[88] See s 38(1) of the 2008 Act.

accordance with section 36' of the 2008 Act. It is noteworthy, that s 38(1) of the 2008 Act is an unalterable provision, which means that the MoI may not provide that a shareholder approval is necessary for the issue of shares.[89]

(i) Resolution of the board

Except to the extent that the MoI provides otherwise, the resolution of the board to authorise or issue shares may be adopted at a physical board meeting,[90] a meeting conducted by electronic communication,[91] or by written consent of the majority of the directors, given in person, or by electronic communication.[92]

(ii) Shareholder Approval

There are two exceptions to the principle that the issuance of shares is induced by the board. The issue must be approved by a special resolution of the shareholders, first, if it is to (a) a (future) director or (future) prescribed officer, or (b) a person related or inter-related to the company, or to a director or prescribed officer of the company, or (c) a nominee of one of those persons, and secondly, if the issue of further shares in a class substantially influences the voting rights within that class. The term 'special resolution' is legally defined in s 1 of the 2008 Act and means a resolution adopted with the support of at least 75 per cent of the voting rights exercised on the resolution, or a different percentage if and as contemplated in the company's MoI.

The first exception contemplated in s 41(1) of the 2008 Act is not of particular relevance to this paper since it is only to prevent conflicts of interests.[93] Of greater interest is the second exception as contemplated in s 41(3), (4) of the 2008 Act. It seeks to have shareholders' participation in the increase of issued share capital in the event of changing in control of the company.[94] S 41(3) of the 2008 Act requires shareholder approval for the issue of shares, of securities convertible into shares, and of rights exercisable for shares in a transaction, or a series of integrated transactions,

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[89] See the definition of 'unalterable provisions' in s 1 of the 2008 Act.
[90] See s 73 of the 2008 Act.
[91] See s 73(3) of the 2008 Act.
[92] See s 74(1) of the 2008 Act.
[93] See Richard Jooste and Jacqueline Yeats 'Shares, Securities and Transfer' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 197 at 206.
[94] Ibid.

> 'if the voting power of the class of shares that are issued or issuable as a result of the transaction or series of integrated transactions will be equal to or exceed 30% of the voting power of all the shares of that class held by shareholders immediately before the transaction or series of transactions.'

S 41(4) of the 2008 Act explains how to determine the voting power of shares issued and issuable in consequence of a transaction or series of integrated transactions by stating that 'the voting power of shares is the greater of (i) the voting power of the shares to be issued; or (ii) the voting power of the shares that would be issued after giving effect to the conversion of convertible shares and other securities and the exercise of rights to be issued'. In addition, s 41(4) of the 2008 Act defines when a series of transactions has to be regarded as integrated, namely if the transactions are made mutually dependent regarding their consummation. They are integrated transactions if they are concluded within one year, and involve the same parties, or related persons; and (a) if they involve the acquisition or disposal of an interest in one particular company or asset; or (b) taken together, if they lead to substantial involvement in a business activity that did not previously form part of the company's principal activity.

It is commendable that the 2008 Act does not only apply to single transactions that will modify the voting power by 30 or more per cent, but also to series of integrated transactions. This will avoid attempts of evasion by, for instance, increasing the holdings in the company incrementally. Perhaps, it would have been desirable if s 41(3) of the 2008 Act had also covered every attempt of obtaining significant changes in control of the company surreptitiously.

(v) Retroactive authorisation

The issuance of shares that have not been authorised, or that exceed the number of authorised shares, does not necessarily lead to a nullity of the issue. S 36(2) of the 2008 Act permits to authorise those shares retroactively. Therefore, either the shareholders or the board have to resolve to retroactively authorise the shares that are already issued. Only if the corresponding resolution fails to be adopted, the share

issue is a nullity to the extent that it exceeds any authorisation, and the company must both re-establish the status quo ante and pay interest.[95]

However, one peculiarity should be pointed out: Provided that the MoI does not demand to have shares authorised by the shareholders, the board may (and must) retroactively authorise those shares that have been issued incorrectly by itself. I recommend that – as long as the board has the power to both authorise and issue shares – one should deem the resolution on the authorisation to be implied in the resolution on the issuance of the shares. From my point of view, the distinction between the authorisation and the issuance is merely literally and thus superfluous if the board may do both. It only leads to a very formal process, which has to be completed within 60 business days,[96] and constitutes the risk of cost-intensive reverse transactions regarding the shares, their consideration and the interest to be paid.

(iv) Issuance of capitalisation shares

While shares are normally issued for cash or non-cash contributions, the board may also resolve to capitalise the profits through the issuance of capitalisation shares. Those shares are issued to the existing shareholders on a pro rata basis,[97] and quasi without any contribution. Instead of distributing the profit in the form of cash dividend, the profit is capitalised. When so doing the board may also resolve to permit any shareholder to choose instead a cash payment, at a value determined by the board.[98] However, the board may only make available both the capitalisation shares and the cash payment, if it has considered the solvency and liquidity test on the assumption that every shareholder would elect to receive cash; and if it is satisfied that the company would satisfy the solvency and liquidity test immediately upon the completion of the distribution.[99] It is submitted that the cash payment in terms of s 47(2) of the 2008 Act is a distribution, as defined in s 1 of the 2008 Act, 'and accordingly must comply with the provisions of s 46 [i.e. the solvency and

[95] See s 37(3)(a), (b) of the 2008 Act.
[96] See s 38(2) of the 2008 Act.
[97] See s 47(1)(a) of the 2008 Act.
[98] See s 47(1)(c) of the 2008 Act.
[99] See s 47(2) of the 2008 Act.

liquidity test] in their entirety.[100]

In general, the board may capitalise as much as they would otherwise have distributed as dividends.[101] Should the board mistakenly believe that there are profits available for dividend and issue capitalisation shares based on this belief, the issuance is null and void and the company may reclaim any dividend that has been paid with respect to those shares.[102] In *Re Cleveland Trust plc.* was held that innocent third parties were in that case

> 'entitled as against [the company] to rely on the share certificates relating to the shares. Their title would derive not from the void bonus issue [i.e. issue of capitalisation shares] itself but from an estoppel based upon the content of the share certificates. A decision that the bonus issue should be declared void for mistake does not [...] place innocent third party assignees in jeopardy.'[103]

The issue of capitalisation shares is, from a financial point of view, only an accounting exchange on the liability side, which means that the balance sheet total remains unchanged. The economic effect of an issue of capitalisation shares has been described as follows:

> 'The company has parted with no assets --- no money or moneysworth --- and the shareholders have received none. The profits dealt with remain in the business as they were before. The only difference is that as they have become portion of the capital they are represented by shares; but these shares do not increase the holder's interest in the company; that also remains exactly what it was before. The distribution being *pro rata* his interest in the old capital plus the undivided profits under the old holding was exactly the same as his interest in the increased capital under the new holding. The total assets of the company have not been changed, and his

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[100] Richard Jooste and Jacqueline Yeats 'Shares, Securities and Transfer' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 197 at 210.
[101] See *Dimbula Valley (Ceylon) Tea Co. Ltd. v Laurie and Another* [1961] Ch. 353 at 372.
[102] See *Re Cleveland Trust plc.* [1991] B.C.C. 33 at 43.
[103] *Re Cleveland Trust plc.* [1991] B.C.C. 33 at 43.

> original share represented the same proportion of the then issue as his increased shares do of the increased issue. The intrinsic value of the new shares is therefore lower than the intrinsic value of each share before the increase of capital. As remarked in *Eisner v Macomber*, "the new certificates simply increase the number of the shares with consequent dilution of the value of each share."'[104]

Since this form of increasing the share capital does not cause an accrual of means from outside the company, it is also known as nominal increase of share capital, whereas those increases of share capital, which bring cash or non-cash contributions into the company from outside the company, are called effective increases of share capital.[105]

(e) Pre-emptive rights

The term 'pre-emptive rights' has two meanings: on the one hand, the common form of restrictions on the transfer of shares, i.e. the right of shareholders to "seize" share sales of other shareholders, and on the other hand, the right of existing shareholders to subscribe for shares to be issued by their company.[106] In the context of this paper, the term pre-emptive rights only refers to the right of existing shareholders to be offered and to subscribe for 'a percentage of the shares to be issued equal to the voting power of that shareholder's general voting rights immediately before the offer was made.'[107]

Pre-emptive rights are perceived to be an important measure in order to prevent the dilutive effect of increases of share capital in respect of shareholder values and voting rights and thus, a democratic right of shareholders.[108]

Yet surprisingly, under the 2008 Act existing shareholders of a public company do generally not have a right to be offered and to subscribe for shares

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[104] *Commissioner for Inland Revenue Appellant v Collins Respondent* 1923 AD 347 at 363-363.
[105] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at preliminary note to §§ 182-191 marginal No. 10.
[106] See Kathleen van der Linde 'Pre-emptive Rights in Respect of Share Issues – Misnomer or Mistake?' in (2008) 20 *South African Mercantile Law Journal* 510 at 510.
[107] S 39(2) of the 2008 Act.
[108] See Farouk HI Cassim 'The Companies Act 2008: An Overview of a Few of its Core Provisions' in (2010) 22 *South African Mercantile Law Journal* 157 at 163.

to be issued. S 39(1)(a) of the 2008 Act expressly excludes public companies from the pre-emptive right as contemplated in s 39(2) of the 2008 Act. The reason for this approach is probably that pre-emptive rights are not only perceived to be important to and a democratic right of shareholders but also to 'affect the flexibility of a company to issue shares.'[109] However, public companies are free to establish pre-emptive rights in their MoIs. And in case they want to be listed on the Johannesburg Stock Exchange, the MoIs have to provide for pre-emptive rights.

