INCOMPLETE COMPANY LAW REFORM: THE TREASURY SHARES QUESTION IN SOUTH AFRICA

by

RUTH DINAH GONDWE

GNDRUT002

Supervisor:

JACQUELINE YEATS

Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the degree of Master of Laws in Commercial Law in approved courses and a minor dissertation.

February 2015

DECLARATION

I do hereby declare that I have read and understood the regulations governing submission of a Master of Laws dissertation, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

________________________ ________________________

Ruth Dinah Gondwe **27th February, 2015**

DEDICATION

For My Dad. It has been a long road. Thank you for standing firmly alongside me.

ABSTRACT

One of the paradoxes in company law is the phenomenon of treasury shares. Their complex nature coupled with the risks attached to their use has rendered them problematic and unnecessary in modern company law.

Refuting arguments stated against the use of treasury shares, this paper aims to build a case for the introduction of treasury shares into South African company law. In order to achieve this, the paper will firstly examine the nature and complexity of treasury shares. Thereafter, it will discuss their importance in modern company law by highlighting their commercial value. A study of their incorporation into a few jurisdictions will also be discussed in an attempt to propose a manner in which South Africa can introduce treasury shares into its law.

It is a suggestion of this contribution that the recent company law reform was a missed opportunity to adopt treasury shares. The adoption of treasury shares would have been an indication of a complete breakup from traditional straitjacket concept of capital maintenance. However, as they were not adopted when the new Companies Act 71 of 2008 this paper will propose, in conclusion, that treasury shares ought to be adopted.

ACKNOWLEDGEMENTS

To God, for His marvellous help. To my Pastor, Joel R. Gondwe, for his spiritual guidance and financial help. To my mother, for being an emotional pillar and a great cheerleader of my work. To my older brothers, for the days they unknowingly encouraged me to dream bigger. To my Cape Town church family, for giving me a home to thrive in as a foreign student. To my editorial team, for the constructive criticism and comments. To my supervisor, Jacqueline Yeats, for her attitude, guidance and encouragement. To the Commercial Law Department, for this wonderful opportunity to pursue my master's programme at UCT.

TABLE OF CONTENTS

DECLARATION ii

DEDICATION iii

ABSTRACT iv

ACKNOWLEDGEMENTS v

TABLE OF CONTENTS vi

LIST OF ABBREVIATIONS xi

CHAPTER ONE: INTRODUCTION 1

1.1. BACKGROUND TO TREASURY SHARES IN MODERN COMPANY LAW 1

1.1.1. Repurchases 1

1.1.2. Repurchases and the Introduction of Treasury Shares 3

1.2. TREASURY SHARES IN MORDERN COMPANY LAW 5

1.3. THE GAP FOR TREASURY SHARES IN THE COMPANIES ACT 2008 6

1.4. PROBLEM STATEMENT 9

1.5. RESEARCH LAYOUT 10

CHAPTER TWO: THE LEGAL NATURE OF TREASURY SHARES 14

2.1. INTRODUCTION 14

2.2. THE PECULIARITY OF TREASURY SHARES 15

2.2.1. Nature of Shares 15

2.2.1.1. Rights Attached to Shares (Rights given to Shareholders) 18

2.2.1.1.1. Right to Participate in Net Assets on Winding up of the Company 18

2.2.1.1.2. Voting Rights......19

2.2.1.1.3. The Preemptive Right of Shareholders......21

2.2.1.1.4. Dividend Rights......23

2.2.1.1.5. Right to Resale and Reissue......24

2.2.1.1.6. The Company's Right to Hold Shares......25

2.3. CONCLUSION......27

CHAPTER THREE: COMPLEXITIES OF TREASURY SHARES......29

3.1. INTRODUCTION......29

3.2. ACCOUNTING PRACTICES......30

3.3. TAXATION ON TREASURY SHARES......35

3.4. CLARIFYING TREASURY SHARE COMPLEXITIES......36

3.4.1. Accounting Alterations......37

3.4.2. Tax Alterations......38

3.5. CONCLUSION......39

CHAPTER FOUR: THE COMMERCIAL VALUE OF TREASURY SHARES 41

4.1. INTRODUCTION......41

4.2. BENEFITS OF USING TREASURY SHARES......42

4.2.1. Flexibility......42

4.2.1.1. Management of Capital Structure......42

4.2.1.2. Raising Funds......43

4.2.1.3. Disposing of shares without the restrictions applicable to issues of new shares......44

4.2.2. Management of Employee Share Schemes 45

4.2.3. Investment in Companies' Own Shares 46

4.2.4. Encourages Repurchases 47

4.2.5. Safeguard against Hostile Take Overs 47

4.2.6. Tax Benefits 48

4.3. CONCLUSION 48

CHAPTER FIVE: THE DANGERS OF TREASURY SHARES 51

5.1. INTRODUCTION 51

5.2. ABUSES OF TREASURY SHARES 52

5.2.1. Treasury Shares and Immorality (Abuse by Directors) 52

5.2.2. Stock Watering 54

5.2.3. Market Manipulation 55

5.2.4. Circumvention of Preemptive Rights 57

5.2.5. Insider dealing 57

5.3. SAFEGUARDS AGAINST ABUSE 58

5.3.1. Restrictions on the Company and Directors 58

5.3.2. Safeguards against Market Manipulation 59

5.3.3. Safeguards against Circumvention of Preemptive Rights 60

5.4. CONCLUSION 61

CHAPTER SIX: TREASURY SHARES FOR SOUTH AFRICA 63

6.1. INTRODUCTION 63

6.2. THE CURRENT STATUS OF TREASURY SHARES IN SOUTH AFRICA 64

6.3. REASONS AGAINST ADOPTION OF TREASURY SHARES IN SOUTH AFRICA 68

6.3.1. Lack of International Precedent 68

6.3.2. Key participants in the South African company law reform process 68

6.3.3. Precaution 69

6.4. LESSONS FROM INTERNATIONAL PRECEDENT 70

6.4.1. Malaysia 70

6.4.2. Singapore 71

6.4.3. The European Union 72

6.4.4. The United Kingdom 73

6.5. CONCLUSION 75

CHAPTER SEVEN: CONCLUSION 78

7.1. SUMMARY 78

7.2. RECCOMENDATIONS: THE WAY FORWARD 85

7.3. CONCLUSION 88

CHAPTER EIGHT BIBLIOGRAPHY 90

8.1. BIBLIOGRAPHY 90

8.1.1. Primary Sources 90

8.1.2. Cases 90

8.1.3. Legislation 91

8.2. Secondary Sources 92
8.2.1. Books 92
8.2.2. Journals 92
8.2.3. Internet Sources 97
8.2.4. Department of Trade and Industry Papers 98
8.2.5. Thesis 98

LIST OF ABBREVIATIONS

ASB	Accounting Standards Board
dti	Department of Trade and Industry
FSA	Financial Services Authority
JSE	Joint Stock Exchange
LSE	London Stock Exchange
MoI	Memorandum of Incorporation
TRB	Tax Revenue Board

CHAPTER ONE: INTRODUCTION

1.1. BACKGROUND TO TREASURY SHARES IN MODERN COMPANY LAW

1.1.1. Repurchases

At the most rudimentary level, treasury shares are issued shares of a company that have been reacquired by the company whether by way of purchase, redemption, forfeiture, donation or otherwise, and which the company, instead of having to cancel upon reacquisition, is allowed to reissue, or resell, for what they will sell on the market.[1]

