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NOTES

ISSUES RELATING TO THE REGULATION OF 'DISTRIBUTIONS' BY THE 2008 COMPANIES ACT

RICHARD JOOSTE
Professor of Law, University of Cape Town

INTRODUCTION

The distribution by a company of its assets to its shareholders, whether they be in the form of cash or otherwise, ought to be carefully regulated by any legal system intent on protecting the interests of creditors and minority shareholders of the company. Until 1999 such protection was largely provided for by the maintenance of capital principle. This principle manifested itself in various ways, the most significant being that it was unlawful for a company to acquire its own shares or shares in its holding company, and the distribution of funds to shareholders other than those representing legally distributable profits usually required a court order. In 1999 this all changed with far-reaching amendments to the Companies Act 61 of 1973 (see the Companies Amendment Act 37 of 1999). The maintenance of capital principle was effectively abolished; companies were permitted to acquire their own shares and shares in their holding companies; and the distinction between profits and other funds of a company was removed. The distribution of funds entailed was allowed provided, inter alia, the company's solvency and liquidity was not placed in jeopardy and, in the case of a buy-back or a purchase of shares in the holding company, a special resolution had been adopted to approve the transaction.

The draft Companies Bill, which was published for public comment in February 2007 (hereafter referred to as 'the Companies Bill, 2007') continued in a similar vein to the 1999 amendments. However, the relevant provisions of the Bill were fraught with problems. A critique of the provisions was published in this journal (see R D Jooste 'The maintenance of capital and the Companies Bill 2007' (2007) 124 *SALJ* 710). The provisions of the Companies Act 71 of 2008 differ in significant respects from the Companies Bill, 2007, both in substance and form, and it seems appropriate to follow up the previous critique with comments on the enacted provisions. (The

Companies Act 71 of 2008 comes into operation on a date fixed by the President by proclamation in the Gazette, which may not be earlier than 9 April 2010. The Companies Act 71 of 2008 will be referred to in this note as 'the new Act' and the Companies Act 61 of 1973 as 'the current Act'.) This note does not purport to be a full analysis of the provisions in question (for a comprehensive article on 'distributions' see Kathleen van der Linde 'The regulation of distributions to shareholders in the Companies Act 2008' 2009 *TSAR* 484).

In a similar fashion to the Companies Bill, 2007, the new Act does not deal separately with the different types of distributions. Section 48 deals specifically with the acquisition by a company of its own shares and shares in its holding company, while distributions generally are dealt with in s 46 of the Act. The definition of 'distribution' in s 1 of the new Act includes a transfer of the consideration for the acquisition by a company of its own shares or shares in any company in its 'group'. Accordingly, acquisitions by a company of its own shares or shares in its holding company are governed by both s 46 and s 48. Sections 46 and 48 are not, however, the only relevant provisions governing distributions. For example, the liability of directors in this context is dealt with in s 77.

This note is structured as follows. First it will set out the *main* relevant provisions, with linkages aimed at providing some coherence to the statutory regime. Thereafter, these provisions, as well as some of the other relevant provisions of the new Act, will be analysed.

STATUTORY PROVISIONS

A 'distribution' is defined in s 1 of the new Act as follows:

' "distribution" means a direct or indirect —

(a) transfer by a company of money or other property of the company, other than its own shares, to or for the benefit of 1 or more holders of any of the shares of that company or of another company within the same group of companies, whether —
  - (i) in the form of a dividend;
  - (ii) as a payment in lieu of a capitalisation share, as contemplated in section 47;
  - (iii) as consideration for the acquisition —
    - (aa) by the company of any of its shares, as contemplated in section 48; or
    - (bb) by any company within the same group of companies, of any shares of a company within that group of companies; or
  - (iv) otherwise in respect of any of the shares of that company or of another company within the same group of companies, subject to section 164 (19);

(b) incurrence of a debt or other obligation by a company for the benefit of 1 or more holders of any of the shares of that company or of another company within the same group of companies; or

(c) forgiveness or waiver by a company of a debt or other obligation owed to the company by 1 or more holders of any of the shares of that company or of another company within the same group of companies,

but does not include any such action taken upon the final liquidation of the company;'

Section 46 determines the requirements that must be complied with for the making of a distribution. It provides:

'46 Distributions must be authorised by the board

(1) A company must not make any proposed distribution unless —

(a) the distribution —

(i) is pursuant to an existing legal obligation of the company, or a court order; or

(ii) the board of the company, by resolution, has authorised the distribution; and

(b) it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution; and

(c) the board of the company, by resolution, has acknowledged that it has applied the solvency and liquidity test, as set out in section 4, and reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.

(2) When the board of a company has adopted a resolution contemplated in subsection (1)(c), the relevant distribution must be fully carried out, subject only to subsection (3).

(3) If the distribution contemplated in a particular board resolution, court order or existing legal obligation has not been completed within 120 days after the board made the acknowledgement required by subsection (1)(c), or after a fresh acknowledgement being made in terms of this subsection, as the case may be, —

(a) the board must reconsider the solvency and liquidity test with respect to the remaining distribution to be made pursuant to the original resolution, order or obligation; and

(b) despite any law, order or agreement to the contrary, the company must not proceed with or continue with any such distribution unless the board adopts a further resolution as contemplated in subsection (1)(c).

(4) If a distribution takes the form of the incurrence of a debt or other obligation by the company, as contemplated in paragraph (b) of the definition of "distribution" set out in section 1, the requirements of this section —

(a) apply at the time that the board resolves for the company to incur that debt or obligation; and

(b) do not apply to any subsequent action of the company in satisfaction of that debt or obligation, except to the extent that the resolution, or the terms and conditions of the debt or obligation, provide otherwise.

(5) If, after considering the solvency and liquidity test as required by this section, it appears to the company that the section prohibits its immediate compliance with a court order contemplated in subsection (1)(a)(i) —

(a) the company may apply to a court for an order varying the original order; and

(b) the court may make an order that —

(i) is just and equitable, having regard to the financial circumstances of the company; and

(ii) ensures that the person to whom the company is required to make a payment in terms of the original order is paid at the earliest possible

date compatible with the company satisfying its other financial obligations as they fall due and payable.

(6) A director of a company is liable to the extent set out in section 77(3)(e)(vi) if the director —

(a) was present at the meeting when the board approved a distribution as contemplated in this section, or participated in the making of such a decision in terms of section 74; and

(b) failed to vote against the distribution, despite knowing that the distribution was contrary to this section.'

Section 48 regulates the acquisition by a company of its own shares and shares in its holding company and, as will be seen below, requires, inter alia, that the distribution pursuant to the acquisition complies with s 46. Section 48 provides:

'Company or subsidiary acquiring company's shares

(1) The making of a demand, tendering of shares and payment by a company to a shareholder in terms of a shareholder's appraisal rights set out in section 164 do not constitute an acquisition of its shares by the company within the meaning of this section.