Paragraph 3.30 of the JSE Limited Listings Requirements reads as follows:

> 'Subject to paragraphs 3.32 and 3.33, an issuer proposing to issue equity securities for cash must first offer those securities, unless the issue is an acquisition issue, effected by way of rights offer, to existing holders of equity securities in proportion to their existing holdings. Only to the extent that such securities are not taken up by holders of equity securities under the offer may they then be issued for cash to other persons or otherwise than in the proportion mentioned above',

where paragraph 3.32 of the JSE Limited Listings Requirements provides that under certain circumstances the offer of shares to be issued may be made directly to third parties, i.e. parties other than existing shareholders, if the authorisation was provided by way of ordinary resolution, and if it is an issue of equity securities for cash. Furthermore, the Johannesburg Stock Exchange may waive some or all of the aforementioned requirements if it is satisfied that the company concerned is in financial difficulties, see paragraph 3.33 in conjunction with Schedule 13 of the JSE Limited Listings Requirements.

(f) Appraisal Remedy

The so-called appraisal remedy is a mechanism for the protection of dissenting minority shareholders, which is triggered in case of certain fundamental changes by the company, and which effects that the dissenting shareholder concerned may

[109] Farouk HI Cassim 'The Companies Act 2008: An Overview of a Few of its Core Provisions' in (2010) 22 *South African Mercantile Law Journal* 157 at 163.

demand his, her (or its) company to re-purchase his, her (or its) shares. Its meaning becomes a bit clearer when one uses the term used in New Zealand: 'buy-out right'.[110] Accordingly, 'the appraisal right is defined as the right of a dissenting shareholder to force his company to purchase his shares at either a mutually satisfactory or a judicially set fair price if his company takes certain triggering actions.[111]

Based on this definition it would make perfect sense to provide shareholders with an appraisal remedy when the board or the shareholders resolve to increase the authorised or issued capital fundamentally. Consequently, *Kathleen van der Linde* recommended in her paper on the provisions in the Companies Bill 2008 'that the appraisal remedy should also be made available in respect of capital increases that may affect existing classes.'[112]

However, the legislator apparently decided not to provide dissenting shareholders with an appraisal right in the event of increasing the authorised or issued capital. S 164 (2) of the 2008 Act sets out that the appraisal right is only triggered, if an amendment of the MoI alters the preferences, rights, limitations or other terms of a class of shares materially and adversely,[113] or if the company induces to enter inter a fundamental transaction in terms of ss 112 to 114 of the 2008 Act.[114] While one could argue that, for instance, a significant increase of the authorised shares can eventually affect a class of shares materially and adversely – at least from an economic point of view – it is submitted that an increase or decrease of authorised shares of a class will not trigger the appraisal right.[115] Unlike Canadian law, where the increase or decrease of the authorised capital is one of the triggers of the appraisal right,[116] South African law only provides for an appraisal right in the event of a *formal* alteration of

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[110] See headline to ss 110 to 115 of the Companies Act 1993 No 105.
[111] Johan Beukes 'An Introduction to the Appraisal Remedy as Proposed in the Companies Bill: Triggering Actions and the Differences between the Appraisal Remedy and Existing Shareholder Remedies' in (2008) 20 *South African Mercantile Law Journal* 479 at 479.
[112] Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 46.
[113] See s 164 (2)(a) read with s 37(8) of the 2008 Act.
[114] See s 164 (2)(b) of the 2008 Act.
[115] See Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 678 at 734; Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 46.
[116] See s 176(1)(a) of the Canada Business Corporations Act, R.S.C. 1985.

class rights, where the increase of the authorised capital is not deemed to be a formal alteration.[117]

With respect to the increase of the issued capital it is not even arguable that it should fall within the scope of s 164 of the 2008 Act, because the increase of the number of issued shares does not require an amendment of the MoI at all, with the result that the technical prerequisites of s 164(2)(a) of the 2008 Act are not met.[118]

Another very important finding for the purpose of this paper is the following one: The appraisal right is definitely not triggered either, if the *board* resolves to increase the authorised or issued shares, because the first element of s 164(2)(a) of the 2008 Act – the holding of a shareholders' general meeting – is left unsatisfied. In other words, dissenting minority shareholders may never opt-out of their company when the board is permitted to increase the authorised or issued capital, unless they can sell their shares on the capital market.

(g) Shareholders' remedies against the increase of share capital

Since shareholders generally have no voice in the board's resolution on increasing the share capital (unless the MoI provides otherwise), it is an important question whether or not unsatisfied shareholders can intervene, after the board has decided to increase the authorised or issued share capital. First of all, dissenting shareholders could, of course, sell their shares. But there is not always a ready market, and if there is one, it might well be the case that the shareholders either do not want to sell for any reason or that they cannot realize a proper price for their shares.

Because there is no express statutory remedy for such case, I will examine whether or not shareholders can make recourse to the general remedies provided for by the 2008 Act and the common law. At first sight, there are – besides the appraisal remedy – three further remedies that might aim the aforementioned shareholders' goal by enabling them either to have the increase of share capital prevented or to opt-out of the company. Namely, (1) the remedy to have the company restrained from

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[117] See Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 678 at 734.

[118] See Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 678 at 737.

doing anything inconsistent with the Act,[119] (2) the oppression remedy with indefinite outcomes the court thinks fit, inter alia to restrain the conduct,[120] and (3) the common law personal action, which might inter alia have the effect that the company must re-purchase the shares of a shareholder.[121]

The remedy under s 20(4) of the 2008 Act permits shareholders to 'apply to the High Court for an appropriate order to restrain the company from doing anything inconsistent with the Act.'[122] Provided that the authorisation or issue of shares as such is lawful, this remedy would only come into question, if one could ascribe the director's behaviour to the company. In other words, if the directors acted inconsistent with s 76(3) of the 2008 Act – i.e. not in good faith, not for a proper purpose or without the degree of care, skill and diligence that may reasonably be expected of them – and if that behaviour was deemed to be *the company's* behaviour likewise, every shareholder of that company could apply to the High Court for an appropriate order to restrain the company from authorising or issuing the shares. But a view of subs 5 of s 20 of the 2008 Act shows that one cannot treat the directors' acting as equal with the company's acting. This is due to the fact that, subs 5 of s 20 of the 2008 Act, which is actually designed structurally identically as compared to subs 4 of s 20 of the 2008 Act, addresses both the company's acting and the directors' acting. Subs 4 of s 20 of the 2008 Act by contrast only addresses the company's acting. Consequently, a director's breach of duties does not equal a company's breach of the provisions of the Act and s 20(4) of the 2008 Act does thus not comprise a proper remedy for the purpose of stopping the company from authorising or issuing shares – provided that the increase of the share capital is lawful as such.

Another question is that – according to s 77(2) in conjunction with s 76(3) of the 2008 Act – the directors can be held liable if they infringe their duties. But this claim will not lead on to the possibility to stop the company from increasing the share capital. It (only) covers any loss, damages or costs sustained by the company.[123]

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[119] See s 20(4), (5) of the 2008 Act.
[120] See s 163 of the 2008 Act.
[121] See Johan Beukes 'An Introduction to the Appraisal Remedy as Proposed in the Companies Bill: Triggering Actions and the Differences between the Appraisal Remedy and Existing Shareholder Remedies' in (2008) 20 *South African Mercantile Law Journal* 479 at 491.
[122] S 20(4) of the 2008 Act.
[123] See s 77(3) of the 2008 Act.

The oppression remedy under s 163 of the 2008 Act enables shareholders, who deem any particular act or omission of their company to be oppressive or unfairly prejudicial, to apply to a court for relief.[124] Hence, s 163 of the 2008 Act constitutes an exception to the majority rule, also known as one of the two *Foss v Harbottle* rules,[125] which states that a court will generally not step in if a simple majority of the shareholders can approve or ratify the wrong action or omission in question.

S 163 of the 2008 Act allows a shareholder to apply to a court for relief if—

> '(a) any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;
> (b) the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant; or
> (c) the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.'

Upon considering an application in terms of the aforementioned prerequisites, the court may make any interim or final order it considers fit.[126] There are no restrictions to the orders the court may make. Thus, the court could, for instance, prohibit the company from increasing the share capital or order that the company must re-purchase the applicant's shares at a fair value.

The personal action at common law causes pretty much the same. Here, too, a court will make an exception to the majority rule, if shareholders believe that a wrong, i.e. a breach of their rights they derive from the MoI or the 2008 Act or the

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[124] See Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 678 at 680, 743.
[125] See *Foss v Harbottle* 67 E.R. 189.
[126] See s 163(2) of the 2008 Act.

common law in respect of their membership,[127] is done to them.

In respect of this paper, the main difference between the oppression remedy contemplated in s 163 of the Act and the personal action at common law is the fact that the latter only applies to minority shareholders, whilst the oppression remedy under the 2008 Act is applicable to every shareholder, regardless of their share in the company.[128] I will thus mainly focus on the statutory remedy.

There have been some cases where the courts held that the increase of share capital was unfairly prejudicial to the minority shareholder. In *Company (No.005134 of 1986) Ex p. Harries, Re* the court held, that the allotment of shares constituted unfairly prejudicial conduct for three reasons: first, because it was made secretly, secondly, because the minority shareholder was not given an opportunity to take up shares proportionate to his holding, and thirdly, because the money raised was irrelevant to the needs of the company, and done for the improper purpose of rewarding the majority shareholder by increasing his and reducing the minority shareholder's holding.[129]

Also, in *Dale and Carrington Investment (P) Ltd & Anr. v P.K. Prathapan & Ors.*[130] the Supreme Court of India has held that the increase of the share capital of a company might amount to oppression, if the sole purpose of the increase is gaining control of the company, and where the majority shareholder is reduced to minority. Similarly, in another Indian case, namely *Needle Industries (India) Ltd and others v Needle Industries Newey (India) Holding Ltd and others*,[131] the court held as follows:

> 'What is objectionable is the use of such power simply or solely for the benefit of directors or merely for an extraneous purpose like maintenance and acquisition of control over the affairs of the company... But if the power to issue shares is exercised for an improper motive, the issue is

[127] See Johan Beukes 'An Introduction to the Appraisal Remedy as Proposed in the Companies Bill: Triggering Actions and the Differences between the Appraisal Remedy and Existing Shareholder Remedies' in (2008) 20 *South African Mercantile Law Journal* 479 at 491.
[128] See Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 679 at 683.
[129] *Company (No.005134 of 1986) Ex p. Harries, Re* [1989] B.C.L.C. 383.
[130] (2005) 1 SCC 212.
[131] (1981) 3 SCC 333.