Before the amendment to the Companies Act 61 of 1973 (the old Act) by the Companies Amendment Act 37 of 1999, a company could neither hold nor acquire its own shares even if permitted to do so by its Memorandum of Association or Articles of Association.[2] The leading case of *Trevor v. Whitworth*[3] had established as the law of England the rule that a company could not properly go into the market and purchase its own shares.[4] If it bought them for resale, it would be trafficking in shares rather than engaging in the business for which it was meant. On the other hand, if it purchased them for retirement, it would be unlawfully decreasing capital without the court approval required by law.[5]

In contrast, the United States of America (United States) allowed repurchases in the majority of states. The Georgia case of *Hartridge v Rockwell*[6] decided that repurchases of shares, while subject to risks[7] had

---

[1]Hand J in *Borg v International Silver Co 11* Fed (1925) (2d) 147; *Pullman v Railway Equipment* (1897) Co 73 111 App 313. See also FHI Cassim 'The repurchase by a company of its own shares: the concept of treasury shares' (2003) 120(1) *SALJ* 136 at 137.
[2]FHI Cassim et al *Contemporary Company Law* 2 ed(2012) 294. See also FHI Cassim 'The New Statutory Provisions on Company Share Repurchases: A Critical Analysis' (1999) 116 *SALJ* 760.
[3](1887) 12 App Cas 409 (HL).
[4]This rule was also adopted in South Africa.
[5]CL Israel 'Corporate Purchase of Its Own Shares Are There New Overtones' (1964-1965) 50 *Cornell LQ* 620.
[6](1828) RM Charlt (Ga.) 260.

numerous advantages. For instance, they could be used positively to facilitate pension and compensation plans for employees. Repurchases could also increase earnings per share by reducing the outstanding shares of the company and establish a market for the company's shares.[8]

As a result of the advantages of these uses, there arose an increasing movement in the world stock market towards implementing or liberalising share repurchases activities.[9] Consequently, the United Kingdom altered its law to incorporate repurchases and so did several other jurisdictions including South Africa in the Amendment of 1999. [10]

---

[7]Repurchases can potentially have an impact on corporate governance, take-over regulation, creditor protection, and discrimination between shareholders, oppression of minorities and the proper functioning of the securities market. They are a distribution of the company's assets, a restructuring of the issued share capital (and accordingly a change in ownership) and a transfer of shares. Therefore, they invite all the abuses associated with each of these three functions. Repurchases can easily be manipulated, sanctioning managing directors to buy back shares from inquisitive or troubling critics. Consequently, it proved problematic to find a legitimate purpose for which a company should be allowed to reacquire its own shares. See Dugan 'Repurchase of Own Shares for New Zealand' (1987)17 *Univ of Victoria Wellington LR*179 180. See also MS Blackman et al *Commentary on the Companies Act* Vol 1 (Original Service 2002) 5-45. See also FHI Cassim et al op cit (n2) 296.

[8]Other uses include the use of repurchases as a substitute for dividends which may have a positive effect on the stock market prices of the company; to adjust owners' equity and capital structure; to take over defensive steps by reducing the public floating shares; to gain tax advantages; to meet merger needs and as a financial instrument, in order to sustain the stock market price in case of market crisis produced by adverse information and overreaction. See NR Sabri 'Using treasury "repurchase" shares to stabilize stock markets' (2003) 8(4) *International Journal of Business* 426.

[9]Canada, the United Kingdom, Australia and New Zealand had adopted this change earlier. See also NR Sabri *A Treasury 'Repurchase' Share as a Stabilizing Instrument in the World Stock Markets* (2001) Working Paper 1.

[10]This change has been maintained in the Companies Act 2008. Repurchases have been especially useful in South Africa since its reentry into the global market. They have allowed companies to reacquire and cancel their own issued shares to prevent a reduction of the value of a company's shares by indiscriminate undertakings taking place on the international stock market. In addition, having this tool also afforded protection to creditors whilst at the same time gave flexibility to companies to achieve sound commercial objectives. See Company Law Reform and Restatement Report No 9, Wellington, 1989. See also New Zealand Companies Act 105 of 1993, ss 58-67C.

1.1.2. Repurchases and the Introduction of Treasury Shares

The United States however, did not only pioneer the use of repurchases. It extended the concept of repurchases to treasury shares resulting in the ability of a company not only to acquire its own share but to hold them once acquired. The law regarding treasury shares was embodied in a number of pre-1979 Model Business Corporation Acts.[11]

However, from the time of their conception, it became clear that treasury shares would be controversial because it proved challenging to reach a definite conclusion or set of conclusions regarding their legal nature. This controversy was first attributed to a characteristic of their youth; that neither their precise legal status nor definitive concepts could be attached to them and it was expected that a gamut of legal wisdom would be investigated before a series of forceful precedents could be recognised by which to fix their status.[12] However, the progression of time only birthed more problems in company law, accounting and finance.

They were *sui generis;*[13] they could not be correctly described as unissued shares, issued shares, cancelled shares, outstanding shares, assets, or non-assets. They were an anomaly, treated as assets for one purpose, but not assets for another. They were treated as existing for one purpose, but non- existent for another. They appeared, reappeared and disappeared; they had a fluidity which is uncommon in company law, where certainty, precision and assuredness are the keynotes.[14]

---

[11]FHI Cassim op cit (n1) 140. Even though treasury shares in the United States have now been consigned to legal history books, the lessons drawn from the experience their of treasury shares remain of value, especially to those jurisdictions which already have, or are proposing to introduce, treasury shares.
[12]Ibid.
[13]Ibid 139. See also HW Ballantine (1946) 'The curious fiction of treasury shares' 4 *California LR* 536.
[14]H Kottler 'Treasury Stock; A Corporate Anomaly' 1 *Clev. Marshall L. Rev* 9 at 22.

Consequently, the United States abandoned treasury shares stating that they are unduly complex, confusing and misleading.[15] Major changes were made to the financial provisions of the Model Business Corporation Act 1969.[16] Section 6.31 (a) and (b) of the Revised Model Business Corporation Act (1984) stated that if a company bought back its own shares, they constituted authorised but unissued shares unless the articles prohibited reissue, in which event the reacquired shares must be cancelled and the number of authorised shares be reduced by the number of shares bought back.[17] This section in effect, eliminated treasury shares since reacquired shares reverted back to the status of authorised but unissued shares whereas previously, treasury shares were authorised and issued shares, reacquired and held by the company.[18]

In South Africa, Section 35(5)(a) of the Companies Act 2008 provides that shares of a company that have been issued and subsequently acquired by that company have the same status as shares that have been authorised but not issued. In other words, they are cancelled as issued shares, and restored to the status of authorised shares.[19] Restoring them to the status of authorised shares upon reacquisition makes them incapable of being treasury shares because they cease to be issued shares. This provision

---

[15]FHI Cassim 'The Challenge of Treasury Shares: corporate formation and corporate finance: part I' (2010) *Acta Juridica: Modern company law for a competitive South African economy*151 at 153.