(2) Subject to subsection (3) —

(a) a company may acquire its own shares, if the decision to do so satisfies the requirements of section 46; and

(b) any subsidiary of a company may acquire shares of that company, but —

(i) not more than 10 per cent, in aggregate, of the number of issued shares of any class of shares of a company may be held by, or for the benefit of, all of the subsidiaries of that company, taken together; and

(ii) no voting rights attached to those shares may be exercised while the shares are held by the subsidiary, and it remains a subsidiary of the company whose shares it holds.

(3) Despite any provision of any law, agreement, order or the Memorandum of Incorporation of a company, the company may not acquire its own shares, and a subsidiary of a company may not acquire shares of that company, if, as a result of that acquisition, there would no longer be any shares of the company in issue other than —

(a) shares held by 1 or more subsidiaries of the company; or

(b) convertible or redeemable shares.

(4) An agreement with a company providing for the acquisition by the company of shares issued by it is enforceable against the company, subject to subsections (2) and (3).

(5) If a company alleges that, as a result of the operation of subsection (2) or (3), it is unable to fulfil its obligations in terms of an agreement contemplated in subsection (4) —

(a) the company must apply to a court for an order in terms of paragraph (c);

(b) the company has the burden of proving that fulfilment of its obligations would put it in breach of subsections (2) or (3); and

(c) if the court is satisfied that the company is prevented from fulfilling its obligations pursuant to the agreement, the court may make an order that —

(i) is just and equitable, having regard to the financial circumstances of the company; and

(ii) ensures that the person to whom the company is required to make a payment in terms of the agreement is paid at the earliest possible date compatible with the company satisfying its other financial obligations as they fall due and payable.

(6) If a company acquires any shares contrary to section 46, or this section, the company may apply to a court for an order reversing the acquisition, and the court may order —

(a) the person from whom the shares were acquired to return the amount paid by the company; and

(b) the company to issue to that person an equivalent number of shares of the same class as those acquired.

(7) A director of a company is liable to the extent set out in section 77(3)(e)(vii) if the director —

(a) was present at the meeting when the board approved an acquisition of shares contemplated in this section, or participated in the making of such a decision in terms of section 74; and

(b) failed to vote against the acquisition of shares, despite knowing that the acquisition was contrary to this section or section 46.'

To determine what happens to shares in a company acquired by the company itself, one needs to turn to s 35(5), which provides:

'(5) Shares of a company that have been issued and subsequently —

(a) acquired by that company, as contemplated in section 48 . . .

have the same status as shares that have been authorised but not issued.'

The solvency and liquidity test referred to in s 46(1)*(b)* is governed by s 4 of the new Act, which provides as follows:

'(4) Solvency and liquidity test

(1) For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time —

(a) the assets of the company or, if the company is a member of a group of companies, the consolidated assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, 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 distribution.

(2) For the purposes contemplated in subsection (1) —

(a) any financial information to be considered concerning the company must be based on —

(i) accounting records that satisfy the requirements of section 28; and

(ii) financial statements that satisfy the requirements of section 29;

(b) subject to paragraph (c), the board or any other person applying the solvency and liquidity test to a company —

(i) must consider a fair valuation of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities,

irrespective whether arising as a result of the proposed distribution, or otherwise; and

(ii) may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances; and

(c) unless the Memorandum of Incorporation of the company provides otherwise, a person applying the test in respect of a distribution contemplated in paragraph (a) of the definition of "distribution" in section 1 is not to regard as a liability any amount that would be required, if the company were to be liquidated at the time of the distribution, to satisfy the preferential rights upon liquidation of shareholders whose preferential rights upon liquidation are superior to the preferential rights upon liquidation of those receiving the distribution.'

The liability of directors in the context of 'distributions' is dealt with in s 46(6), s 77(3)*(e)*(vi)–(vii) and s 77(4)–(10), which provide:

'46 . . .

(6) A director of a company is liable to the extent set out in section 77(3)(e)(vi) if the director —

(a) was present at the meeting when the board approved a distribution as contemplated in this section, or participated in the making of such a decision in terms of section 74; and

(b) failed to vote against the distribution, despite knowing that the distribution was contrary to this section.'

'77 . . .

(3) A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having —

. . .

(e) been present at a meeting or participated in the making of a decision in terms of section 74, and failed to vote against —

. . .

(vi) a resolution approving a distribution, despite knowing that the distribution was contrary to section 46, subject to subsection (4);

(vii) the acquisition by the company of any of its shares, or the shares of its holding company, despite knowing that the acquisition was contrary to section 46 or section 48; . . .

(4) The liability of a director in terms of subsection (3)(e)(vi) as a consequence of the director having failed to vote against a distribution in contravention of section 46 —

(a) arises only if —

(i) immediately after making all of the distribution contemplated in a resolution in terms of section 46, the company does not satisfy the solvency and liquidity test; and

(ii) it was unreasonable at the time of the decision to conclude that the company would satisfy the solvency and liquidity test after making the relevant distribution; and

(b) does not exceed, in aggregate, the difference between —

(i) the amount by which the value of the distribution exceeded the amount that could have been distributed without causing the company to fail to satisfy the solvency and liquidity test; and

(ii) the amount, if any, recovered by the company from persons to whom the distribution was made.

(5) If the board of a company has made a decision in a manner that contravened this Act as contemplated in subsection (3)(e) —

(a) the company, or any director who has been or may be held liable in terms of subsection (3)(e), may apply to a court for an order setting aside the decision of the board; and

(b) the court may make —

(i) an order setting aside the decision in whole or in part, absolutely or conditionally; and

(ii) any further order that is just and equitable in the circumstances, including an order —

(aa) to rectify the decision, reverse any transaction, or restore any consideration paid or benefit received by any person in terms of the decision of the board; and

(bb) requiring the company to indemnify any director who has been or may be held liable in terms of this section, including indemnification for the costs of the proceedings under this subsection.

(6) The liability of a person in terms of this section is joint and several with any other person who is or may be held liable for the same act.

(7) Proceedings to recover any loss, damages or costs for which a person is or may be held liable in terms of this section may not be commenced more than 3 years after the act or omission that gives rise to that liability.

(8) In addition to the liability set out elsewhere in this section, any person who would be so liable is jointly and severally liable with all other such persons —

(a) to pay the costs of all parties in the court in a proceeding contemplated in this section unless the proceedings are abandoned, or exculpate that person; and

(b) to restore to the company any amount improperly paid by the company as a consequence of the impugned act, and not recoverable in terms of this Act.

(9) In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that —

(a) the director is or may be liable, but has acted honestly and reasonably; or

(b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.

(10) A director who has reason to apprehend that a claim may be made alleging that the director is liable, other than for wilful misconduct or wilful breach of trust, may apply to a court for relief, and the court may grant relief to the director on the same grounds as if the matter had come before the court in terms of subsection (9).