> liable to be set aside, and it is immaterial that the issue is made in a bona fide belief that it is in the interest of the company...'[132]

But from my point of view, the far more interesting question is whether or not it is also an oppression or unfair prejudice to or an unfair disregarding of the shareholder's interests if the increase of the share capital merely results in a significant watering down of the shares. One could argue that a significant watering down of shares alone might – from an existing shareholder's point of view – be oppressive, unfairly prejudicial, or that it unfairly disregards the shareholder's interests in terms of s 163 of the 2008 Act. One argument therefore would be that the section does not only cover the shareholder's rights, but also his, her (or its) *interests*. And I submit that the continuity of the rights and the power a shareholder derives from his, her (or its) shares is one of the fundamental *interests* that a shareholder has. One could also argue that it is unfairly prejudicial if the shareholder concerned has no vote in the watering down of the shares. But this line of argument would turn the system of the 2008 Act upside down. The 2008 Act does precisely not provide for the need of a shareholders' approval. Would one allow that shareholders may apply to a court just because their shares have been watered down – which is, as mentioned before, inherent in an increase of the share capital – one would counteract the new system for the increase of the share capital. I thus submit that there must be further circumstances, such as a reprehensible motive or economical irrationality, in order to trigger the oppression remedy.

(h) Determination of the issue price and of the contribution

Another important factor in connection with the increase of share capital and its impact on existing shareholders is the issue price of new shares. This is due to the fact that the lower the issue price is as compared to the actual value of the company the more attractive is the acquisition of the new shares. But an issue price below the 'actual value' that may be calculated by dividing the total value of the company by the number of existing shares inevitably results in a watering down of the existing

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[132] *Needle Industries (India) Ltd and others v Needle Industries Newey (India) Holding Ltd and others* (1981) 3 SCC 333.

shares.[133] In Germany, it is thus prohibited to issue shares to a price below their 'nominal value' which could be defined as the price calculated by dividing the share capital by the number of existing shares.[134]

In South Africa there is no such regulation. Whereas listed public companies usually determine the issue price through, for instance, a book building process, there is obligation to do so. The board may determine the issue price that it thinks fit. Indeed, S 40(1)(a) of the 2008 Act provides that the board may only issue authorised shares for an *adequate* consideration, but it does not define what adequate means and how it is to be determined. The arising question thus is whether the consideration has to be adequate from the economic point of view, or from the existing shareholders' point of view, or if the board has to consider all stakeholders' interest, etc. If it was only the economic point of view that the board has to consider, one could argue that even a price far below the actual (or even the nominal) value could be adequate since such a low price increases the attractiveness of investing in the company. The increase of attractiveness results from the fact, that subscribers would then get more than they pay for, and it thus leads to an increase of likelihood that all shares are being purchased. This in turn, increases the effectiveness of the increase of share capital and the velocity of the raise of capital. But bearing in mind that the directors owe the duty to act in the best interest of the company[135], and that, at common law, the word company refers 'to the interests of the collective body of present and future shareholders'[136], such a low price could not be considered adequate. The board also has to consider the existing shareholders' interests and since they would suffer a watering down of their shares it is not in their interest to sell shares for a very low price. But still, the concept of 'adequate consideration' is a flexible one which allows the board to consider not only the current and future shareholders' interests but also the company's current financial situation as well as market conditions.[137]

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[133] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktienrecht*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 46.
[134] See § 9 I Aktiengesetz.
[135] See s 76(3)(b) of the 2008 Act.
[136] Farouk HI Cassim 'The Duties and the Liability of Directors' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 459 at 468; *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch. 286 at 291.
[137] See Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 49.

Beside the fact that the board already has a lot of leeway in determining the issue price, it also may determine the form of consideration. According to s 1 of the 2008 Act consideration means both cash and non-cash considerations, namely

> 'anything of value given and accepted in exchange for any property, service, act, omission or forbearance or any other thing of value, including—
>
> (a) any money, property, negotiable instrument, securities, investment credit facility, token or ticket;
>
> (b) any labour, barter or similar exchange of one thing for another; or
>
> (c) any other thing, undertaking, promise, agreement or assurance, irrespective of its apparent or intrinsic value, or whether it is transferred directly or indirectly'.

It is submitted that companies may not restrict the types of considerations through their MoI; those restrictions would be void.[138] However, whatever type of consideration the board may choose, it has to be adequate in terms of s 40(1)(a) of the 2008 Act.

The concept of adequacy determined by the board flanked by an important restriction set out in s 40(3) of the 2008 Act: The adequacy of the consideration as determined by the board may only be challenged on the basis of s 76 read with 77(2) of the 2008 Act. In other words, as long as the board determines the consideration in a proper manner, it is immaterial whether or not the consideration reflects the actual value of the share. While in the past the courts held that a consideration was also inadequate if it and the share did not correspond in the value,[139] under the 2008 Act one can only challenge the adequacy of the consideration on the basis that one or more directors did not avoid conflict of interests, act in good faith, for a proper purpose and in the best interest of the company and/ or with due care, skill and diligence.[140] Once again, unless the directors breach their duties as contemplated in s 76 of the 2008 Act, a consideration cannot be challenged or rather revised even

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[138] See Richard Jooste and Jacqueline Yeats 'Shares, Securities and Transfer' in Farouk HI Cassim et al. (eds.) *Contemporary Company Law* (2011) 197 at 208.
[139] See *Ooregum Gold Mining Co of India Ltd v Roper* [1982] AC 125 (HL) at 136-137.
[140] See s 76(3) of the 2008 Act.

though the consideration itself might be inadequate. However, the directors will usually have breached their duties, if the consideration does not reflect the value of the share, because the incorrect determination is likely caused by an insufficient approach.

Regrettably, the 2008 Act is silent about the question what the consequences of a successful challenge are. It is thus unclear if the issue remains valid, or if the issue can be declared void. The company will suffer loss or damage either way, unless the subscriber can be held liable.[141] Also, the position of the subscribers after a successful challenge is unclear under the 2008 Act. Will they have to pay the difference between the initial determination and the amount the court thinks fit, or will they only have to pay as much as they undertook to contribute? However, clear is that the directors would be liable, since the challenge is successful because of their breach of duties as contemplated in s 76 of the 2008 Act. I recommend that the issue remains valid and that the subscribers are liable for the adequate price. I deem this position investor-friendlier, because a shareholder can rely on the fact that new shares will not be issued at an inadequate price. I suppose that one would avoid investing in South African entities if one cannot be sure that succeeding investors imperatively have to make an adequate contribution. But, admittedly, it might also well be that the jeopardy of having to pay more than undertaken could discourage potential investors.

Finally, it is noteworthy that there are no requirements regarding the valuation of non-cash considerations. In fact, it is submitted that the board does not have to evaluate the non-cash consideration regarding its specific monetary value.[142] Here, too, existing shareholders thus rely on the adequacy of determination of the consideration.

(k) Determination of the beginning of the participation

In view of the existing shareholders it is also important to consider when the

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[141] See Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 50.

[142] See s 40(2) of the 2008 Act; see Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 45.

participation of the new shareholder begins. In case a subscriber purchases the share(s) during the year he, she (or it) could either participate in the dividend completely, pro rata, or not at all. The term dividend is not defined under the 2008 Act but it can be described as a 'proportionate payment to a class of shareholders from the profits of a company.'[143]

The 2008 Act does not regulate that a shareholder who has received his share during the (business) year is only entitled to get an attributably reduced dividend paid. In fact, it appears that every shareholder – no matter whether or not he, she (or it) has fully paid-up the shares – enjoys the right to receive the full dividend, except to the extent that the MoI's description of the class of his, her (or its) share provides otherwise. At common law it is the basic presumption that all shares enjoy equal rights.[144]

Thus, the board may in principle not resolve to have new shareholders participated only in proportion to the period of time of their membership of the company.

(l) Policy of legislation

As far as could be determined, there were no explicit reasons given for the shift from shareholder approval as the basic principle for the authorisation and issue of shares to a regime that principally vest all this power in the board. The *Department of Trade and Industry's* report on 'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform' deals with this change in positions under the 1973 Act and the 2008 Act, but it gives no clear reasons why the new system should be preferred in South Africa. It may state that

> '[i]n increasingly time-sensitive globalizing capital markets it is important that companies attain maximum flexibility in creating financing mechanisms. This implies that they should have significant freedom to create financial instruments. New company law will facilitate

[143] Kathleen van der Linde 'The regulation of distributions to shareholders in the Companies Act 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 3, 484 at 487, with further references.
[144] See *Birch v Cropper Re Bridgewater Navigation Co, Ltd* [1886-1890] All ER Rep 628.

this as far as possible.'[145]

But coming to the details in respect of the power to issue shares it only points out that

> '[c]onsideration will be given to allowing directors to issue shares, subject to shareholder agreement in the articles and to agreement by a special majority of shareholders. This would necessitate outlining a clear set of duties for directors regarding share issuance and provision for enhanced disclosure. Clear and effective rules in this regard would alleviate or prevent the problem of dilution of equity'[146]

The report completely ignores the question of who should be in charge for the authorisation of shares.