[16] See RW Hamilton & RA Booth *Corporation Finance, Cases and Materials* (1984) 55.

[17] R Garrett 'Treasury shares under the Model Business Corporation Act' (1960) 15 *Bus Law* 916 at 917. See also FHI Cassim op cit (n1) 140.

[18]Ibid 143.Several other countries like Australia, Canada, New Zealand and until recently England, also require repurchased shares to be cancelled on their repurchase.

[19] The wording of the New Companies Act 2008 differs with the wording on repurchased shares in the previous Act. Section 85(8) of the old Act provided that shares issued by a company and acquired under this section shall be cancelled as issued shares and restored to the status of authorised shares forthwith. This implies that to be restored to the status of authorised shares, there must have been a cancellation of the issued shares. The wording in the Acts may therefore be different but the result is the same.

therefore effectively prohibits the use of treasury shares in South African company law.[20]

1.2. TREASURY SHARES IN MORDERN COMPANY LAW

However, it is unduly narrow, rigid and restrictive to prohibit a company from holding its own shares in treasury even in a case where this may have been done in good faith, and there is no fraud on the creditors.[21] In countries where they have been allowed, treasury shares have proven to be useful for the company.

They can be used as a source of ready cash and to some extent, to affect the trends of stock prices.[22] More undeniable distinct advantages of treasury shares that have become apparent are, affording flexibility to companies in managing their capital structure, raising funds and cost effectively disposing of shares. Moreover, they can facilitate the management of employee share schemes, permit investments in the company's own shares and encourage repurchases.[23]

In view of this, during the last decade, share repurchases have once again, seen further extension on world stock market towards treasury shares. In several jurisdictions, companies are permitted to hold repurchased shares for limited or unlimited time for future uses or resale.[24] Treasury shares are currently permitted in Singapore, Malaysia, the United Kingdom and the European Union[25]. Their inherent flexibility portrayed by their ability to be

---

[20] FHI Cassim op cit (n15) 152.
[21] FHI Cassim op cit (n2) 760.
[22]NR Sabri op cit (n8) 435.
[23]Securities and Futures Commission of Hong Kong *Consultation Paper on Treasury Shares* (SFCHK November, 1998) para 3.5-3.8 available at *http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/doc?refNo=98CP6#Arguments%20in%20favour%20of%20treasury%20shares* accessed on 19th November 2014.
[24]NR Sabri op cit (n9) 21.
[25]FHI Cassim op cit (n15) 151.

resold as and when a need arises effectively enables them to bypass or at least minimise the complexities and associated costs of raising new capital.[26]

Given these developments, it is surprising that in the recent law reform, South Africa did not incorporate treasury shares. The Companies Act 2008 sets aside capital maintenance practices, and adopted flexible laws from several jurisdictions, and yet it stopped short of the extension from repurchases to treasury shares. In this regard therefore, South Africa is still quite paradoxically and exasperatingly still clinging to the concept of capital maintenance as it was understood for almost a century.

1.3. THE GAP FOR TREASURY SHARES IN THE COMPANIES ACT 2008

For decades, the capital maintenance doctrine formed an integral part of South African company law inasmuch as it was considered to be the most effective way to protect creditors and shareholders.[27] More specifically, the prohibitions against a company acquiring its own shares or the shares of its holding company as well as the payment of dividends out of share capital were pivotal to the doctrine.[28] The amendment of 1999 was an exciting development that marked a turning point in South African company law jurisprudence. The introduction of the new sections 85 to 90 of the old Act coupled with the repeal of the former sections 83 to 90 effectively remoulded the understanding of capital maintenance.[29] It infused flexibility into the system, enabling a company acquire its own shares or the shares of its holding company.

---

[26]This presupposes that there is a demand for such shares. However, an original issue of shares equally presupposes that there is a market for such shares.

[27]More information on Capital maintenance doctrine can be found at Delport, De Koker & Pretorius *Cilliers and Benade Corporate Law* 3 ed (2000) 322; Pretorius et al *Hahlo's South African Company Law through the Cases: A Source Book: A Collection of Cases on Company Law with Explanatory Notes and Comments* 6 ed (1999) 122-124. See also .FHI Cassim 'The reform of company law and the capital maintenance concept: note' (2005) 122(2) *SALJ* 283 at 284.

[28]D Bhana 'The company law implications of conferring a power on a subsidiary to acquire the shares of its holding company' (2006) 17(20) *Stellenbosch Law Review* 232. See also Cassim 'The Right of a Company to Purchase its own Shares' 1985 *THRHR* 318 at 330-331.

[29]Ibid.

This was a move in the right direction but still characteristic of the patchwork and piecemeal reform that had been taking place for the past three decades leading to the amendment. On the one hand, the old Act, as amended had boldly swept away in some respects the capital maintenance concept and adopted a flexible approach to creditor and shareholder protection, yet, in other, respects, it clang to the archaic and obsolete nineteenth-century rules of capital maintenance which prohibit, for instance, treasury shares.[30] Nevertheless, this proved to be the beginning of the transition from traditional rigidity to flexibility.

An official launch of a reform for new legislation was later announced by the Department of Trade and Industry (dti) in July 2003. The intention was to undertake the long overdue comprehensive overhaul of the old Act.[31] Participants of the drafting process were challenged to think about the purpose of the new Act and were consequently requested to identify the fundamental principles of the desired company law for South Africa. This made it clear that the dti was not just looking to amend the existing legislation, viz the old Act, but that the stage was being set for an extensive fundamental reconstruction of corporate legislation[32].

The dti envisaged the first step to be the production and publication of a document setting out the guidelines for corporate law reform. These guidelines formed the basis for drafting instructions which would subsequently be prepared for the chief drafter in drafting the new Act. Leading up to the reform therefore, the dti published a policy paper[33] which strongly emphasised flexibility in the design and organisation of companies

[30] F H I Cassim & R Cassim 'The capital maintenance concept and share repurchases in South African law' (2004) *International Company and Commercial Law Review* 188.

[31] TH Mongalo 'An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) *Acta Juridica: Modern company law for a competitive South African economy* xiii.

[32] Ibid xv.

[33] Department of Trade and Industry (dti) *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform*. GN 1183 of 2004 GG26493 (May 2004) para 1.2.2(a).

as one of the main guidelines or pillars of company law reform in South Africa. This emphasis was stated with the aim to develop an enterprise culture in South Africa.[34]

According to the government's vision for South Africa, the objective was to create a true enterprise culture where companies of all types and sizes could be adaptive, innovative and internationally competitive.[35] The key to facilitate this culture and enhance the attractiveness of South Africa as a location in which to do business, for both domestic entrepreneurs and international investors,[36] would be an infusion of flexibility into the law. South African company law had to be sufficiently flexible in order to be competitive in global markets and to achieve legitimate economic and social goals.[37]

Consequently, the new Companies Act 2008 came into force in the year 2011, repealing and replacing the old Act and marking and welcoming the beginning of a significant new era in South Africa's company law. The old Act, built on foundations which were put in place in during the English Victorian era in the middle of the nineteenth century had become extremely old-fashioned and incapable of meeting the needs of South Africa's fast growing economy and rapidly altering society.[38] As South Africa's societal and economic changes had progressed, and the international company laws changed, serious deficiencies in the law had gradually been exposed.[39]