COMMENTARY

'Acquisition' and 'distribution'

It is important to note that the provisions being examined regulate two different actions on the part of a company. The provisions regulate 'distribu-

tions' as defined on the one hand, and certain acquisitions of shares on the other hand. Some of the 'distributions' are 'distributions' pursuant to these acquisitions of shares. To be more specific, the provisions govern:

- the acquisition by a company of its own shares (governed by s 48);
- the acquisition by a company of shares in its holding company (governed by s 48);
- distributions of the consideration for:
  - the acquisition by a company of its own shares;
  - the acquisition by a company of shares in its holding company;
  - the acquisition by a company of shares in a company in the same group as the acquiring company (all governed by s 46);
- distributions other than the above by a company to shareholders of any other company in the same group as the distributing company. Included are dividends distributed by a company to its own shareholders. Distributions are included here whether out of profits or 'capital' (in fact the new Act does not contain the concept of capital).

With regard to the definition of 'distribution', a difficulty arises as to whether the transfers referred to in sub-parts (i) to (iv) of part *(a)* of the definition apply also to parts *(b)* and *(c)* of the definition, even though they are not listed in *(b)* and *(c)*? For example, does the consideration for an acquisition referred to in *(a)*(iii) of the definition include the incurring (the legislation uses the unusual construction 'incurrence') of a debt referred to in part *(b)* of the definition, or the forgiveness or waiver of a debt or other obligation referred to in part *(c)* of the definition? Is the incurring or the waiver of the obligation as consideration for such acquisition a 'distribution' as defined? If not, there is a loop-hole that needs plugging. The definition, as it currently stands, means that, for example, if a company acquires its own shares and the consideration takes the form of the company incurring a debt on behalf of the selling shareholder, or waiving a debt owed to the company by the selling shareholder, the company does not have to comply with the solvency and liquidity test required for a distribution by s 46(1)*(b)* of the new Act. This surely could not have been intended, and clarification is required. It is submitted that the definition of 'distribution' should be reformulated to make it clear that the transfers in sub-parts (i) to (iv) of part *(a)* of the definition apply also to part *(b)* and *(c)*. An alternative would be to delete sub-parts (i) to (iv) altogether (in this regard see the definition of distribution in the New Zealand legislation below). It is, of course, arguable that parts *(b)* and *(c)* are framed widely enough to include sub-subsecs *(a)*(i) to (iv) — that the definition of 'distribution' includes *any* waiver or incurring of a debt in favour of a shareholder — but then why are (i) to (iv) included in part *(a)* but not in parts *(b)* and *(c)* ? It is submitted that there is at least sufficient ambiguity to warrant an amendment clarifying such an important issue.

The words 'in respect of any of the shares' in part *(a)*(iv) of the definition of 'distribution' are vague. Presumably, what part *(a)*(iv) is intended to convey is that any transfer by a company of money or other property to the

shareholders referred to, and in some form other than the forms referred to in sub-parts (i) to (iii), are distributions. The words 'in respect of any of the shares' presumably mean that such a transfer must be to the shareholders in question *in their capacity as shareholders* and not in some other capacity. If this is the case, more appropriate wording is required.

In New Zealand, s 2(1) of the Companies Act, 1993 defines 'distribution' as follows:

> 'Distribution, in relation to a distribution by a company to a shareholder, means —
> (a) The *direct or indirect* transfer of money or property, other than the company's own shares, *to or for* the benefit of the shareholder; or
> (b) The incurring of a debt to or for the benefit of the shareholder —
> in relation to shares held by that shareholder, and whether by means of a purchase of property, the redemption or other acquisition of shares, a distribution of indebtedness, or by some other means.' (My emphasis.)

The italicised words are also used in the definition of 'distribution' in the South African Act and therefore it may be of assistance in interpreting the South African Act's definition of 'distribution' to note that it has been held in *Re DML Resources Ltd (In Liquidation)* [2004] 3 NZLR 490 (HC) at 505 that the concepts captured by the elements of the definition of distribution in the New Zealand Act:

> 'Are the transfer of property (or the incurring of a debt) by the company; the corresponding provision of a benefit to or for its shareholders; and receipt of the benefit by, or on behalf of, the shareholder in its capacity as a shareholder. A link must be established between the outflow of wealth from the company and the benefit received by or on behalf of a shareholder.
>
> The use of the expressions "direct or indirect" and "to or for" the benefit of the shareholder serve to confirm the necessary link between the negative impact on the net value of the company and the positive impact on the net value of the shareholder. They also emphasise that the inquiry is one of substance rather than form. An analysis based on the substance of the transaction lessens the likelihood of a shareholder using its influence, as an insider, to mask the true nature of the transaction to avoid compliance with the distribution rules.'

It is odd that the New Zealand definition does not mention the forgiveness or waiver by a company of a debt or other obligation owed to the company by a shareholder of the company.

It is worth noting that in the United States 'the common theme of the American decisions is the need to apply the distribution provisions if wealth is passed from a company to its shareholders, without adequate consideration, at a time when the company is insolvent' (M S Blackman, R D Jooste, G K Everingham *Commentary on the Companies Act* Vol 1 (Original ed 2002) 5-117 (hereafter '*Commentary*'). Cases referred to are *Re Munford Inc* 97 F 3d 456 (1996) 460; *C-T of Virginia Inc v Barrett* F 2d 606 (1992) 610–13; *Wiebolt Stores Inc v Schottenstein* 94 BR 488 (1988) 510–12; and *Re DML Resources Ltd (In Liquidation)* [2004] 3 NZLR 490 (HC)).

'Acquire'

Section 48(2)*(a)* of the new Act refers to the 'acquisition' by a company of its own shares (fortunately the inconsistency of the 2007 Bill, which used the

words 'acquire', 'purchase' and 're-acquire' interchangeably, is not repeated in the Act). The term 'acquisition' is, however, a misnomer because it indicates that the acquiring company holds the shares. This is not possible, as a company cannot acquire rights against itself (see Blackman et al *Commentary* 5–43). In any event, s 35(5) of the Act (set out earlier) makes it clear that the shares acquired by the company no longer retain the status of issued shares on acquisition, but have the same status as shares that have been authorised but not issued. It follows that the direct acquisition by a company of treasury shares is not possible, although a limited acquisition thereof is possible through the company's subsidiaries (see further below).

It is not clear whether the acquisition by a company of its own shares by gift or inheritance is covered by s 48. Clearly there is no 'distribution' (as defined) involved and therefore s 46 has no direct application. However, if such acquisition falls within the purview of the term 'acquire' in s 48(2)*(a)*, then the company would have to comply with s 46. Such compliance does not make sense in this case. In fact, s 48 in its entirety seems geared towards an acquisition by a company of its own shares or shares in its group that involves a distribution of some consideration, something which is absent in the case of an acquisition through a gift or inheritance. If, in fact, an acquisition through a gift or inheritance is included for the purposes of s 48(2)*(a)*, then the shares would have to be 'cancelled' in terms of s 35(5)*(a)*, which refers to an acquisition contemplated in s 48. (It is worth noting that s 37 of the Canada Business Corporation Act, 1985 expressly permits the acquisition of its shares by a company by gift, and no provision is made for the cancellation of the shares.)