In respect of the capital maintenance regime based on par value the Memorandum on the Companies Bill, 2008 submits that 'capital maintenance rule' has been abolished in favour of a capital maintenance regime based on the solvency and liquidity test in order to enhance 'corporate efficiency'.[147]

IV GERMAN LAW: THE STOCK CORPORATION ACT

1. Structure of the share capital of an Aktiengesellschaft

As a basis for the German Aktiengesellschaft serves the principle of Haftkapital, which could be translated as liable capital. Haftkapital refers to the certain amount of money that is available at most for creditors. The minimum Haftkapital of an

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[145] Memorandum on the Objects of the Companies Bill, 2008 and Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (GN 1183 of 2004, published in GG Vol. 468 No. 26493 of 23June 2004) at 34.

[146] Memorandum on the Objects of the Companies Bill, 2008 and Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (GN 1183 of 2004, published in GG Vol. 468 No. 26493 of 23June 2004) at 35.

[147] Memorandum on the Objects of the Companies Bill, 2008 at item 1.2.3(a).

Aktiengesellschaft amounts to EUR 50,000.00.[148] As a principle, neither shareholders nor the management of an Aktiengesellschaft are personally liable for the claims of creditors.

In Germany the minimum Haftkapital is regarded as the quid pro quo for the fact that shareholders are not personally liable.[149] However, the minimum Haftkapital in the amount of EUR 50,000.00 is clearly too low in consideration of the commercial risks taken by a lot of enterprises. Thus, particularly bigger Aktiengesellschaften do not confine their share capital to the minimum amount but choose an amount that is rather appropriate as compared to their business. It is thus submitted that the Haftkapital fulfils rather the function of preventing persons from forming an Aktiengesellschaft, who are not even able to raise the required minimum amount of capital, than it serves as a sufficient resource for creditors' claims.[150]

Like in South Africa, the capital of an Aktiengesellschaft is divided into shares, which are, as a matter of principle, freely transferable. They can either be traded on organised or unorganised capital markets.

The Aktiengesetz does not prohibit par value shares. In fact, according to § 8 I Aktiengesetz shares either are of par value or of no par value. Also, a company can resolve to issue shares with different rights. As is in South Africa, there are no restrictions in respect of preferences.[151] Shares representing identical rights belong to one class.[152]

As is in South Africa, German companies may only increase their share capital through the issue of *new* shares. An increase of the value of par value or nominal shares is prohibited by law.[153]

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[148] See § 7 Aktiengesetz.
[149] See Andreas Engert 'Die Wirksamkeit des Gläubigerschutzes durch Nennkapital Überprüfung anhand von Daten der Creditreform Rating AG und weiteren Rechtstatsachen' in *GmbH-Rundschau* 2007 337 at 338.
[150] See Ingo Drescher in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 7 marginal No. 1.
[151] See § 11 Aktiengesetz.
[152] Ibid.
[153] See § 182 I 4 Aktiengesetz.

2. Issuance of shares

(a) Regular increase of share capital

§ 182 Aktiengesetz is the cardinal norm for increase of share capital through cash or non-cash contributions. In conformity with the Second Council Directive 77/91/EEC of 13 December 1976 it provides that every increase of share capital needs to be approved by the shareholders.[154] One can also deduce from it a clear division of competencies from § 182 Aktiengesetz: Even if there are no effective financial means brought to the Aktiengesellschaft by an increase of share capital through a conversion of profits or reserves, the general meeting of shareholders has still to approve such an increase of share capital.[155] This is due to the fact that even a nominal increase of share capital through such a transfer, or rather conversion will affect the allocation of voting power within the general meeting.[156]

However, in Germany there has also been some debate over the question, whether or not the competence to increase the share capital should be transferred to the Vorstand or to the Aufsichtsrat, or if (1) the general meeting and the Vorstand or (2) the general meeting and the Aufsichtsrat or (3) the Vorstand and the Aufsichtsrat should share this competence.[157] But the Second Council Directive 77/91/EEC of 13 December 1976 obliges the German legislator to adhere to the concept of shareholder approval in respect of increases of share capital. For that reason alone the academic opinions could not prevail in Germany. As far as could be determined, there have thus not been any more serious papers on changing the division of competencies since the early 1980s.

§ 182 I Aktiengesetz requires not only any shareholder approval but it sets out certain thresholds in respect of the vote. One has to pay regard to *two* majority requirements. On the one hand, the resolution needs to be approved by a majority of affirmative votes, which were validly given at the general meeting. This is due to the fact that the increase of share capital is an amendment of the Satzung and therefore needs a resolution in accordance to § 133 I Aktiengesetz. § 133 I Aktiengesetz

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[154] See § 182 I Aktiengesetz.

[155] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 1.

[156] Ibid.

[157] See Bundesministerium der Justiz (ed.) *Bericht über die Verhandlungen der Unternehmensrechts-kommission* (1980) at 187-192.

provides that every amendment of the Satzung needs to be approved by the ordinary majority of the shareholders. It is important to bear in mind that votes are only deemed to be 'given' if they are either affirmative or negative. Abstention from voting does not count as a given vote.[158] This threshold is to prevent the opportunity of the minority to have a basic resolution passed.[159]

On the other hand, at least three-fourths of the shareholders present at the general meeting must vote in favour of the resolution on increasing the share capital.[160] This qualified majority is – in Germany – the classic instrument for the protection of minority shareholders,[161] where – de facto – not small shareholders are protected but holders of bigger blocks of shares.[162]

The accumulation of these two different requirements regarding the majority implies that the attendance of shareholders at the general meeting is of vital importance. However, the requirement of both the ordinary majority of the votes given and the qualified majority of the shareholders present at the general meeting does not lead to the requirement of two separate votes. Instead, the chairman of the general meeting has to count the votes in two different ways: on the one hand, in respect of the share capital and on the other hand, in respect of the number of shares validly given.[163] The result of those two countings may differ, if, for instance, there are holders of preference shares without a voting right,[164] or where – in case a shareholder holds several shares – the Satzung limits the voting right by determining a maximum amount or graduations.[165]

Whereas § 182 I 2 Aktiengesetz allows that the Satzung may determine a different majority in respect of the shareholders present at the general meeting, the majority in respect of the votes given at the general meeting may not be amended. If the Satzung

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[158] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 15.
[159] Ibid.
[160] See § 182 I 1 Aktiengesetz.
[161] See Herbert Wiedemann *Gesellschaftsrecht*, Volume I, (1980) at 421.
[162] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 16.
[163] See Wolfgang Servatius in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 182 marginal No. 14.
[164] See § 139 II Aktiengesetz.
[165] See § 134 I 2 Aktiengesetz.

determines a different majority in respect of preference shares without a voting right, which must be achieved by the share capital represented at the passing of the resolution, it only may raise the bar.[166] In respect of shares with a voting right the Satzung may either lower or raise the bar.[167] There is consensus that the Satzung may not provide for a lower majority than the ordinary majority of the share capital represented at the general meeting.[168] However, the Satzung may require unanimity for the resolution on the increase of share capital, unless it is foreseeable that this requirement would never be met. Such a de facto prohibition of the increase of share capital would be invalid.[169]

The Satzung may also provide for further requirements,[170] such as quorums regarding the attendance of general meetings, the approval of certain or all shareholders or – in case of a group of companies – the approval of the holding company or the subsidiary.[171] But one has to bear in mind here too, that a *de facto* prohibition of the increase of share capital would be invalid.[172] Besides that, the Satzung may not provide either that the validity of the increase of share capital depends on the approval of the Vorstand or the Aufsichtsrat. The only organ of a company with the competence of increasing the share capital is the general meeting. It is permissible however that the company binds itself *by contract* not to increase the share capital or to require the approval of a third party for an increase of share capital.[173] But such a contract would only be effective *inter partes*, i.e. between the parties.

In the event of having different classes of shares, the resolution on the increase of share capital is only valid, if the shareholders of each class have voted in favour of

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[166] Ibid.
[167] Ibid.
[168] See Uwe Hüffer *Aktiengesetz* 9th ed. (2010) at § 182 marginal No. 8.
[169] This is controversial. See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 18, with further references also in respect of the holders of the different opinion.
[170] See § 182 I 3 Aktiengesetz.
[171] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 18.
[172] See above.
[173] Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 20.

it.[174] This resolution must be passed as a special resolution, in other words as a separate resolution.[175] In a situation where the special resolution is missing – either because the shareholders of the particular class are not present at the general meeting or because they do not participate in the voting –, or it is at fault, the resolution on the increase of the share capital is in a floating state; but once the special resolution/s is/are passed validly within three months succeeding the resolution of the general meeting, the resolution on the increase of share capital in total comes into effect.[176] After this period of three months the resolution of the general meeting becomes ultimately void, if the special resolution/s was/were not passed validly.[177] Apart from that, the provisions on nullity (see § 241 Aktiengesetz) and on voidability (see § 243 Aktiengesetz) apply without restriction, but it would go far beyond the scope of this paper if I would discuss it in greater detail.