The coming into force of the Companies Act 2008 brought company law in South Africa in line with international global trends, ideas and best

[34]E Ferran 'Company Law reform in the UK' (2001) *Singapore Journal of International & Comparative Law* 516.
[35]Department of Trade and Industry (dti). *Integrated Manufacturing Strategy* (April 2002) 2.
[36]E Ferran op cit (n34) 516.
[37] FHI Cassim op cit (n2) 760.
[38]G Morse 'The introduction of treasury shares into English law and practice' (2004) 3 *Journal of business law*303.
[39]One such deficiency was the capital maintenance doctrine. See C Hofmeyr et al 'Key Aspects of the New Companies Act' (2012) Cliffe Dekker Hofmeyr, available at *http://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/legal/sectors/downloads/Cliffe-Dekker-Hofmeyr-Key-Aspects-of-the-New-Companies-Act.pdf* available on 9th October 2014.

practices. Section 7(b) (ii) of the Act encapsulated the need for flexibility in providing that one of the purposes of the Act was to promote the development of the South African economy by 'creating flexibility and simplicity in the formation and maintenance of companies'. Further, that it was to promote 'innovation and investment in South African markets'[40] and to create 'optimum conditions for the aggregation of capital for productive purposes and for the investment of that capital in enterprises and the spreading of risk'.[41]

The Companies Act 2008 incorporated concepts from various jurisdictions around the world which are agreed to be the pioneers of modern company law. Aspects were borrowed from the United States, Canada, the United Kingdom, Australia and others.[42] For instance, new concepts such as the business rescue mechanism for companies in financial difficulty, have given companies an opportunity to rectify their financial situation before creditors intervene to liquidate.[43] The company law framework in South Africa was therefore enriched and modernised.[44]

1.4. PROBLEM STATEMENT

Treasury shares fit seamlessly in this context. As stated earlier, treasury shares have a flexibility and efficiency that potentially give countries a slight competitive edge compared to those countries that do not use them. Considering that flexibility and global competitiveness are both themes in the Companies Act 2008, it becomes problematic to justify the omission of the use treasury shares in the South Africa. Moreover, quite a number of

---

[40] Section 7(c) of the Companies Act 2008.
[41] Dti op cit (n35) 8.
[42] Ibid 1.
[43] C Hofmeyr op cit (n39).It is such flexibility and concepts found in many parts of the Act that persuades one to agree the purpose set out in section 7 of the 2008 Companies Act to encourage entrepreneurship, innovation and investment in South Africa is being achieved.
[44] C Stein 'The Most Significant Changes to South Africa's Company Laws Brought about by the Companies Act, 2008' (2010) *Bowman Gilfillan Attorneys* available at *http://www.bowman.co.za/FileBrowser/ContentDocuments/NewCompanies-Act-Brochure.pdf* accessed on 9th October, 2014.

provisions in the Act were adopted from various jurisdictions in an endeavour to align the law to global trends. However, the recent trend or rather surge of treasury shares was still not approved. One can only speculate the reasons why this was so.

Perhaps their nature has still not been understood and their complexity and disadvantages still outweigh their commercial value. Even more, perhaps it is a question of the morality of a company acquiring and holding its own shares. Whatever the reason, the author suggests that the commercial value they afford would prove to be more beneficial for the South African economy than harmful. The recent surge in jurisdictions adopting treasury shares shows that with some safeguards, treasury shares can be effectively and productively managed. For South Africa, to have ignored them was therefore arguably, an error that needs to be addressed. This paper aims to build a case for the introduction of treasury shares into South African company law.

1.5. RESEARCH LAYOUT

The second chapter of this paper will therefore, endeavour to address this problem by describing the nature of treasury shares and what their reason for existence is.[45] As indicated, despite their use historically, and their increasingly important functions, their status was inadequately defined by courts and the legislature. The next chapter will thus, explore the peculiarity of treasury shares in an attempt to disentangle the web of confusion surrounding them thereby proposing that despite their nature, they can still be applicable in modern company law. This chapter will involve a brief account on their historical status in the jurisdiction that has had the most experience with treasury shares, the United States.

The third chapter will continue to clarify the treasury share phenomenon. As previously stated, treasury shares did not only facilitate

---

[45] FHI Cassim op cit (n1) 137.

much confusion in the narrow scope of company law but in accounting and financial fields as well. This was another of the reasons that they were initially abandoned in the USA. The discussion in this chapter will include references to other jurisdictions, more specially the United Kingdom, that are currently using the treasury shares in attempt to argue that treasury shares have outgrown the complexity they experienced in their youth. They can therefore, be productively used and recorded in fields beyond company law.

Thereafter, fourth chapter will set out the different benefits that treasury shares had and have in an endeavour to establish the commercial value to be gained in allowing companies to have treasury shares. It has been found that treasury shares offer a less burdensome and a less expensive alternative process than a mere simple share repurchase which involves cancellation of the repurchased shares followed by a new issue of shares. This advantage, for instance, enhances the flexibility given to companies in adjusting their capital structures.[46]

The fifth chapter will discuss several shortcomings attendant on treasury shares that their use attracts. These include abuse of control by directors, stock watering, market manipulation by a company in relation to its own shares and insider dealing. Effective management of such dangers is imperative.[47] Thus, the discussion will extend to safeguards that can be employed in order to reduce such misuse. Once again reference to other jurisdictions and how they have reduced the risks will be made. In so doing, the chapter will highlight that the risks of treasury shares are manageable.

Subsequently, the sixth chapter will contain a discussion on the current status of treasury shares in South Africa. Given the underpinning themes of the reform, as discussed above, it is surprising that Section 35(5) of the Companies Act 2008 should provide for shares repurchased by a

[46]FHI Cassim op cit. (n. 15) 159.
[47] D Bhana op cit (n28) 247.

company to be restored to the same status as shares that have been authorised but not issued. This section precludes the existence of treasury shares in South Africa but it is curious whether treasury shares were properly and fully considered[48].

Therefore, chapter six will include speculations on reasons why South Africa has not adopted treasury shares. Assumptions can be raised that there was a lack of persuasive international precedent. Alternatively, the drafters may have not considered it or if they did doubted the readiness of South Africa to take up the challenge of treasury shares.

However, when one considers the similarities between the arguments refuting the use of repurchases, and those against treasury shares, it can be argued that if it was possible to adopt the former regardless of the risk of abuse, the latter can be adopted and implemented correctly. It is the purpose of this paper to propose a reevaluation of the law in this area, suggesting that acknowledging treasury shares would have been a logical extension of the adoption of repurchases.

Additionally, the chapter will once again look at various jurisdictions and how they have pursued the contrary preference and adopted the treasury shares. The experience of the United Kingdom specifically, demonstrates that complex legislation to curtail the potential abuse of treasury shares is unnecessary. All that is required in order to benefit from the much needed flexibility which treasury shares would inject into the South African developing economy are a few simple and surprisingly uncomplicated statutory provisions.