In terms of the new Act, companies can issue redeemable shares (of any class and not only preference shares (s 37(5)*(b)*) and the redemption thereof is treated as an acquisition by a company of its own shares, which must comply with ss 46 and 48. There is no special provision, like there is in the current Act (s 98), governing the redemption of shares.

Conflict with memorandum of incorporation

It appears that a distribution or acquisition which complies with the relevant requirements of s 46 and s 48, as the case may be, is valid even if it conflicts with the memorandum of incorporation. (For a contrary view see Van der Linde op cit at 492.) So, provisions in the memorandum of incorporation that prohibit certain distributions or acquisitions altogether, or permit them only if certain conditions are met, are ineffective. This is borne out by a reading of s 15(2)*(a)*(ii) of the new Act and the definition of 'alterable provision' in s 1 of the new Act. Section 15(2)*(a)*(ii) provides:

'The Memorandum of Incorporation of—
(a) any company may include any provision —
. . .
(ii) altering the effect of any alterable provision of this Act;'

An 'alterable provision' means (s 1 of the new Act):

> '[A] provision of this Act in which it is expressly contemplated that its effect on a particular company may be negated, restricted, limited, qualified, extended, or otherwise altered in substance or effect by that company's Memorandum of Incorporation;'

An examination of s 46 and s 48 shows that they are not alterable provisions. There is nothing in either s 46 or s 48 that 'expressly contemplate[s]' that the effect of ss 46 and 48 may be 'negated, restricted, limited, qualified, extended, or otherwise altered in substance or effect by' a company's memorandum of incorporation. Sections 46 and 48 are hence unlike ss 44 and 45 of the new Act, for example, which are 'alterable provisions'. Section 44 'expressly contemplates' that a company's memorandum of incorporation may override the company's ability to assist in a subscription for its shares, which is permitted by s 44 subject to the requirements of the section. This is clear from the words '[e]xcept to the extent that the memorandum of incorporation of a company provides otherwise . . .' in s 44(2) (see also s 44(4)). Section 45, which deals, inter alia, with the giving of financial assistance by a company to its directors, is similarly an alterable provision with the same wording as s 44.

It is doubtful whether the legislature intended the memorandum of incorporation to be nullified in this way. For example, why should a company not prohibit dividends out of anything other than profits in its memorandum? A clarifying amendment is required. The position in the new Act may be contrasted with, for example, s 59(1) of the New Zealand Companies Act, 1993, which requires a buy-back expressly to be permitted by the company's constitution.

Authorisation

It is evident that the board of directors of a company needs no authorisation from the shareholders of the company to make a 'distribution' as defined. A board resolution suffices, unless the acquisition is pursuant to an existing legal obligation of the company, or a court order, in which case no board resolution is required (see s 46(1)*(a)* of the new Act).

It is questionable whether the shareholders should be excluded from the making of such a decision. Their interests are also at stake, and not just those of the creditors. As Cassim says with regard to buy-backs:

> 'A share repurchase entails a change in the ownership of the company's shares, and . . . may thus be used to change control of a company or, for that matter, to prevent a change of control; or it may be used to manipulate the market price of the company's shares. Share repurchases clearly have a . . . potential for unequal treatment of shareholders. In short, the share repurchase power may be abused and it may, unless safeguards are provided, enable one group of shareholders to obtain an unfair advantage over other shareholders. . . . It is not enough to protect creditors — shareholders and the investing public must also be protected. This is clearly acknowledged and recognised in the JSE Securities Exchange Listings Requirements on share repurchase.' (F H I Cassim 'The reform of company law and the capital maintenance concept' (2005) 122 *SALJ*

283 at 287–8. The Companies Bill, 2007 was equally questionable (see Jooste op cit at 714–15). In the previous Companies Act a special resolution was required (see s 85(1) of the Companies Act 61 of 1973).)

Not only does the new Act exclude shareholders from deciding on a buy-back, it also contains no provisions aimed at informing shareholders as to the merits or de-merits of an offer to acquire their shares. No circulars in a prescribed form, like those required by the current Act (see s 87 of the current Act), have to be sent to all shareholders when an offer for their shares is made (in the case of listed shares the Listing Rules of the JSE Securities Exchange SA would of course be applicable). No distinction is drawn in the new Act between general and selective offers (unlike s 87 of the current Act). No special safeguards have been enacted, aimed at the potential mischief inherent in selective offers. In relation to the provisions of the current Act, which are far more protective of shareholders than the new provisions, Cassim says ('The new statutory provisions on company share repurchases: A critical analysis (1999) 116 *SALJ* 760 at 776):

> 'The safeguards provided by our Companies Act are not only inadequate; they are clearly rudimentary, and require further thought and analysis. The provisions of the Act relating to selective share repurchases leave too much scope for mischief. Specific statutory safeguards must be provided to guard against the very real danger of abuse here. It is not a sufficient safeguard that at common law the directors have a fiduciary duty to act bona fide in the best interests of the company, or that it may not be a proper exercise of their powers for directors to repurchase shares of the company with the primary motive of perpetuating themselves in office.'

With regard to the authorisation of a buy-back, s 48(2)*(a)* provides:

> '(2) Subject to subsection (3) —
> (a) a company may acquire its own shares, if the decision to do so satisfied the requirements of section 46; . . .'

The reason for this provision is unclear. A buy-back is included in the definition of a distribution, and therefore the requirements of s 46 apply anyway. Section 48(2)*(a)* appears, as a result, to be superfluous. What muddies the waters further is that an acquisition of shares by a company in its holding company is also a distribution, and yet s 48(2)*(a)* is not applicable to such an acquisition.

Limit on 'treasury' shares

Section 48(2)*(b)*(i) places a limit on the number of shares that subsidiaries of a company may hold in the company. The limit is to curb the holding company's ability to traffic in its own shares indirectly through its subsidiaries. Section 48(2)*(b)*(i) provides:

> '[A]ny subsidiary of a company may acquire shares of that company, but —
> (i) not more than 10%, in aggregate, of the number of issued shares of any class of shares of a company may be held by, or for the benefit of, all of the subsidiaries of that company, taken together'.

There is uncertainty regarding this limit. Is the limit ten per cent of each class or ten per cent of the total shares, irrespective of class of share? For example, Company X has three classes of shares: A shares, B shares and C shares. One hundred of each have been issued. Is the maximum limit on the number of shares that subsidiaries of company X can acquire in company X: (i) ten A shares, ten B shares and ten C shares; or (ii) thirty shares, irrespective of their class? In terms of the current Act (s 89) the answer is the latter.

It is clear from s 48(2)*(b)*(i) that, in determining the number of shares held by subsidiaries in their holding company, shares acquired by the subsidiaries before they became subsidiaries of the holding company must be taken into account. The position is different in the current Act, where the view is taken that such shares do not have to be taken into account (see Blackman et al *Commentary* 5-98).

It appears that shares acquired by a subsidiary as a trustee or in a representative capacity must be taken into account in determining the percentage holding. This is anomalous. The same anomaly is to be found in s 89 of the current Act.