(b) Conditional increase of the share capital

Beside the normal case of increasing the share capital through the authorisation and issue of shares by the shareholders, the Aktiengesetz also provides for a so called 'conditional increase of share capital'. § 192 I Aktiengesetz defines the 'conditional increase of share capital' as follows:

> 'The shareholders' meeting may decide an increase of the share capital which shall be executed to the extent a use is made of a conversion [right] or [a] preemptive right which the [company] grants with regard to the new shares.'[178]

'Conversion right' means that the holder of this right may substitute his, her (or its) redemption claim deriving from a bond with a claim on subscribing for new shares, whereas 'pre-emptive right' in terms of § 192 Aktiengesetz means that either the redemption claim and the claim on subscribing for new shares exist accumulatively or that the claim on subscribing for new shares exists independently

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[174] See § 182 II 1 Aktiengesetz.
[175] See § 182 II 2 Aktiengesetz.
[176] See Christof v. Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 182 marginal No. 50.
[177] See Wolfgang Servatius in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 182 marginal No. 31.
[178] Translation adopted from: Rudolf Mueller and Evan G. Galbraith *Aktiengesetz – The German Stock Corporation Act*, 2nd ed. (1974) at 247.

of any redemption claim.[179]

Hence, § 192 I Aktiengesetz enables the Aktiengesellschaft to raise equity capital demand-based, provided that legally accepted purposes exist[180] and that further quantitative restrictions are not exceeded.[181] Whereas the resolution on the increase of share capital is unconditionally, the increase itself by contrast is conditioned by the execution of conversion rights and/or pre-emptive rights. However, neither the holders of the conversion rights nor the holders of the pre-emptive rights are committed to exercise these rights; the conditional increase of share capital is thus characterised by an uncertainty in respect of the future development of the amount of the share capital. This uncertainty can – at least theoretically – last for an unlimited amount of time, because there are no time limits for the issue of new shares on the basis of a resolution on a conditional increase of share capital.[182]

§ 192 II Aktiengesetz provides for the legally accepted purposes under which the conditional increase of share capital is permissible, namely (1) for granting conversion or pre-emptive rights to creditors with convertible bonds in the sense of § 221 I Aktiengesetz, (2) for the preparation of combining several enterprises, and (3) for granting pre-emptive rights to employees of the company for the subscription to new shares against the contribution of monetary claims, which pertain to the employees from a profit sharing granted to them by the company. Even though the wording of the law ('shall') implies that this list of purposes is non-exhaustive, there is consensus that it is exhaustive.[183] § 192 III Aktiengesetz refers to the quantitative restrictions on the conditional increase of shares capital and states that the nominal amount of '[t]he conditional capital may not exceed one half of the share capital as it exists at the date of the passing of the resolution for the conditional capital increase.'[184]

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[179] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 192 marginal No. 8.
[180] See § 192 II Aktiengesetz.
[181] See § 192 III Aktiengesetz.
[182] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 192 marginal No. 1.
[183] See Uwe Hüffer *Aktiengesetz* 9th ed. (2010) at § 192 marginal No. 8.
[184] Translation adopted from: Rudolf Mueller and Evan G. Galbraith *Aktiengesetz – The German Stock Corporation Act*, 2nd ed. (1974) at 249.

(c) Authorised capital

Similar to the South African provision, § 202 I, II Aktiengesetz also allows the company to authorise the Vorstand and the Aufsichtsrat to issue new shares without the immediately precedent approval of the shareholders. This authorisation lasts five years at the longest and the total nominal amount of the authorised capital may not exceed one half of the share capital existing at the date of the authorisation.[185] The resolution of the shareholders' meeting requires a majority of at least three fourth of the share capital represented at the passing of the resolution; the Satzung may determine a greater capital majority and additional requirements.[186]

The authorised capital is to facilitate the opportunity for companies to raise capital. It allows a quick and flexible increase of share capital, without requiring any further involvement of the general meeting at the time the shares are to be issued. In fact, the general meeting may transfer the competence in respect of the issue of shares to the Vorstand. Therefore, the general meeting has to amend the Satzung allowing the Vorstand to resolve at its own discretion, whether and what extent it wants to issue shares. The only conditions are then that the Vorstand does not exceed the scope of the Aktiengesetz and the Satzung and that the Aufsichtsrat approves the issue in advance.[187] § 202 Aktiengesetz is thus an exemption to § 119 I No. 6 Aktiengesetz, which states that the general meeting is entitled to resolve on measures to increase and to decrease share capital.[188]

The reliefs in respect of raising capital are to provide particularly listed companies with the necessary liberty of action in order to react flexibly and in a timely manner for the interest of the company and its shareholders on the occasions, which the national and international capital markets offer.[189] In the course of this, the *Bundesgerichtshof* (Engl.: Federal Court of Justice of Germany) bears in mind company expansions, such as mergers, amalgamations or participations, which can be financed with the new shares, which are available as 'acquisition currency' after

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[185] See § 202 III Aktiengesetz.
[186] See § 202 II 2, 3 Aktiengesetz.
[187] See § 202 III 2 Aktiengesetz.
[188] See Uwe Hüffer *Aktiengesetz* 9th ed. (2010) at § 202 marginal No. 1.
[189] BGH, decision of 23 June 1997 – II ZR 132/93 – published in *Neue Juristische Wochenschrift* 1997, 2815 at 2815.

using of the authorised capital.[190]

However, the general meeting can only allow the Vorstand to use the authorised capital and to issue shares. But it cannot oblige the Vorstand to exert it; the Vorstand is free to do or not to do so, as long as its decision stays within the limits of the authorised capital as set out in the Aktiengesetz and the Satzung.[191]

(d) Nominal increase of the share capital

Finally, the Aktiengesetz also provides for an increase of share capital from the company's reserves.[192] Since the company does not raise outside capital when it increases its share capital in this way, it is common to call this increase 'nominal increase of the share capital'.[193] As a basic principle, a nominal increase of the share capital may not – by law – be conducted if a loss and/ or a loss carried forward is shown in the balance sheet used.[194] Also, in case the reserves are bound to a certain purpose they may only be converted if the conversion is consistent with this purpose.[195]

Unlike under the 2008 Act, a company under the Aktiengesetz may not convert its profits directly into share capital, but may only use reserves for the increase of share capital. This does however not imply that the company may not convert profits at all, but the Aktiengesetz requires that the profits must first be converted into reserves before the reserves can be converted into share capital. § 208 I Aktiengesetz therefore states that the increase can only be conducted by converting the *Kapitalrücklage* (Engl.: capital reserves) or the *Gewinnrücklage* (Engl.: profit reserves) into share capital.

Whereas the *Gewinnrücklage* may entirely be converted into share capital the *Kapitalrücklage* may only be converted as far as it exceeds the 'minimum reserves'

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[190] Ibid.
[191] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 202 marginal No. 3.
[192] See §§ 207-220 Aktiengesetz.
[193] See Cornelius Simons in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 207 marginal No. 2.
[194] See § 208 II 1 Aktiengesetz.
[195] See § 208 II 2 Aktiengesetz.

as determined by law or by Satzung.[196] The *Kapitalrücklage* consists of those means which current and future shareholders have paid for the subscription of shares ('agio' or 'premium') or for any other granting of preferences.[197] Both *Gewinnrücklage* and *Kapitalrücklage* may only be converted to the extent that they have been expressly determined in the last annual financial statement or in an in-year balance sheet.

§ 209 Aktiengesetz determines the term 'balance sheet' further: the balance sheet must be examined by an auditor for whether or not it accords with §§ 150, 152 Aktiengesetz and §§ 242 – 256, 264 – 274 Handelsgesetzbuch, and it must have received an unqualified attestation.[198] The Handelsgesetzbuch regulates, in essence, how a balance sheet has to be designed, which items it must display, what those items include and most importantly, that the *Kapitalrücklage* must expressly be called as such. Furthermore, the balance sheet date may not date back more than eight months before the application of the resolution for entry into the trade register.[199]

Once the increase of share capital is done and effective, the (existing) shareholders are entitled to the new shares in the relation of their shares to the previous share capital.[200] The general meeting may not resolve to spread the new shares in any other way; such a resolution would be void.[201]

3. Pre-emptive rights

(a) Regular increase of the share capital

In Germany, the pre-emptive rights for existing shareholders are considered to be one of the most important subjects within the provisions regarding the increase of the share capital.[202] The pre-emptive right is to guarantee, that existing shareholders preserve their participation in the company qualitatively, i.e. in view of their voting

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[196] See § 208 I 2 Aktiengesetz; 'Minimum reserve' means that the company has to keep in any case and that totals to the tenth of the current share capital or any other higher amount as determined by the Satzung.

[197] See Cornelius Simons in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 208 marginal No. 6.

[198] See § 209 III 2 Aktiengesetz.

[199] See § 209 I, II 2 Aktiengesetz.

[200] See § 212 Aktiengesetz.

[201] See § 212 Aktiengesetz.

[202] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 186 marginal No. 1.

power, and quantitatively, i.e. in view of the value of his, her (or its) share(s).[203] The *Bundesgerichtshof* once held that an exclusion of pre-emptive rights means a 'schwerer Eingriff in [die] Mitgliedschaft'[204] (Engl.: a serious interference in the membership). And *Wiedemann* even named the pre-emptive right one of the 'Mitgliedschaftsgrundrecht[e]'[205] (Engl.: fundamental right[s] of the membership).

Hence, as a basic principle, every existing shareholder is entitled to claim such portion of the new shares to be issued that represents his, her (or its) present share on a percentage basis.[206] The time limit within which the pre-emptive right must be used is determined either by the general meeting, by the Satzung or by the Vorstand,[207] but it may not be shorter than two weeks.[208]

If the existing shareholder does not wish to or if he, she (or it) is not able to exercise the pre-emptive right, he, she (or it) may sell the pre-emptive right as compensation for the loss in the voting power and for the watering down of his, her (or its) shares. In case the existing shareholder just allows the time limit to lapse it is controversial what the legal consequences are. Some academics hold the opinion that the pre-emptive right of silent shareholders demises to the remaining shareholders,[209] while others argue that the fate of the pre-emptive right rests with the involved parties.[210] Both views are to be rejected. The theory on the demising of the remaining shareholders is not supported by the law and there is no reason why the remaining shareholders' participation in the company on a proportional basis should change after one or more shareholders did not use their pre-emptive rights. The theory that the involved parties may decide what will happen with the non-exercised pre-emptive rights cannot be upheld either. There is agreement as to the fact that the pre-