In conclusion the paper will, based on the nature of treasury shares and their use and misuse in USA and the other jurisdictions, attempt to propose a manner in which treasury shares may be adopted in South Africa. It seeks to lift the carpet under which treasury shares have been swept and,

---

[48]Ibid.

in so doing, endeavours to shed light on some of the conceptual and theoretical mysteries that beset modern company law and to clarify some of the issues underlying the treasury share debate. This paper aims to suggest that legislation be introduced to permit a company to purchase its own shares subject to adequate safeguards for creditors and shareholders. Such an amendment would be in harmony with modem trends in other jurisdictions, making South African companies more competitive internationally.

CHAPTER TWO: THE LEGAL NATURE OF TREASURY SHARES

2.1. INTRODUCTION

As indicated, treasury shares are issued shares of a company that are reacquired by the company itself by way of a repurchase, donation or other means but that are neither retired, cancelled nor restored to the status of unissued shares upon their reacquisition. They are instead held by the company in its treasury until their reissue or resale at the discretion of the company.[49]

This description encapsulates the nature of shares. However, it is also paradoxical in itself and brings to the surface legal aspects of treasury shares upon which the law, statutory and judicial, was unclear and complicated for many years.[50] Whether, it meant, for instance, that treasury shares belonged to the company as property before reissue or whether they granted the company any peculiar rights in itself were questions that proved challenging at first.[51]

Eventually though, the courts admitted that attaching legal rights that are ordinarily attached to shares would be nonsensical and result in circumgyration.[52] A company could not have ownership or a proprietary interest in itself. It could not have legal rights and powers derived from itself.[53] As a result, treasury shares did not generally carry any voting or dividend rights or, for that matter, a right to participate in net assets on winding-up of the company.[54]

However, since treasury shares could not have any of the ordinary rights or obligations of shares, the issue then became whether they should

---

[49]*Borg et al v International Silver* supra (n1) 150. See also FHI Cassim op cit (n1) 137.
[50]JAS 'The Legal Status of Treasury Shares'(1937) *University of Pennsylvania Law Review and American Law Register* 622.
[51]Ibid.
[52]DF Vagts *Basic Corporation Law* 3ed (1989) 399-400. See also FHI Cassim op cit (n15) 156.
[53] I Morawetz *Private Corporations* 2ed (1886) 114. See also JAS op cit (n50) 622.
[54]*Gustin v. Merrill* (1906) 144 Mich. 498. See also JAS op cit (n50) 622.

properly be termed shares or whether they should rather be regarded as assets of the company, much as its machinery and equipment.[55] Alternatively, it was also uncertain whether they could merely be regarded as choses in action, remaining in suspended animation until the assertion of some company rights which would revitalise them and give them force and personality[56]

Still, amid these issues, treasury shares did have shareholder rights attached to them in some exceptional instances. The courts had held in several cases that treasury shares could have legal rights and be termed assets.

This chapter delves into a description of the legal nature of treasury shares.[57] As stated, uncertainty was one of the reasons that the United States abandoned treasury shares. Therefore, this description is done in an attempt to disentangle the web of confusion surrounding treasury shares thereby proposing that despite their peculiar nature, they can still be applicable in modern company law.

2.2. THE PECULIARITY OF TREASURY SHARES

2.2.1. Nature of Shares

The first step in understanding the peculiarity of treasury shares is to understand the nature of regular shares.[58] Regrettably, the exact legal nature of shares eluded and continues to elude company lawyers. As L. C. B. Gower openly states:

> 'The question what is the exact juridical nature of the share is more easily asked than answered. A share is somewhat of a misnomer,

[55]Ibid 622.
[56]*Gustin v. Merrill* supra (n54) 498. See also JAS op cit (n50) 622.
[57]FHI Cassim op cit (n1) 137.
[58]Regular shares in this instance refers to all shares to which rights can be attached to like ordinary shares, preference shares etc.

> not easily described because it does not readily fit into any "normal legal category"'[59]

Lawyers know that a share is not a direct interest in the company's assets, apart from when a company is wound up, because the company owns its property beneficially and not in trust for its members.[60] Nonetheless, while it is clear what a share grants the shareholder, there is still vagueness in defining the exact nature of a share. For example, in defining a share, one leading company lawyer got into the following mesh:

> 'A share is, therefore, a fractional part of the capital. It confers upon the holder a certain right to proportionate part of the assets of the corporation, whether by way of dividend or of distribution of assets in winding up. It forms, however, a separate right of property. The capital is the property of the corporation. The share, although it is a fraction of the capital, is the property of the corporator. The aggregate of all the fractions if collected in two or three hands does not constitute the corporators the owners of the capital - that remains the property of the corporation. But, nevertheless, the share is a property in a fractional part of the capital.'[61]

Although this passage is cited with approval by some contemporary company law papers, it is neither coherent nor helpful. It is not clear what it means to have the right of property or the fractional part of the capital.

Similarly the matter has also not been clarified by the Companies Act 2008 which defines a share as one of the units into which the proprietary interest in a profit company is divided.[62] Once again, the lack of elaboration in this definition does not clarify the nature of shares.

It is the wearers of judicial robes that took the lead to clarify the nature of shares.[63] Initially, throughout the eighteenth and early nineteenth centuries, the term share was used in its ordinary sense, namely as a

---

[59]LCB Gower *Modern Company Law* (1979) 397. See also PL Davies *Gower & Davis: the principles of modern company law* (2008) 309.
[60]Ibid. See also P Ireland, I Grigg-Spall & D Kelly op cit (n58) 152.
[61]Lord Wrenbury in *Bradbury v English Sewing Cotton Co. Ltd.* (1923) A.C. 744 at 767 (H.L.).
[62] Section 1 Companies Act 71 of 2008.
[63]See *Cooper v Boyes* (1994) 4 SA 521 (C) 535. F Oditah ' Takeovers, Shares Exchanges and the Meaning of Loss' (1996) 112 LQR 424 at 426-427.

significant part of a whole undertaking.[64] To own a share in a company inferred ownership of a share of the entirety of the company's assets. Legally, a share in company, was regarded as an equitable interest in the property of the company and shareholders were viewed as owners in equity of the company's property.[65]

It was only from the 1830's that it was settled that shareholders, had no direct interest in the physical assets of companies. Shares were personal property irrespective of the nature of the company's assets or its legal status. They were an entirely separate form of property and were legal objects in their own right. They had been liberated from their direct link to the property of companies. [66]

It became clear that a share is an individual's interest in a company; that interest being composed of rights and obligations which are defined by the companies Act and the Memorandum of Incorporation (MoI).[67] They are not purely personal rights; they are proprietary rights in the company though not in its property. The company is therefore at one and the same time a juridical person with rights and duties of its own, and a res owned by its shareholders.[68]

A share was a bundle of rights and liabilities ascribed to the holder and this is probably the nearest that one could get to its character, as long as it is appreciated that it is more than a bundle of contractual rights.[69]

---

[64]WR Scott *The constitution and finance of English, Scottish and Irish joint-stock companies to 1720.* Vol 1(1912) 45.

[65] DG.Rice 'The Legal Nature of the Share' (1955, unpublished dissertation) 2.

[66] It took company lawyers over two hundred years to accommodate this fact that property no longer predominantly takes the form of rights in specific material things like land, factories, machines but the form of legal rights or abstract, intangible forms of property. The law now not only enforces these rights of property but constitutes them as property on a par with property in actual material things. A share is one such right. See DG Rice op cit (n65)2.