It also seems that shares acquired by subsidiaries in their holding company by way of a capitalisation issue must be taken into account in determining whether the ten per cent limit has been exceeded. This is also the position in the current Act. In order to remove any doubt, this should be stated expressly to be the position.

It should be noted that nowhere has it been explained how the limit of ten per cent was arrived at. In this regard one sees that in the initial draft Companies Amendment Bill preceding the Companies Amendment Act, the Co-ordinating Research Institute for Corporate Law originally proposed a general prohibition on a subsidiary acquiring its holding company's shares, except to a nominal extent of one per cent of the issued share capital of the holding company. The published proposed amendment, which was adopted in the current s 89, recommended a ten per cent limitation (GN 724 *GG* 18868 of 8 May 1998). This modification was not explained (see D Bhana 'The company law implications of conferring a power on a subsidiary to acquire shares of its holding company' (2006) 17 *Stellenbosch LR* 232 at 240).

Convertible or redeemable shares

With regard to the requirement (see s 48(3)*(b)*) that an acquisition by a company of its own shares or those in its holding company must not result in the company whose shares are acquired being left with only 'convertible or redeemable' shares, it is noteworthy that there is no specific definition of a 'convertible' or 'redeemable' share. It is presumed that the meaning of both must be derived from s 37(5)*(b)*, which provides:

> '(5) Subject to any other law, a company's Memorandum of Incorporation may establish, for any particular class of shares, preferences, rights, limitations or other terms that —
>
> . . .

(b) provide for shares of that class to be redeemable, subject to the requirements of sections 46 and 48, or convertible, as specified in the Memorandum of Incorporation —
  (i) at the option of the company, the shareholder, or another person at any time, or upon the occurrence of any specified contingency;
  (ii) for cash, indebtedness, securities, or other property;
  (iii) at prices and in amounts specified, or determined in accordance with a formula; or
  (iv) subject to any other terms set out in the company's Memorandum of Incorporation;'

It appears that the provisions of (i) to (iv) of s 37(5) of the new Act relate both to the redeemable and convertible shares in question and not only to redeemable shares, although the provisions do not seem to fit the concept of a convertible share. One does not normally think in terms of a convertible share being 'converted', for example, either into cash or at a price. The idea of a share being convertible envisages the conversion of the share into a share of a different class, or into a debenture. The wording in the preamble to (i) to (iv) does, however, seem unequivocally to apply to both redeemable and convertible shares.

The current Act (see s 85(9)) contains the same requirement as the one in s 48(3)*(b)* of the new Act, but does not define a convertible share. The 2007 Companies Bill also contained this requirement (see clause 51(4) of the Bill) but did define 'convertible shares'. Clause 1 provided that 'convertible shares' meant:

'(i) any non-voting shares in a company that —
  (i) are reasonably likely in future to become voting shares, or
  (ii) become voting shares if the holder of those shares so elects at some time after acquiring the shares; or
(j) options in voting shares in the company . . .'

The rationale for the requirement that a buy-back must not result in a company being left with only redeemable shares is presumably to prevent a situation arising where the company, as a result of a redemption of the redeemable shares, has no shares. The requirement that the company must not be left with convertible shares alone is not so easily fathomable. The definition of convertible shares in the 2007 Companies Bill indicated that perhaps the rationale was that a company should not be left without voting shares, although the definition of convertible shares in the Bill was not without its problems. (See Jooste op cit at 716–17: 'The rationale behind clause 51(4) of the Bill and s 85(9) of the current Act appears to be to prevent a situation arising where a company as a result of an acquisition is left with no shares or only non-voting shares. If this is the rationale, it is odd that only convertible non-voting shares are referred to in clause 51(4). It is possible that a company could have convertible voting shares, and thus on conversion the company could be left with only shares that are non-voting. An amendment is required.')

An absurdity relating to the requirement regarding convertible and redeemable shares is that it does not only apply where a company acquires its

own shares, but also where a company acquires shares in its holding company. Obviously when a company acquires shares in its holding company the acquiring company holds the shares like any other shareholder. These shares are not cancelled. So how can the holding company, as a result of the acquisition, be left with only redeemable or convertible shares? This is the type of problem that arises when different transactions are not governed by their own specific provisions. Buy-backs and the acquisition by a company of shares in its holding company should be dealt with in their own separate sections of the Act. A similar problem arose in the 2007 Companies Bill (see Jooste op cit at 726.) The problem does not present itself in the current Act.

The solvency and liquidity test

The requirement applicable to distributions that 'it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution' entails passing the solvency and liquidity test prescribed by s 4 of the new Act (see s 46(1)*(b)*). This part of the note highlights some of the shortfalls of the provisions embodying this requirement (for a detailed examination of this requirement see Kathleen van der Linde 'The solvency and liquidity approach in the Companies Act 2008' 2009 *TSAR* 224).

Section 4(1)*(a)* is confusing. It draws a distinction between two situations. The one is where a company is not a member of a group of companies, and the other where it is a member of a group of companies. In the former situation the 'solvency' test is satisfied if 'the assets of the company . . . equal or exceed the liabilities of the company'. In the latter situation the solvency test is satisfied if 'the aggregate assets of the company . . . equal or exceed . . . the aggregate liabilities of the company'. But this appears to be a distinction without a difference. Surely in the first situation the 'assets' and 'liabilities' of the company must mean its 'aggregate' assets and liabilities? The term 'aggregate' is superfluous.

The reference to membership of a 'group' of companies indicates that perhaps what was intended was to include the assets and liabilities of all the companies in the group. This, however, conflicts with the plain, ordinary meaning of the wording. Such interpretation could also result in an insolvent company passing the solvency test by relying on the assets of other companies in its group — clearly an undesirable result as far as creditors are concerned.

It is submitted that what needs to be done to reflect accurately what was probably intended is to amend s 4(1)*(a)*. The amendment should make it clear that if a company is in a group, it will only pass the solvency test if each individual company in the group passes the test. In this way creditors will be protected, which, of course, is the aim of the solvency (and liquidity) test.

It is worth remembering that there were four drafts of the Companies Bill before it was introduced to Parliament. In the first draft the solvency test was passed by a company if its assets exceeded liabilities. In the second draft it was passed if the 'consolidated' assets exceeded the 'consolidated' liabilities of the company. The wording in s 4(1)*(a)* of the new Act was introduced after the

fourth Bill was introduced to Parliament. It is not clear why 'consolidated' was replaced, nor what 'consolidated' in fact meant — perhaps it had an accounting connotation and for that reason was deemed inappropriate.

One should not forget that schemes aimed at circumventing the solvency test could be set aside by the court on application by the Companies and Intellectual Property Commission or the Takeover Regulation Panel (s 6(1) of the Act). It is hoped, however, that suitable amendments to s 4(1)*(a)* will be made so as to avoid having to resort to such a time-wasting and resource-consuming procedure, the outcome of which is uncertain. It must also to be noted that the application to court cannot be made directly by a creditor, but must go through the Commission or the Panel.