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[203] See Uwe Hüffer *Aktiengesetz* 9th ed. (2011) at § 186 marginal No. 1.
[204] BGH, decision of 13 March 1978 – II ZR 142/76 – published in *Neue Juristische Wochenschrift* 1978, 1316 at 1317.
[205] Herbert Wiedemann in Klaus J Hopt and Herbert Wiedemann (eds.) *Großkommentar zum Aktiengesetz*, Volume 6, 4th ed. (2006) at § 186 marginal No. 13.
[206] See § 186 I 1 Aktiengesetz.
[207] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 186 marginal No. 18.
[208] See § 186 I 2 Aktiengesetz.
[209] See Wolfgang Groß 'Bookbuilding' in *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* 162 (1998) 318 at 333.
[210] See Ernst-Thomas Kraft and Gerd Krieger in Michael Hoffmann-Becking (ed.) *Münchener Hanbuch des Gesellschaftsrechts, Volume 4, Aktiengesellschaft* 3rd ed. (2007) at § 56 marginal No. 56.

emptive right expires if the existing shareholder renunciates it expressly.[211] The same should apply if the existing shareholder does not exercise the pre-emptive right by just letting the time limit lapse. From my point of view, the correct approach is thus to let the pre-emptive right expire and to let the Vorstand place the issued share(s) otherwise.[212]

However, § 186 Aktiengesetz also allows the general meeting to exclude the pre-emptive rights along with the resolution on the increase of the share capital.[213] This resolution requires a three fourth majority except to the extent that the Satzung provides for a higher majority.[214] Since every exclusion of the pre-emptive rights is deemed to be an interference with the membership of the shareholders, which is even protected by Article 14 I of the *Grundgesetz* (Engl.: Basic Law for the Federal Republic of Germany), every exclusion needs to be positively and materially justified. The *Bundesgerichtshof* shares this view. In its decision on *Kali & Salz* of 1978 it held that every exclusion of the pre-emptive rights requires an express and material justification, even though this requirement is not contemplated in the Aktiengesetz.[215] Hence, an exclusion of the pre-emptive rights must be in the interest of the company, where it must be suitable, necessary and appropriate to achieve this aim.

'In the interest of the company' means, in the abstract, that the aim promotes the purpose of the company as defined by its Satzung.[216] Criterion for a profit-oriented Aktiengesellschaft is thus the increase of the return on equity.[217] The interests of individual shareholders or of groups of shareholders are basically not identically equal to the interests of the company, nor are the interests of the Vorstand or the Aufsichtsrat in strengthening their position. One has to distinguish such interests

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[211] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 186 marginal No. 27.
[212] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 186 marginal No. 28.
[213] See § 186 III 1 Aktiengesetz.
[214] See § 186 III 2 Aktiengesetz.
[215] See BGH, decision of 13 March 1978 – II ZR 142/76 – published in *Neue Juristische Wochenschrift* 1978, 1316 at 1317.
[216] See Wolfgang Servatius in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 186 marginal No. 44.
[217] Ibid.

from the interest of the company as long as they are not de facto identical.[218]

An exclusion of the pre-emptive right may be, for instance, permissible, if the company seeks to strengthen a 'strategic alliance' in order to develop substantial synergy effects.[219] The same applies to hostile takeovers: If – from the shareholders point of view – the company is about to be taken over hostilely, the company may exclude the pre-emptive rights of the existing shareholders.[220] It may also do so when the exclusion of the pre-emptive rights helps – for example as a reorganisation measure – to sell *all* new shares or when there is an investor who offers to contribute vitally needed (financial) means or expertise, which may particularly be the case at a debt-equity-swap.[221] Another reason for the exclusion of the pre-emptive rights could be the wish to place the new shares on a foreign stock exchange, if strong capital markets can thereby be tapped.[222] The going public as such does however not justify the exclusion of the pre-emptive rights, if the high demand for the new shares is the only reason given.[223] Furthermore, the uncertainty, whether or not the existing shareholders will exercise their pre-emptive rights, does per se not justify the exclusion of the pre-emptive rights either.[224]

In case the company involved is a part of a group of companies, it is not the interest of the company which counts but consequently the interest of the group of companies (controversial).[225]

As mentioned above, the reason for the exclusion of the pre-emptive rights must not only be in the interest of the company but also suitable, necessary and

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[218] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 186 marginal No. 75.
[219] See BGH, decision of 19 April 1982 – II ZR 55/8 – published in *Neue Juristische Wochenschrift* 1982, 2444 at 2446.
[220] See BGH, decision of 6 October 1960 – II ZR 150/58 – published in *Neue Juristische Wochenschrift* 1961, 26 at 27.
[221] See Wolfgang Servatius in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 186 marginal No. 45.
[222] See BGH, decision of 07 March 1994 – II ZR 52/93 – published in *Neue Juristische Wochenschrift* 1994, 1410 at 1410-1411.
[223] See Wolfgang Servatius in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 186 marginal No. 45.
[224] See OLG Celle, decision of 29 June 2001 – 9 U 89/01 – published in *Neue Zeitschrift für Gesellschaftsrecht* 2001, 1140 at 1140.
[225] See Wolfgang Servatius in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 186 marginal No. 46. For the different view see: Uwe Hüffer *Aktiengesetz* 9th ed. (2011) at § 186 marginal No. 26.

appropriate. Suitable simply means that the aim can generally be achieved by the measure concerned.[226] Beyond that, the exclusion of the pre-emptive rights is necessary either if there is no alternative or if the exclusion of the pre-emptive rights is the best and effective opportunity among others.[227] And finally, it is appropriate if the interest of the company ranks higher than the interest of the existing shareholders in keeping their position by means of the exercising of their pre-emptive rights.[228] The more intense the interference with the shareholders' rights and positions is the more important must be the interest of the company for the exclusion of the pre-emptive rights.[229] From the shareholders' point of view, two factors are especially relevant: the watering down and the loss in voting power. If, for instance, existing shareholders will lose their blocking minority, there must be a vital reason for the exclusion of the pre-emptive rights.[230] Also, a complete exclusion of the pre-emptive rights cannot, as a rule, be justified. Only in very exceptional cases the pre-emptive rights can be excluded completely.

Since the existence of pre-emptive rights is the legal principle and their exclusion the exceptional case, the burden of proof in respect is on the company, i.e. the company must establish that the interference with the shareholders' rights is exceptionally justified by the interest of the company.[231] However, under certain circumstances it is presumed that the exclusion of the pre-emptive rights was reasonable. In other words, there is a rebuttable presumption[232] for the fact that the exclusion of the pre-emptive rights was in the (best) interest of the company.[233] The burden of proof that this was not the case is then on the suing shareholder. This so-called *'simplified exclusion of the pre-emptive rights'* is contemplated in § 186 III 4 Aktiengesetz, which permits an exclusion of the pre-emptive rights if the increase of the share capital against cash consideration does not exceed 10 per cent of the current

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[226] See BGH, decision of 07 March 1994 – II ZR 52/93 – published in *Neue Juristische Wochenschrift* 1994, 1410 at 1410-1411.
[227] Ibid.
[228] Ibid.
[229] See Uwe Hüffer *Aktiengesetz* 9th ed. (2011) at § 186 marginal No. 28.
[230] Ibid.
[231] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 186 marginal No. 81.
[232] *Busch* holds even the opinion that the presumption is irrebuttable: See Torsten Busch 'Bezugsrecht und Bezugsrechtsausschluß bei Wandel- und Optionsanleihen' in *Die Aktiengesellschaft* 1999, 58 at 59.
[233] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 186 marginal No. 82.

share capital and if the issue price does not significantly fall short of the exchange price.

(b) Conditional increase of the share capital

Unlike within the context of a regular increase of the share capital, existing shareholders do not enjoy legal pre-emptive rights in terms of § 186 Aktiengesetz when the company increases its share capital conditionally in terms of §§ 192 to 202 Aktiengesetz. This is due to the fact that pre-emptive rights would contradict the purposes contemplated in § 192 II Aktiengesetz. The existing shareholders are however protected through the requirement of qualified majorities in terms of § 193 I Aktiengesetz, through the restriction of the legally accepted purposes in terms of § 192 II, III Aktiengesetz as well as through the granting of pre-emptive rights in the event of issuing convertible bonds, see § 221 IV 1, 1st alternative, Aktiengesetz.

(c) Nominal increase of the share capital

In view of a nominal increase of the share capital the question whether or not existing shareholders enjoy a pre-emptive right does not arise. This is due to the fact that only existing shareholders participate in the new shares issued. Only if existing shareholders do not subscribe for 'their' new shares within a period of at least 26 months[234] the company may offer their shares to third parties and sell them at the exchange price or – in case an exchange price does not exist – through a public auction.[235] Since the company must request the shareholder at least three times to collect his, her (or its) new shares, and since such a long period of time must pass before the company may sell the new shares to a third party, the shareholder concerned does not deserve the protection of pre-emption rights.

4. Appraisal rights

The German law does not know an appraisal right as it is contemplated in s 164 of the 2008 Act. However, under German (case) law, every member of a *Gesellschaft mit beschränkter Haftung* (Engl.: company with limited liability) enjoys a mandatory and inalienable right of extraordinary cancellation, namely in case there are

[234] See § 214 II, III Aktiengesetz; see also: Cornelius Simons in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 208 marginal No. 6.
[235] See § 215 III Aktiengesetz.

circumstances that make the continuance in the membership unacceptable.[236] The courts accept, for instance, the significant shift in legal or economic relationships as such a circumstance.[237] Furthermore, they also consider the fundamental reorganisation of the company's structure to be a circumstance that allows the extraordinary cancellation.[238] But the most interesting fact here is, that an increase of the share capital of a *Gesellschaft mit beschränkter Haftung* may trigger the right of extraordinary cancellation. § 24 of the Act on companies with limited liabilities (hereinafter: GmbH-Gesetz) provides that all members of a *Gesellschaft mit beschränkter Haftung* are liable for the contribution of their co-members as far as they are not able to pay up their shares and as far as the value of the share cannot be raised through the disposal of those shares. This leads on to the fact that every increase of the share capital of a *Gesellschaft mit beschränkter Haftung* also increases (at least temporarily) the liability of every single member. Hence, both courts and academics accept that members of a *Gesellschaft mit beschränkter Haftung* may opt-out in case the increase of their liability becomes inacceptable due to § 24 GmbH-Gesetz.[239]

However, § 24 GmbH-Gesetz constitutes an exception in German companies law. Neither shareholders of an Aktiengesellschaft nor members of any other type of companies are liable for the contributions of their co-members. Thus, there is no right of extraordinary cancellation in respect of *Aktiengesellschaften*[240], and no appraisal right either.