[67]Farwell J in *Borland's Trustee v Steel Brothers & Co Ltd* (1901) 1 Ch 279 which was approved by the Lordships' House in *Inland Revenue Commissioners v Crossman* (1937) AC 36.

[68]Davies, P.L. (1997). *Gower's Principles of Modern Company Law* 6th ed. Sweet & Maxwell 301.

[69]*Hindustan Lever Employees Union v. Hindustan Lever Ltd.* ALLER 1995 SC 470.

These rights included, inter alia, the right to elect directors; to vote on resolutions at meetings of the company; to enjoy the profits of the company, if and when dividends are declared and distributed; and to share in the surplus, if any, upon liquidation.[70] In essence, shares give shareholders income rights, capital rights and control rights through voting and election of directors.

2.2.1.1. Rights Attached to Shares (Rights given to Shareholders)

The basic presumption is that all shares enjoy equal rights although it is possible for a company to have shares with different rights, preferences, limitations and terms.[71] In contrast treasury shares are peculiar in that they do not enjoy these rights. This will be elaborated below:

2.2.1.1.1. Right to Participate in Net Assets on Winding up of the Company

Shares have the right to participate in net assets on winding up of the company. In contrast, while treasury shares resemble assets because they can be resold, in truth they are no more assets than are any authorised but unissued shares of a company. Unlike regular shares, they are not a property, interest or claim and not a form of self-ownership.[72] Should the company become insolvent, the treasury shares it holds would disappear or represent nothing of value to the creditors.

They are therefore not assets in computing net company assets or surplus available assets for dividends, or for the purchase of shares or the making of other distributions to shareholders, or upon liquidation, and consequently provide no edge of protection to creditors of the company.[73] When a company is in decline, so too are its treasury shares, which then

---

[70]Ibid. Alternatively, a share is jus in personam, a right of action: See *Liquidators Union Share Agency v Hatton* (1927) AD 240 at 250.

[71] Section 36(1) Companies Act No 71 of 2008. *Birch v Cooper re Bridgewater Navigation Co* (1889) 14 App Cas 525 (HL) 543.See also FHI Cassim op cit (n2) 215.

[72]GS Hills 'Federal taxation v corporation law' (1936-1937) 12 *Wisconsin LR* 280 at 299. See also FHI Cassim op cit (n1) 138.

[73]A Nussbaum 'Acquisition by a corporation of its own stock' (1935) 35 *Columbia LR* 971 at 980.

become very difficult, if not impossible to sell. Their value completely disappears at the very time when most needed by creditors, like upon bankruptcy.[74]

Moreover, were treasury shares to be regarded as assets, then by merely restricting each purchase to the amount of the surplus and by then using the acquired shares to indicate a continuation of the same surplus, a company could continue to purchase its own shares indefinitely and thus rescue all shareholders at the expense of the creditors. It is for these reasons that they do not participate as assets upon liquidation.[75]

2.2.1.1.2. Voting Rights

It is trite law that a company cannot vote whether directly or indirectly upon any shares issued by it.[76] The underlying theory is not that the voting power is lost, but that it is reserved to effect equal distribution of the voting power among the shareholders, and to prevent the directors from maintaining their control of the company.[77]

Since a company cannot vote using its own shares, the device of pledging the shares to third persons has been attempted with varying degrees of success. Generally, it was held by the majority cases in the United States that because a company has no right to vote its own shares held by it, it cannot by agreement, as pledgor, confer upon the pledgee the right to vote. Nevertheless, in the case of *Allen v Lagerberger,* [78] the court held that it was permissible for a company to pledge its shares to third persons.[79] It was stated that the shares in a company of which the company was itself a pledgor, might vote the shares at an election, if by the contract to pledge it was intended that the pledgees should vote, and the right to vote was

[74]Ibid.
[75]H Kottler op cit (n14) 12.
[76] Ibid 16.
[77]H Kottler op cit (n14) 17. See also FHI Cassim op cit (n1) 148-149; D Bhana op cit (n28) 247.
[78](1888)10 Ohio Dec. Repr. 341, 20 Bull. 368.
[79]H Kottler op cit (n14) 17.

conferred for a consideration that would benefit all the shareholders, and the mere fact that it might have been expected that the pledgees would vote for the existing management of the company would be no ground for setting aside the contract, if they gave full value for the collateral with power to vote.[80]

In other words, if the pledgees were not bound by any fraudulent agreement between them as directors, secured by parting with the rights of the company to support the existing board, their preference in the matter, growing out of confidence in the management, even if known to those managers at the time of the transfer, did not indicate a fraud upon the rights of the shareholders.[81]

The court declared that the inability of the company to vote arose in fact from the equal distribution of the power to vote among the shareholders, and that, therefore, there was no reason why, under a pledge, by express contract, the right to vote might not be transferred, if transferred for a consideration inuring to the benefit of all the shareholders.[82] It should be pointed out, however, that in the this case, the court found no evidence of bad faith on the part of the directors in making the pledge, while the majority of the cases concerning this matter, the pledges were made to enable the directors to vote the treasury shares and not in any way for the benefit of the company.[83]

Accordingly, it would appear that the guiding principle in determining whether or not a pledgee may vote treasury shares depended upon the good or bad faith of the directors in making such a pledge. Nonetheless, completely suspending the voting rights of treasury shares as the majority of courts did, minimises the possibility of manipulation. Such a

[80]Ibid.
[81]Ibid.
[82]Ibid.
[83]H Kottler op cit (n14) 17.

restriction is necessary to ensure that the benefits of this privilege are not abused.

2.2.1.1.3. The Preemptive Right of Shareholders

The preemptive right of shareholders in a company is a right that additional shares should not be issued without first offering a reasonable opportunity to take them to all existing shareholders having similar rights.[84] Further, that those shares offered to the shareholders, but not taken by them, should not then be issued to others upon terms more favourable to them than the terms formerly offered to the shareholders.[85] The preemptive right gives existing shareholders in a company the right to subscribe for their pro rata share of any new shares issued for cash, providing them with protection against inappropriate dilution of their investments.[86]

As a basic rule, shareholders do not have preemptive rights to treasury shares upon their being resold by the company, even though they may have had preemptive rights to new shares offered by the company.[87] The reason for this denial is that the shareholders proportionate interest is determined by the original authorised issue, and is not, affected by reissues.[88] This exception to preemptive rights has been argued to be arbitrary and necessitated by the courts' desires to break down a rule which they have found too inflexible for modern corporate needs.[89] Notwithstanding , irrespective of any preemptive rights, it is the duty of directors as fiduciary proxies, to exercise the power to issue additional shares in good faith for the benefit of the shareholders who constitute the

[84]V Morawetz 'The Preemptive Right of Shareholders' (1928) *42 Harvard Law Review* 186.
[85]Ibid.
[86]Ibid.
[87]Ibid. Also a recognition and discussion of preemptive rights of shareholders can be found in the following cases: *Titus v. Paul St. Bank* (1919) 32 Idaho 23, 179 Pac. 514 ; *Eidman v. Bowman*, (1871) 58 Ill. 444 ; *Ohio Ins. Co. v. Nunnemacher* (1860)15 Ind. 294 ; *Schmidt v. Pritchard* (1907)135 Iowa 240, 112 N. W. 801; *Stone v. Envelope Co.*, (1920) 119 Me. 394, 111 Atl. 536.
[88] BG Edma 'Treasury Shares and Pre-Emptive Rights: Schwartz v. Marien' (1976) 26 *Buff. L. Rev.*147. See also JAS op cit (n50) 622 at 623.
[89]JAS op cit (n50) 622 at 623.