The solvency and liquidity test is met if 'it reasonably appears that the company will satisfy the solvency and liquidity test' (s 46(1)*(b)*) and the board has acknowledged that 'it has applied the solvency and liquidity test' and 'has . . . reasonably concluded that the company will satisfy the solvency and liquidity test' (s 46(1)*(c)*). In regard to this wording two issues arise:

First, is the solvency and liquidity of the company a purely objective test (ie would a hypothetical reasonable board have been satisfied with the solvency and liquidity of the company?) or is the test both objective and subjective (ie would the particular board in question, taking into account the knowledge, skill and experience of that board, have been reasonably satisfied with the solvency and liquidity of the company?). The subjective/objective test would take into account the knowledge, skill and experience in reasonably concluding that the company will satisfy the solvency and liquidity test. The objective test, on the other hand, would disregard these subjective factors. An analogy can perhaps be drawn with the test as to whether a director has acted with due care and diligence in a particular respect. In this regard, s 76(3)*(c)*(ii) provides that a director

> 'must exercise the powers and perform the functions of director —
>
> . . .
>
> (c) with the degree of care, skill and diligence that may reasonably be expected of a person —
>
> (i) carrying out the same functions in relation to the company as those carried out by that director; and
>
> (ii) having the general knowledge, skill and experience of that director'.

This is a subjective/objective test. It is submitted that the test in so far as the solvency and liquidity requirements is concerned is purely objective. If the legislature intended that the subjective factors mentioned above should be taken into account, it should have said so. (The test in the current Act was purely objective: see s 85(4).)

A second point to note regarding the solvency and liquidity test in the context of distributions is that the test appears to be different in s 44 (which deals, inter alia, with a company assisting in the acquisition of its shares), and s 45 (which deals, inter alia, with a company giving loans or financial assistance to its directors). In both instances the transaction must meet certain requirements, one of which is that 'the board is satisfied' that 'the company

would be in compliance with the solvency and liquidity test' (see s 44(3)*(b)*(i) and s 45(3)*(b)*(ii)). Here it could be argued that the wording 'the board is satisfied' is purely subjective. As long as the board is satisfied, no matter how unreasonable that satisfaction may be, the requirement is met. (The board must, in satisfying itself, of course, comply with the requirements of s 4(2) which do contain an element of 'reasonableness'. See in this regard the word 'fair' in s 4(2)*(b)*(i) and the word 'reasonable' in s 4(2)*(b)*(ii).) If this is so, it is difficult to rationalise why the test in s 44 and s 45 should be different to the one applicable to distributions. One would expect consistency in this regard.

A clouded issue in the current Act (and also the 2007 Companies Bill) is whether contingent assets and liabilities are to be taken into account when applying the solvency test. The clarification in s 4(2)*(b)* in the new Act that they are to be taken into account is welcomed. Contingent assets and liabilities have to be taken into account in the current Act when applying the solvency and liquidity test for the purposes of s 38 of that Act (s 38 deals with the prohibition on the provision of financial assistance by a company for the acquisition of its shares or the shares of its holding company). There is thus an element of uncertainty in this regard in the current Act which fortunately does not present itself in the new Act. Section 4(2)*(b)* does require contingent assets and liabilities to be taken into account for the purposes of both the solvency and the liquidity test. It thus appears that the term 'liabilities' used in the solvency test (s 4(1)*(a)*), and the term 'debts' (s 4(1)*(b)*) used in the liquidity test (s 4(1)*(b*) are used inter-changeably.

Subject to what is said below, preference shareholders are left out in the cold in the new Act when applying the solvency and liquidity test on a distribution. Any amounts that would be required if the company were to be liquidated at the time of the distribution to satisfy the preferential rights upon liquidation of preference shareholders, are expressly excluded (unless the memorandum of incorporation provides otherwise) in the determination of the company's liabilities (see s 4(2)*(c)* of the Act). The current Act is silent in this regard (see Blackman et al *Commentary* 5-70 and 5-128).

The new Act does not make reference to fixed preferential returns on shares ranking ahead of those in respect of which a distribution is made. It only deals with the preferential rights on liquidation. There is accordingly some uncertainty as to whether such returns should be taken into account. It is interesting to note that the preferential rights of preference shareholders are taken into account in the New Zealand Companies Act, 1993, which provides in s 52(4):

'(4) In applying the solvency test . . . —

(a) Debts includes fixed preferential returns on shares ranking ahead of those in respect of which a distribution is made (except where that fixed preferential return is expressed in the constitution as being subject to the power of the directors to make distributions), but does not include debts arising by reason of the authorisation; and

(b) Liabilities includes the amount that would be required, if the company were to be removed from the New Zealand register after the distribution,

> to repay all fixed preferential amounts payable by the company to shareholders, at that time, or on earlier redemption (except where such fixed preferential amounts are expressed in the constitution as being subject to the power of directors to make distributions); but, subject to paragraph (a) of this subsection, does not include dividends payable in the future.'

In South Africa, the preferential rights of preference shareholders are only disregarded for the purposes of part *(a)* of the definition of 'distribution' in s 1 of the new Act (s 4*(c)* refers only to part *(a)* of the definition of 'distribution'). If the distribution takes the form of a debt being incurred, or an obligation or forgiveness or waiver referred to in parts *(b)* and *(c)* of the definition, then it appears that the preferential rights of preference shareholders must be taken into account in determining the liabilities of the company. There appears to be no justification for this distinction.

The general rule is that the solvency and liquidity test must be satisfied 'immediately after completing the proposed distribution' (s 46(1)*(b)*). An exception to the rule is the case where the distribution 'takes the form of the incurrence of a debt or other obligation by the company, as contemplated in paragraph (b) of the definition of "distribution" set out in section 1' (s 46(4)). In such cases it appears that the solvency and liquidity test must be satisfied 'at the time that the board resolves that the company may incur that debt or obligation; and . . . [does] not apply to any subsequent action of the company in satisfaction of that debt or obligation, except to the extent that the resolution, or the terms and conditions of the debt or obligation, provide otherwise' (s 46(4)). It is not clear why this distinction is drawn. Surely the solvency and liquidity test should be satisfied after the debt has been incurred? Also, if an exception is to be made in respect of a distribution in the form of a debt being incurred, why is an exception not also made in respect of forgiveness or waiver of a debt (see part *(c)* of the definition of 'distribution')? Presumably the general rule (s 46(1)*(a)*) applies to such forgiveness or waiver, and quite rightly so; namely, that the solvency and liquidity test must be satisfied after the forgiveness or waiver has taken place (and not at the time when the board resolves to forgive or waive the debt).

Inability to meet an agreement

Section 48(4) provides that '[a]n agreement with a company providing for the acquisition by the company of shares issued by it is enforceable against the company, subject to subsection (2) and (3)'. Where the company alleges that it cannot comply with such an agreement as a result of the operation of s 48(2) or (3), s 48(5) prescribes the course to be followed by the company. A problem in this regard is that s 48(4) and s 48(5) apply only to buy-backs. They do not apply to an agreement for the acquisition by a company of shares in its holding company. The rationale for this distinction is not clear. Although such an acquisition and a buy-back have different implications, one would have expected subsecs 48(4) and (5) to apply to both these forms of agreement, and where the company's inability to meet its obligations is

due to the insolvency or illiquidity of the company. As subsecs 48(4) and (5) are only applicable to buy-backs, to avoid confusion they should refer more specifically to s 48(2)*(a)* and not to s 48(2), because the limit in s 48(2)*(b)* has no application to a buy-back.