5. Determination of the issue price

De jure, the shareholders' general meeting is obliged to determine the issue price of the new shares, see § 182 III Aktiengesetz. It is principally free to determine any price it wants to, albeit it has to consider the prohibition of the issue (a) of par value shares at a discount to their nominal value, i.e. below par value, or (b) of no-par value shares below their calculated proportion of the capital, as contemplated in § 9 I

[236] See Carola Stenger '§ 33 Die Übertragung der Mitgliedschaft an einer Kapitalgesellschaft' in Heinrich Sudhoff (ed.) *Unternehmensnachfolge* 5th ed. (2005) at marginal No 1.
[237] See Götz Hueck and Lorenz Fastrich in Adolf Baumbach and Alfred Hueck (eds.) *GmbH-Gesetz* 19th ed. (2010) at § 34 marginal No. 20.
[238] Ibid.
[239] Ibid.
[240] BGH NJW 1992, 895; OLG Karlsruhe BB 1984, 2016; BayObLG GmbHR 1990, 222; Scholz/Winter § 15 GmbHG Rn 114; Hachenburg/Ulmer § 34 GmbHG Anh. Rn 44.

Aktiengesetz. In addition, it has to bear in mind § 255 II Aktiengesetz, which regulates that a member can have the resolution on the increase of the share capital without pre-emptive rights declared void, if the issue price is determined unreasonably low. In other words, (only) in the event of excluding the pre-emptive rights in connection with an increase of the share capital the shareholders' general meeting must determine a *reasonable* issue price.[241] This applies to both the direct and indirect exclusion of pre-emptive rights.[242] Finally, in case of issuing shares of no par value the issue price per share may not fall short EUR 1.00, see § 8 III 3 Aktiengesetz.

Beyond those restrictions, the shareholders' general meeting enjoys freedom of discretion: it can determine a fixed issue price or confine itself to the determination of a minimum issue price and delegate the final determination to the Vorstand[243] or to both the Vorstand and the Aufsichtsrat in co-operation,[244] but not to the Aufsichtsrat by itself.[245] However, it may not delegate the power of determining the minimum issue price to the management. By further restrictions on the delegation, such as the determination of a maximum issue price, the shareholders' general meeting can avoid exceeding the line to authorised capital in terms of § 202 Aktiengesetz, and that its own decisive power gets undermined.[246] In case the shareholders' general meeting has delegated its power of determining the final issue price to the management, the management's decision is subject to its obligatory discretion.[247]

Since § 182 III Aktiengesetz only provides for the determination of a minimum issue price if the issue is supposed to be above par value, it might well be the case that the shareholders' general meeting does not resolve on the issue price at all. This would not make the resolution void or voidable, but the question is, how to handle

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[241] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 186 marginal No. 47.
[242] See BGH, decision of 13 March 1978 – II ZR 142/76 – published in *Neue Juristische Wochenschrift* 1978, 1316 at 1318.
[243] See Hanseatisches OLG Hamburg, decision of 29 October 1999 – 11 U 71/99 – published in *Neue Zeitschrift für Gesellschaftsrecht* 2000, 549 at 550.
[244] See Wolfgang Servatius in Gerald Spindler and Eberhard Stilz (eds.) *Kommentar zum Aktiengesetz*, 2nd ed. (2010) at § 182 marginal No. 54.
[245] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 186 marginal No. 48.
[246] Ibid.
[247] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 182 marginal No. 60.

those cases. In Germany, there is no consensus in this regard. The courts and some of the academics argue that one can deduce from the wording of § 182 III Aktiengesetz that new shares have to be issued at par value or – in case of no-par value shares – at their calculated proportion of the capital.[248] The dissenting academics take the view that the management has to issue the shares at the maximally achievable price, where the par value (or its equivalent in respect of no par value shares) constitutes the minimum issue price.[249] The third view is that one has to differentiate if the shareholders enjoy direct or indirect pre-emptive rights or if the pre-emptive rights were excluded. In case they enjoy pre-emptive rights the shares have to be issued at par value (or its equivalent), and in case they don't the shares have to be issued above par value at a price, which is maximally achievable.[250]

In my opinion, the management should always be obliged to issue the shares at the maximally achievable price. When determining the issue price the management has to take into account the interests of the existing shareholders as well as the financial interests of the company. In case the pre-emptive rights are excluded, § 255 II Aktiengesetz indicates that the reasonable issue price is regularly above par value (or its equivalent in respect of no-value shares) since § 255 II Aktiengesetz provides that the validity of the resolution on the increase of the share capital may be contested if the issue price is unreasonably low although it is above par value (or its equivalent in respect of no par value shares). In case the pre-emptive rights are not excluded the existing shareholders logically benefit from a low issue price; thus, their interests are obviously not jeopardized if the management decides to issue at par value (or its equivalent in respect of no-value shares). It is thus crucial whether or not the financial interest of the company may prevail the interest of the existing shareholders in an issue at a rather low price. I think it may prevail since the existing shareholders themselves have waived their possibility of determining a fixed or minimum issue price when they voted at the general meeting without insisting on voting on the issue price as well. Hence, they have virtually given up their right of preferential consideration of their interests.

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[248] See BGH, decision of 6 October 1960 – II ZR 150/58 – published in BGHZ 33, 175 at 178.
[249] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 182 marginal No. 52.
[250] See Jens Ekkenga 'Kapitalmarktrechtliche Aspekte des Bezugsrechts und Bezugsrechtsausschlusses' in *Die Aktiengesellschaft* 1994, 59 at 65.

6. Determination of the beginning of the participating

Unlike under South African law, shareholders of an Aktiengesellschaft, who have subscribed for shares *during* the business year, are not entitled to participate in the dividend as do shareholders, who have held the shares the whole year. Only the latter are entitled to the full dividend. The 'new' shareholders only receive that part of the dividend that reflects the period of time they have held the shares. This is derived from an analogous application of § 60 II 3 Aktiengesetz, which states that contributions paid during the business year are only taken into consideration as far as it reflects the time that has passed since the contribution has been paid.[251]

However, the general meeting may also resolve to have the new shareholders have fully participated even if the capital was increased during the business year.[252] There are, in fact, some authors who deem a resolution to be valid where it entitles the new shareholders to participate in dividends of *preceding* business years – as long as the general meeting has not yet decided on the appropriation of earnings as contemplated in § 174 Aktiengesetz.[253]

In respect of a nominal increase of share capital the participation of the new shares is regulated by § 217 Aktiengesetz. They participate in the profits of the whole business year except to the extent that the resolution on the increase of the share capital provides otherwise, see § 217 I Aktiengesetz. As it is with the other forms of increase of share capital, the general meeting may also resolve to have the new shares participated in the profits of the preceding business years – provided that this resolution is adopted before the shareholders' general meeting votes on the appropriation of earnings.[254]

V ADVANTAGES AND DISADVANTAGES

It goes without saying that every system has both advantages and

[251] See Uwe Hüffer *Aktiengesetz* 9th ed. (2011) at § 182 marginal No. 15.
[252] Ibid.
[253] See Uwe Hüffer *Aktiengesetz* 9th ed. (2011) at § 60 marginal No. 10 (controversial).
[254] See § 217 II Aktiengesetz.

disadvantages. Logically, there cannot be a system which fits every single stakeholder's demand. Existing shareholders have different issues than prospective ones. A legal system can only seek to balance the different needs. Furthermore, legislators may pursue different goals and politics, such as having rather an investor-friendly than a shareholder-friendly law, or as creating law that provides greatest possible flexibility and that attempts to attract, for instance, foreign investors. The list of possible goals to pursue is nearly infinite. And thus, I can only discuss the different aspects and the likelihood that the one goal or another might be accomplished.

1. South Africa

The new South African law seeks to enhance flexibility and it seeks to be investor-friendly. As cited before, the Department of Trade and Industry stated 'that companies attain maximum flexibility in creating financing mechanisms. This implies that they should have significant freedom to create financial instruments'[255] and that '[t]he mobility of international capital has highlighted the need for domestic laws to be investor-friendly and competitive with international trends.'[256] From my point of view, the 2008 Act accomplishes those two aims quite widely. In respect of the increase of the share capital, there are only a few unalterable provisions in the new Act. The founders can design a set of rules they deem fit in respect of, for instance, the company's size, the company's business, the shareholders' structure, etc., and the MoI may be amended at any time when the shareholders think the company is better off with a different set of rules. Furthermore, the default of the 2008 Act permits the board of directors to increase the share capital whenever they think fit and it avoids time consuming decision-making procedures of the shareholders' meeting. This has the welcome side effect of saving expenses for planning, convening and holding the meeting.

However, I consider the advantage of maximum flexibility to be a disadvantage likewise. The provisions of the 2008 Act demand a very high

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[255] Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (GN 1183 of 2004, published in GG Vol. 468 No. 26493 of 23June 2004) at 32.
[256] Ibid.

level of knowledge from the founders, shareholders and directors. They have to examine how and to what extent the increase or decrease of, for example, the board's power would affect the willingness of potential shareholders to invest in the company on the one hand, and how it would have effect on the company's opportunities to react promptly and efficiently on (sudden) changes of economic or commercial circumstances on the other hand. I think it would have been helpful, if the legislator had taken potential founders a little more by the hand. Even if potential founders know their business very well, they probably cannot assess how the different factors will interact. One would not only need profound knowledge of commercial and economic correlations, but also of the legal and especially psychological ones.