company.[90] It is a breach of duty on the part of directors to sell treasury shares not to benefit the shareholders, but to benefit themselves or to enable particular shareholders or to enable them to acquire shares at less than their value.[91]

Consequently, even though ordinarily, treasury shares would have no preemptive rights, under circumstance that may be prejudicial to the shareholders and a breach of duty of the directors,to issue or to sell such shares without first offering them to the shareholders, [92] treasury shares will have preemptive rights. Likewise, in the United Kingdom preemptive rights for treasury shares are accepted.[93]

There is a fundamental principle that here is a fundamental principle which underlies this prior reasoning. Attaching preemptive rights to treasury shares enables shareholders to assert their legal and equitable remedies where there is bad faith or a breach of the directors' fiduciary duties. Without this safeguard, there is an increased potential for abuse of treasury shares.[94] Directors can by a secret purchase of treasury shares, the sale of which are wholly in their control, increase their voice in the control of the company or obtain the shares at an inadequate price.[95] Shareholder's preemptive rights are the only sure protection against the dilution of shareholders' interests because the courts have shown an inclination to protect a director's breach of fiduciary duty. It is often difficult to prove that

---

[90]V Morawetz op cit (n83) 187.
[91]Ibid.
[92]Ibid.
[93] Such rights could be dispensed with or may not be applied by a special resolution of the members of the company, or in the articles of association of the company. See N Adams 'Treasury Shares: More Efficient Management of Share Capital?'(2003) *Practical Law*. Available at *uk.practicallaw.com* accessed on 20th October, 2014.
[94]V Morawetz op cit (84) 187.
[95] Ibid.

directors were acting fraudulently, and it is too expensive a procedure for the small shareholders to bring a suit without certainty of recovery.[96]

2.2.1.1.4. Dividend Rights

Treasury shares, unlike regular shares do not also enjoy any right to a dividend or other distribution whether in cash or otherwise of the company's assets.[97] This is because it is futile for companies to pay dividends to themselves.[98] However, when a company reacquires its own shares, company assets, cash or other property flow out to the selling shareholders, just as it does when a dividend is declared, so that financially, and from the point of view of creditors, a repurchase of shares, predominantly on a pro rata basis, has an effect similar to the payment of a dividend, although it, differs from a dividend in that the company receives shares in return for the repurchase.[99]

Thus, under the Model Business Corporation Act of 1984, share repurchases are treated like dividends for legal purposes with the result that companies' statutes in general classify both dividends and share repurchases as distributions.[100] To this extent therefore, Model Act enabled dividends to be declared and paid on treasury shares.

However, such a dividend did not constitute a share dividend in the usual sense of the word. Since stated capital was not reduced when the treasury shares were bought by the company, stated capital was not increased when the shares were reissued in payment of dividend.[101] The

---

[96] V Morawetz op cit (84) 187.

[97] United Kingdom Department of Trade and Industry Consultative Document (UKdti) *Treasury Shares (URN* 01/500, Sep 2001). Para 2.13 at 7.

[98]Ibid.

[99] FHI Cassim op cit (n1) 141.

[100] Ibid. Based on s 166 of the California Corporation Code of 1977, distributions are defined, for instance in s 1.40(6) of the Revised Model Business Corporation Act of 1984, as all transfers of money or other property, whether direct or indirect, made by a company in respect of the shares, and for the benefit of shareholders of the company. A distribution includes the payment of a dividend, purchase, redemption or other acquisition of shares.

[101]H Kottler op cit (n14) 17.

effect of a dividend paid on treasury shares was permanently to reduce surplus by the amount which was appropriated when the treasury shares were bought by the company. The transaction was, therefore, viewed from that perspective, in many respects similar to the payment of a cash dividend.[102]

However, it should still be distinguished from a cash dividend because the proportionate interests of the shareholders remain the same as it was prior to the declaration of the share dividend. Therefore, in reality, it just maintained the status quo with respect to their comparative equities and did not enrich them as would a cash dividend.[103]

2.2.1.1.5. Right to Resale and Reissue

The only right of treasury shares that remains fully regardless of the circumstances is the right of the company to reissue its treasury shares.[104] Unless the MoI provides otherwise, treasury shares may be disposed of for such considerations as the board of directors may choose.[105] However, even though the directors have a broad discretion in disposing of treasury shares and in fixing the amount of consideration, as in the case of an original issue of shares, they are bound to act fairly and set an amount of consideration which is reasonable under the circumstances.[106]

When the treasury shares are reissued or sold by the company, the company is viewed as an intermediate transferee between the former and new shareholders, explicitly, the shareholder from whom the company bought the shares and the shareholder to whom the company will sell the shares respectively. This is in reality a fiction since the old share contract has

---

[102] Ibid.
[103] H Kottler op cit (n14) 17.
[104] Ibid.
[105] Ohio General Code Sec. 8623-19.
[106] H Kottler op cit (n14) 17.

been extinguished and replaced with new units of interest that are created in their place in the form of new shares.[107]

2.2.1.1.6. The Company's Right to Hold Shares

Shares are personal property. At the heart of company law is the concept of a company as a separate legal person. All human beings are legal persons, which means they have the capacity to acquire legal rights and incur legal duties. This in turn, means that a company does possess its own legal personality to acquire rights and incur obligations that are distinct from those of the directors and shareholders of the company.[108]

In the Companies Act 2008, this has been confirmed in Section 19(1)(b). The section states that the company, once registered has all the legal powers and capacity of an individual, except to the extent that a juristic person is incapable of exercising any such power or having any such capacity, or except to the extent that the company's memorandum of incorporation provides otherwise.[109]

Legally therefore, the company is entitled to acquire and hold its own shares. However, this is not a right exercised fully in South Africa. Accordingly, a company as a holder of its own shares enjoys no incidents of shareholdership.

2.2.2. Nature of Treasury Shares

The second step in understanding treasury shares is to accept that they are sui generis. The Companies Act 2008 draws a distinction between 'authorised' and 'issued' shares.[110] Authorised shares are shares which the

---

[107]Ibid.
[108]TH Deinzer 'This Treasury Stock Question' (1937) 12(3) *the Accounting Review* 256.
[109]Additionally, the constitution of the Republic of South Africa, 1996 provides in Section 8(4) that a company is entitled to the same fundamental rights as natural persons in so far as they may be exercised by a juristic person. As stated earlier, natural persons do have the right to own shares and therefore to control some aspects of the company. The right of control incident to ownership is a right which civilization has made an inherent part of itself; That is, it is mine; I can do with it what I will.
[110]FHI Cassim op cit (n2) 213.

company is permitted by its Memorandum of Incorporation to issue, but which have not yet been issued and as long as they remain in this status, the rights that the board of directors can attach to these shares are not exercised.[111] On the other hand, issued shares are shares that have been both authorised and issued.[112] These can either be preference shares, redeemable shares, and ordinary shares or deferred shares depending upon what the board of directors determines to classify them as.[113]

Treasury shares resemble authorised shares in that there are no legal obligations against them. However, they are not authorised shares per definition because treasury shares are already issued. Succinctly, treasury shares have substantially the same status as shares that have never been issued even though they are defined as issued.[114]

Nevertheless, treasury shares cannot be accurately defined as issued shares. Technically, issued shares are outstanding shares until they are reacquired, or redeemed or cancelled. However, treasury shares cannot be regarded as outstanding because they are held not by a shareholder but by the company itself, and to be outstanding, there must be effective obligations against them.[115] Moreover, they cannot be referred to as cancelled shares because they still exist in the treasury of the company.