Effect of contravention on distribution

(a) Reversing the distribution

If a company acquires shares in itself or in its holding company in contravention of the requirements of the new Act, the new Act does not expressly state that the acquisition is void or not void. Section 48(6) implies that it is voidable — this is implied by the fact that s 48(6) enables the company to apply to court to reverse the acquisition. (It is to be noted that in terms of s 218(1) it is not void unless a court declares it to be void. Section 218(1) provides: 'Nothing in this Act renders void an agreement, resolution or provision of an agreement, resolution, Memorandum of Incorporation or rules of a company that is prohibited, void, voidable or may be declared unlawful in terms of this Act, unless a court declares that agreement, resolution or provision to be void.') It is not clear why an unlawful distribution is not expressly stated to be void. This is the case with a contravention of s 44 (financial assistance for the acquisition of securities; see s 44(5)) and s 45 (financial assistance to directors et al; see s 45(6).) One would expect unlawfulness in all three cases to have the same result.

Where the court orders a reversal of the acquisition, the court may then order (s 48(6))

> '(a) the person from whom the shares were acquired to return the amount paid by the company; and
> (b) the company to issue to that person an equivalent number of shares of the same class as those acquired'.

The manner in which s 48(6) is worded indicates that both *(a)* and *(b)* apply not only where a company acquires shares in itself, but also where a company acquires shares in its holding company. It is absurd to make *(b)* applicable to such an acquisition. It means that in a situation where subsidiary A acquires shares in its holding company B from X, the court can set the acquisition aside and order: (1) X to return the amount paid by A (s 48(6)*(a)*); and (2) A to issue to X an equivalent number of B shares of the same class as those acquired (s 48(6)*(b)*). It is impossible for A to comply with (2). If s 48(6) is to be interpreted to mean that only s 48(6)*(a)* applies where a company acquires shares in its holding company, then one would expect there to be, in addition, a provision to the effect that the court may order the acquiring company to return the shares acquired to the seller thereof. There is, of course, no such provision. It is true that 'reversing the acquisition' as provided for by s 48(6) arguably implies that the court may order the acquiring company to return the shares to the seller, but then why is s 48(6)*(a)* necessary? The return of the amount paid is also implied in a 'reversal'. It is also not possible to argue that s 48(6) only applies where a

company acquires shares in itself, because the wording at the beginning of s 48(6), namely, '[i]f a company acquires any shares contrary to section 46, or this section', clearly refers to both an acquisition by a company of its own shares and to an acquisition by a company of shares in its holding company. It is submitted that an amendment is necessary which clearly differentiates between the two different forms of acquisition.

It will be recognised that s 48(6) has no application to a distribution by a company to shareholders of the company constituting a dividend (out of profit or otherwise). There is also no provision in s 46 similar to s 48(6) that enables a court to order the return of the dividend to the company. Section 46 does not expressly provide that if a company makes such a distribution in contravention of s 46, the distribution is void. In contrast to s 46, s 90 of the current Act expressly provides that a shareholder is liable to the company for any dividend received contrary to s 90. It is submitted that s 46 should be amended so as to deal with the voidness aspect of a contravening dividend and to provide for the recovery of the dividend from the recipient shareholder. One can see no rationale for omitting such vital provisions.

If a company acquires its own shares or shares in its holding company contrary to s 46, it is the company that is given the right to apply to court in terms of s 48(6). Section 48(6) does not give such right to a shareholder or creditor of the company. By contrast, s 86(3), read with s 89 of the current Act, gives both shareholders and creditors the right to apply to court for repayment of the amount paid for the acquisition. It may of course be possible for a shareholder or a creditor to bring a derivative action to secure repayment, but then the procedure laid down by s 165 will have to be followed.

The question arises whether the person to whom a distribution has been made in contravention of s 46 or s 48 is provided with any protection by the new Act. Can such person prevent a reversal of the transaction? In this regard s 20(7) and s 20(8) are relevant. They provide:

> '(7) A person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.
>
> (8) Subsection (7) must be construed concurrently with, and not in substitution for, any relevant common law principle relating to the presumed validity of the actions of a company in the exercise of its powers.'

It will be recognised that s 20(7) does not apply where the recipient of the distribution is a shareholder. Accordingly, where the distribution takes the form of a dividend, or the acquisition by a company of its own shares, s 20(7) has no application. So a shareholder is not entitled to presume that all the formal and procedural requirements have been complied with. If, however, the distribution is one arising from the acquisition by a company of shares in

its holding company, s 20(7) could have application provided the recipient is not a director, prescribed officer or shareholder of the acquiring company.

If s 20(7) does have application, it presumably means that the recipient can prevent the company from having the transaction reversed on the ground that the formal and procedural requirements have not been complied with. Section 20(7) does not state this expressly, but it appears to be implied. Clarity is required.

Section 20(7) appears to be an attempt at a statutory '*Turquand* rule'. (The so-called common law '*Turquand* rule' arose from *Royal Bank v Turquand* (1885) SE & B 248; affd (1856) 6E & B 327; [1843–60] All ER Rep 435 and was generally that a person transacting in good faith with a company could assume that the internal requirements of the company had been complied with and so prevent the company from setting aside the transaction on the basis of the non-compliance. In *Farren v SunService SA Photo Trip Management (Pty) Ltd* 2004 (2) SA 146 (C) it was decided that the *Turquand* rule did not apply to an internal requirement laid down by statute.)

It is by no means clear which common law principles s 20(8) encompasses. The legislature may have had estoppel in mind, although it is doubtful whether estoppel has any application where a misrepresentation is made that a statutory requirement has been complied with (see *Farren*'s case (supra)). Also, if estoppel could apply, why would it be necessary to prove estoppel when it is far easier to use s 20(7)? The legislature may have been referring to the common law *Turquand* rule, but it is not clear if the common law rule differs from the statutory rule. These are issues which require deeper examination and are beyond the scope of this note.

(b) Liability of directors

If a distribution is made contrary to s 46 or s 48, s 46(6) and s 48(7) impose liability on any director who was present at the meeting when the board approved the resolution or agreement, or, where no formal board meeting was held, participated in the making of such a decision by way of a 'round robin' resolution. The liability arises if the director failed to vote against the resolution, despite *knowing* that the provision of financial assistance was inconsistent with s 46 or s 48. Liability accordingly hinges on a subjective enquiry into the director's knowledge at the relevant time.