(a) The statutory power of the board to increase the share capital

Coming from that general estimation, I will now consider several provisions and their dis/advantages in greater detail. At first, the general power of the board of directors to increase both the authorised share capital and the issued share capital gives a company the opportunity to respond to changed situations quickly and without 'undue' effort. Provided the board acts constantly and objectively in the best interest of the company, this provision seems to be an excellent approach. But there is de facto hardly ever only one right way to go and the board of directors might be influenced by interests being beyond the shareholders' interests. At this point, the well-known problem of 'distinguishing the ownership interests and the powers of control'[257] comes into play. Since this distinction forms the basis of modern corporate governance, one should consider the national and international approaches in this regard:

Just recently the European Commission issued a Green Paper on 'Corporate governance in financial institutions and remuneration policies', where it stated that

> '[t]he financial crisis has shown that confidence in the model of the shareholder-owner who contributes to the company's long-term viability

[257] See Adolph Augustus Berle and Gardiner C. Means *The Modern Corporation and Private Property* 1st edition (1932) at 113.

> has been severely shaken, to say the least. ... More generally, it raises questions about the effectiveness of corporate governance rules based on the presumption of effective control by shareholders.'[258]

In other words, the European Commission wants to encourage shareholders to participate and to control the management in order to avoid crises such as the financial crisis triggered by the insolvency of Lehman Brothers Inc. in late 2008. The United Kingdom is even a step ahead. In July 2010, the Financial Reporting Council has issued the UK Stewardship Code, which focuses entirely on the relationship between institutional investors and listed companies in the United Kingdom. One of the goals of the UK Stewardship Code is to 'enhance the quality of engagement between institutional investors and companies to help long-term returns to shareholders and the efficient exercise of governance responsibilities.'[259] Furthermore, '[b]y creating a sound basis of engagement [the UK Stewardship Code] should create a much needed stronger link between governance and the investment process'[260]. And actually, the King III Report in South Africa also requires that '[t]he board should encourage shareholders to attend AGMs and other company meetings'[261]. One can thus summarise that the international efforts in respect of corporate governance tend to a greater commitment of shareholders and institutional investors. I submit that the abolition of shareholder approval for the increase of the share capital is a step in the opposite direction. In fact, it rather counteracts the wish for shareholder activism if shareholders are not allowed to participate in one of the most fundamental decisions of the company's progress.

(b) s 41(3) of the 2008 Act

Even though I deem it right that shareholder approval is stringently required if – according to s 41(3) of the 2008 Act – an issue of shares results in a substantial change in the voting power of one class of shares, the provision entails a disadvantage as well. The application of the provision does not only depend on the

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[258] European Commission *Green Paper. Corporate governance in financial institutions and remuneration policies* at 8.
[259] See UK Stewardship Code at 1.
[260] Ibid.
[261] See Principle 8.2.18 of the King III Report.

change of the voting power, but – for no apparent reason – also on the number of shares. *Van der Linde* provided an apt example for the illustration of this imbalance:

> 'Say a particular class of shares has ten per cent of the total votes in the company. The voting power that the new shares will have once they are issued, expressed as a percentage of the voting power of the shares immediately before the issue, is 33 per cent. This means that the issue will trigger the provision. Shareholder approval is thus necessary despite the fact that the voting power of each shareholder has been diluted by only 3,3 per cent. However, if the company has only one class of shares, and has issued 10 000 shares in that class, a further 4 285 shares can be issued without a special resolution of the shareholders. The voting power of the new shares will be just under 30 per cent of the voting power of the shares immediately before the issue. Shareholder approval is not required for this issue, although each shareholder's rights have been diluted by 30 per cent.'[262]

(c) The lack of pre-emptive rights

As should have become clear from preceding paragraphs, I consider the lack of pre-emptive rights the most important innovation in the 2008 Act besides the lack of shareholder approval. Despite all flexibility and modernisation I cannot detect any reason why shareholders of unlisted public companies should not generally enjoy pre-emptive rights in respect of the issue of new shares. Of course, there might be situations when the new shares should definitely be issued to anyone but the existing shareholders – for example when the share capital is increased in order to be sold on foreign capital markets, or when the potentially new investor possesses special knowledge that he, she (or it) wants to invest in the company concerned as a contribution for the shares.[263] But those occasions do not de facto represent the normal case, but the exceptional case. I would thus have preferred that the law reflects the reality. As a general rule, existing shareholders should enjoy pre-emptive rights, but they should

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[262] Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 48.
[263] See Karl-Nikolaus Peifer in Wulf Goette, Mathias Habersack (eds.) *Münchener Kommentar zum Aktiengesetz*, Volume 4, 3rd ed. (2011) at § 186 marginal No. 2.

also be able to resolve on waiving their rights under certain circumstances. The Johannesburg Stock Exchange is apparently of the same opinion since its Listing Requirements only allow a listing on the Stock Exchange if the company's MoI provide for pre-emptive rights.[264]

2. Germany

As stated above, in Germany every single increase of the share capital has to be approved by the shareholders' meeting – regardless of whether it is a regular increase of the share capital, a conditional increase of the share capital or the authorised increase of the share capital. Eventually, in respect of the shareholders' involvement, the three types of increasing the share capital only differ in period of time between the shareholder approval and the actual increase of the (issued) share capital.

(a) Shareholder approval

Certainly, the obligatory shareholder approval is not only an advantage – even though I just adduced the reasons against it. The main two disadvantages of the German law are the costs of planning, convening and holding the shareholders' meetings and the time that the planning, convening and holding of the shareholders' meetings consumes.[265] Besides, in Germany there is always the jeopardy that the shareholders prevent an increase of the share capital and restrain the company from performing in a way which would actually be more advisable.

(b) Pre-emptive rights

A look at the pre-emptive rights shows that the disadvantages I mentioned in respect of the South African law are the advantages of the German law, and vice versa. The two sets of rules and their advantages and disadvantages are figuratively two sides of the same coin. In Germany, directors, who want to issue shares to certain but not all existing shareholders or who want to attract new or foreign investors, must ask the shareholders' meeting for it. This makes the procedure time

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[264] See above.

[265] See Christof von Dryander and Gerold Niggemann in Wolfgang Hölters (ed.) *Aktiengesetz* 1st ed. (2011) at § 191 marginal No. 4.

consuming, inflexible and uncertain.

VI CONCLUSION AND RECOMMENDED PROCEEDING

In summary it can be said, therefore, that neither of the two systems is perfect or at least nearly perfect. But I deem the German Aktiengesetz to be more balanced and I assume that the Aktiengesetz is more investor-friendly than the South African system, since as a German shareholder one has got clearly more influence and one can almost always be sure that the board cannot assert a measure without the approval of the shareholders – thus, the only burden for the disagreeing one is to convince the majority of his, her (or its) opinion. On the other hand, the Aktiengesetz does not provide for much leeway in creating, for instance, more flexibility through the Satzung. The founders and shareholders may not resolve to abolish the pre-emptive rights generelly or to vest their powers completely in the directors. Thus, I cannot propose any recommendations for founders and shareholders. They just have to adhere to the provisions of the Aktiengesetz.

The opposite applies in South Africa. Bearing again especially in mind that shareholders of South African public companies do generally not have a vote in the authorisation and issuance of shares I would strongly recommend that also unlisted companies' Memoranda of Incorporation provide for pre-emptive rights. Even though pre-emptive rights might affect the flexibility of a company to issue shares, it is submitted that 'limiting, through the notion of authorised capital, the number of additional shares that may be issued; preserving the balance of power through pre-emptive rights; subjecting the issuing of shares to approval of shareholders'[266] are the means against the potentially significant dilution of the relative interests of existing shareholders caused by the issuing of further shares.[267] And thus, I would recommend to strengthen the position of existing shareholders in order to attract new and/or foreign investors. Only if they may see themselves in a good (prospective) position, they will decide to invest in public companies.

(At least) with regard to those public companies which are smaller, rather private

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[266] Kathleen van der Linde 'The Regulation of Conflict Situations Relating to Share Capital' in (2009) 21 *South African Mercantile Law Journal* 33 at 42

[267] See ibid.

and characterised by a more personal structure of the shareholders, I would recommend that they vest – through their MoI – the power to authorise shares in the shareholders. I would actually also recommend that even the power of issuing shares should be vested in the shareholders, but – again – s 38(1) of the 2008 Act is an unalterable provision and the MoI may hence not provide that shares may only be issued after the shareholders have approved the board's resolution. However, since the 2008 Act seeks to provide greatest possible flexibility, I propose to consider a corresponding amendment of the 2008 Act. Shareholders of companies as aforementioned should be able to intervene in the company's fate. I do not deem it contradictory, if one wants to found a public company with generally freely transferable shares and at the same time, to keep the influence of the existing shareholders. That does not imply, that (new) shares are not transferable to third parties at all, but only that the existing shareholders may participate in the decision whether or not they want the shareholders' structure to be conserved.

Since the 2008 Act and if the company's MoI do not provide for pre-emptive rights, I would recommend that the courts allow release for unsatisfied existing shareholders in case their shares suffered a significant watering down through the increase of the share capital. As discussed above, either the appraisal right or the oppression remedy could be a proper solution for opting out. Since the burden of proof of the oppression remedy is much higher than the burden of proof of the appraisal right, it would be commendable if the courts ruled that the appraisal right is triggered in such situations.[268]

However, it is surely a brave and progressive step of the South African legislator to follow such a modern approach of company law, and only the future will show whether or not my criticism are appropriate and if South African businessmen, shareholder and especially directors can field their gained flexibilities and powers in order to enhance the economy of South Africa.

[268] See also Kathleen van der Linde 'The regulation of share capital and shareholder contributions in the Companies Bill 2008' in 2009 *Tydskrif vir die Suid-Afrikaanse Reg*, Issue 1, 39 at 46, where she holds the same opinion.

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