The liability of directors for breach of s 46 or s 48 is liability for any loss, damages or costs sustained by the company as a direct or indirect consequence of the voidness of the resolution or agreement (s 77(3)*(e)*(vi) and (vii)). Section 77(3)*(e)*(vii) refers to an 'acquisition' that 'was contrary to section 46 or section 48'. A criticism of this wording is that the reference to section 46 is inappropriate, because s 46 deals only with 'distributions'. A transfer of the consideration pursuant to an acquisition is a 'distribution' (see definition of 'distribution' above) but not the acquisition itself. Section 77(3)*(e)*(vii) should only refer to s 48. It is to be noted that for the purposes of s 77 'director' includes an alternate director, a prescribed officer, and a person who is a member of a committee of a board of a company or of the audit committee of a company (s 77(1)).

If the board of a company has made a decision contrary to s 46 or s 48 the company, or any director who has been or may be held liable, may apply to a court for an order setting aside the decision (s 77(5)*(a)*). The court may make an order setting aside the decision in whole or in part, absolutely or conditionally, and any further order that is just and equitable in the circumstances, including an order:

- to rectify the decision, reverse any transaction, or restore any consideration paid or benefit received by any person in terms of the decision of the board (s 77(5)*(ab)*(ii)*(bb)*; and
- requiring the company to indemnify any director who has been or may be held liable in terms of this section, including indemnification for the costs of the proceedings under this subsection (s 77(5)*(b)*(ii)*(bb)*.

The rationale for the order in the last bullet is difficult to comprehend. As has been seen above, a prerequisite for liability is *knowledge* on the part of the director at the time of voting on the resolution that the distribution was inconsistent with s 46 or s 48. Why should a director be indemnified when he or she knew of such inconsistency and yet failed to vote against the resolution?

Section 77(9) provides no relief in the context of s 46 or s 48. Section 77(9) provides:

> '(9) In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that —
> (a) the director is or may be liable, but has acted honestly and reasonably; or
> (b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.'

A director appears to be disqualified from this relief on two counts. First, if he or she knew of the inconsistency and yet failed to vote against the resolution, how can such conduct be honest and reasonable? Secondly, if the director has such knowledge at the time that the resolution is voted on, is there not ipso facto 'wilful misconduct or wilful breach of trust'? Regarding s 77(9)*(b)*, it is by no means clear what 'circumstances of the case, including those connected with the appointment of the director' justify excusing such director from liability.

Similar misgivings arise in relation to the reference to s 77(9) in s 77(10). Section 77(10) provides:

> '(10) A director who has reason to apprehend that a claim may be made alleging that the director is liable, other than for wilful misconduct or wilful breach of trust, may apply to a court for relief, and the court may grant relief to the director on the same grounds as if the matter had come before the court in terms of subsection (9).'

The above analysis of the liability provisions with their indemnification and relief provisions leaves one wondering whether there is a serious attempt

to impose liability. The directors' lobby has obviously been hard at work. This clearly does not bode well for good corporate governance.

The proceedings to recover any loss, damages or costs 'may not be commenced more than three years after the act or omission that gave rise to the liability' (s 77(7)). The same problem arises in relation to liability for a breach of s 44 (financial assistance for the acquisition of shares). The wording in s 77(7) is different from the wording in s 12 of the Prescription Act 68 of 1969, which states that the three-year prescription period for extinction of a debt shall begin to run as soon as the debt is due and that a debt shall not be deemed to be due until the creditor has knowledge of the identity of the debtor and of the facts from which the debt arises. The commencement dates of the three-year period in these two pieces of legislation may be different, and it is not clear which would prevail in the event of such a conflict.

A further problem arises in connection with the commencement date of the prescription period in s 77(7). The problem arises because of the provisions of s 218(1) of the new Act. Section 218(1) provides:

> 'Nothing in this Act renders void an agreement, resolution or provision of an agreement, resolution, Memorandum of Incorporation or rules of a company that is prohibited, void, voidable or may be declared unlawful in terms of this Act, unless a court declares that agreement, resolution or provision to be void.'

It appears from s 218(1) that the directors' liability only arises once the relevant resolution has been declared void, yet the three-year prescription period runs from the date of the act or omission that gave rise to the liability. Is one to understand from this that the taking of a prohibited resolution marks the beginning of the three-year period, but that the liability attached to that transgression only arises once the court has declared the resolution void — ie possibly three years or more (depending on the length of the case) after the act occurred? How does this interact with the potential common law liability based on the directors' duties of care and skill in a prohibited act of this nature — does liability arise at the time of the act (as one would expect, and as seems to be the case in terms of s 77(2)*(a)*), which would mean that this occurs at a different point in time than the statutory liability? Does common law liability still exist in this context, irrespective of whether the act which gives rise to such liability is ultimately declared void in terms of s 218(1) or is not so declared? Finally, it would seem that the simplest way for a director to avoid liability in terms of this section would be not to attend the meeting or participate in the making of the decision at all if he is uncertain whether the requirements of s 45 will be complied with, or if he would prefer not to vote against a particular resolution for political reasons. If the decision is not taken at a formal meeting but by way of a round robin resolution and a director refrains from voting, it appears from s 45(7)*(a)* that the director will not incur liability. A counter to this may be that by being presented with the round robin resolution the director has 'participated in the making of such a decision' as specified in s 45(7)*(a)*.

Unlike the current Act, the new Act does not provide creditors with a specific remedy in circumstances in which a company acquires its own shares

or shares in its holding company in contravention of the Act. Section 86(3) of the current Act gives creditors of the company the right to apply to court for a reversal of the acquisition and restitution, or any such order as the court deems fit. It is submitted that the new Act should provide such a direct remedy and not confine creditors to a derivative action in terms of s 165.

CONCLUSION

An examination of the provisions of the new Act governing 'distributions' and 'acquisitions' exposes serious flaws in the legislation. Omissions, loopholes and anomalies abound. Protection of creditors by the solvency and liquidity requirement is limited due to defects in the requirement. Shareholders have been left out in the cold by having no direct input into the important decision-making involved, and the similarity between preference shareholders and creditors has been ignored. Directors have been given absolute powers, and whether there is commensurate liability on their part for transgressions is questionable. It appears that a company's memorandum of incorporation can play no part in limiting their powers. The precise status of an irregular distribution is unclear, as is the statutory '*Turquand*' rule.

The structure of the new Act is messy and confusing when one considers the important matters that it is supposed to regulate. One should not need to jump from one part of a statute to another to the extent that is required. The effect on the shares when a company acquires its own shares should be dealt with under the provisions dealing with such acquisitions, not in a different part of the Act. The effect is dealt with in s 35 and the other provisions in s 46 and s 48. The same goes for the provisions governing the liability of directors in situations where either an acquisition by a company of its own shares or shares in its holding company, or a distribution, is made contrary to the new Act. The liability provisions are dealt with in s 77 and the other provisions in s 46 and s 48. Considerations applicable to acquisitions are different from those applying to dividends, and should be kept apart. Similarly, the considerations applicable to the acquisition by a company of its own shares are different from those that are applicable to the acquisition by a company of shares in its holding company, as is the case where a company acquires shares in another company in its group which is not its holding company. Some of the considerations may be the same, but there are also significant differences. Confusion creeps in when these acquisitions are dealt with together.