Consequently, treasury shares are best treated as being *sui generis*.[116] They may not be accurately described as authorises shares, issued shares, cancelled shares, outstanding shares, assets or non-assets. In view of the peculiar nature of such shares, their various attributes should receive careful consideration in each case. Any attempts to force them into these rigid categories merely because of strong analogies in particular situations has

---

[111]Section 36(1) Companies Act 2008.
[112]Ibid.
[113]FHI Cassim op cit (n2) 215-216.
[114]WA Paton 'Postscript on Treasury Shares' (1969) *Accounting Review* 277.
[115]*Borg et al v International Silver* supra (n1) 150. See also FHI Cassim op cit (n1) 138.
[116]HW Ballantine op cit (n13) 536.

proved only result in increasing confusion both as to legal policies and the rationale. [117]

2.3. CONCLUSION

It has been explained in this chapter that share was a bundle of rights and liabilities ascribed to the holder and this is probably the nearest that one could get to its character, as long as it is appreciated that it is more than a bundle of contractual rights.[118] These rights include the right to elect directors; to vote on resolutions at meetings of the company; to enjoy the profits of the company, if and when dividends are declared and distributed; and to share in the surplus, if any, upon liquidation.[119] In essence, shares give shareholders income rights, capital rights and control rights through voting and election of directors.

Treasury shares, unlike regular shares, do not enjoy the essential features of share ownership. In other words, treasury shares do not have a right of participation upon liquidation nor do they have any preemptive rights. Additionally, voting rights or dividend rights cannot be exercised too.[120]

The only right that treasury shares enjoy fully is the right to reissue or to resale once they are reacquired. Additionally, as a juristic person, the company does possess its own legal personality to acquire rights and incur obligations that are distinct from those of the directors and shareholders of the company. However, from this discuss it appears that, a company cannot exercise its personality and hold its own shares.

Furthermore, it has been accepted that treasury are *sui generis;*[121] they cannot be correctly described as unissued shares, issued shares, cancelled

---

[117]JAS op cit (n50) 622 at 628.
[118]*Hindustan Lever Employees Union v. Hindustan Lever Ltd* supra (n69)470.
[119]*Liquidators Union Share Agency v Hatton* supra(n70) 250.
[120]WA Paton op cit (n114) 278.
[121]Ibid 139. See also HW Ballantine op cit (n13) 536.

shares, outstanding shares, assets, or non-assets. They are an anomaly, treated as assets for one purpose, but not assets for another. They are existing for one purpose, but non- existent for another. They appear, reappear and disappear; they have a fluidity that makes them susceptible to varying descriptions.

In summary, this chapter has concluded that largely, no incidents of shareholdership are enjoyed by a company as a holder of its own shares. Treasury shares are fundamentally homogeneous to all authorised shares not yet outstanding. They represent an instrument for raising funds that remains dormant, at least for a period.[122] Treasury shares are not really shares in the strict sense of the word. As Ballantine stated, their existence as issued shares is indeed fictitious , a creation of something out of nothing and using the term shares, is but one way of describing the special rules and privileges that apply to them as to their subsequent reissue.[123]

However, although the nature of treasury shares has been clarified, there were still complexities that surrounded treasury shares beyond the scope of company law. The next chapter will delve into the discussion of such complexities.

[122]Ibid.
[123]FHI Cassim op cit (n15) 153.

CHAPTER THREE: COMPLEXITIES OF TREASURY SHARES

3.1. INTRODUCTION

In the 1980's amendments in the United States were adopted eliminating the traditional concepts of par value, stated capital and treasury shares along with them. Treasury shares were not only not understood legally but consequent to the uncertainties in law, complexities in accounting and tax practices arose.

The natural ability of treasury shares to adopt to varying concepts in different situations, depending, upon the practicality in the case at hand, and upon the equities which appeared to exist in a given circumstance[124] did not only facilitate much confusion in the narrow scope of company law but also in various other regulatory systems. In accounting for instance, it was uncertain how treasury shares should be represented on the balance sheet.[125] Upon company balance sheets they appeared as current assets, investment assets, unclassified assets, and on the other hand as deductions from earned surplus, from stated capital, from aggregate net worth, and from various arrangements of different elements of net worth. They were variously valued at cost of acquisition, original price issued for, par or stated value, market value, and a fractional portion of capital stock value.[126]

In addition, there was considerable difficulty for the Federal Treasury Department in income tax cases.[127] For many years the treasury regulations stated that treasury shares were not true assets and therefore a company realised no gain or loss from the purchase or sale of its own shares.[128] Yet despite the apparent clarity of this expression, the Board of Tax Appeals and the federal courts allowed losses incurred in an exchange of company assets

---

[124]H Kottler op cit (n14) 13.
[125]Ibid 19.
[126]EG Rudolph 'Accounting for Treasury Shares under the Model Business Corporation Act' (1959). 73 *Harvard Law Review* 323.
[127]JAS op cit (n50) 625.
[128]*Houston Bros. Co. v. Commissioner of Int. Rev.*, (1930)21 B. T. A. 804. See also JAS op cit (n50) 625.

for previously issued shares to be treated as losses for income tax purposes.[129] These uncertainties presented opportunity for abuse of treasury shares.

On an endeavour to further understand this phenomenon and to clarify the uncertainties surrounding it, this chapter will discuss how the accounting and tax regulatory bodies handle treasury shares. As mentioned, the reason treasury shares were deserted in the United States was because they were unduly complex. This chapter will look into these complexities not only historically but presently to determine whether there is now clarity. Should there be clarity, the reason why they were abandoned in the United States will have been discredited thereby strengthening the case for treasury shares in South Africa.

3.2. ACCOUNTING PRACTICES

The subject of treasury shares was for a long time a basis for disagreement between lawyers and accountants.[130] It was unclear to both fields what the transaction involved and how the acquisition should be recorded in company books.[131] The practice among accountants originally was to carry treasury shares in the company books as assets.[132] This was particularly true when the shares had been acquired in anticipation of quick resale, even though the intent to resell would not seem to justify such an interpretation when the corporation by purchasing the shares in effect was reducing the outstanding equity, not obtaining assets.[133] Furthermore, during the time that the treasury shares were held by the corporation the shares were not

---

[129]Ibid.
[130] See Note 'The Legal Status of Treasury Shares' (1937) 85 *University of Pennsylvania Law Review.* 622 at 622. See also CH Rankin 'Treasury Stock: A Source of Profit or Loss?' (1940) *Accounting Review* 71.
[131] Ibid.
[132]Bowles 'Treasury Shares on the Balance Sheet'(1934) 8 *Journal of Accountancy* 98.
[133] Ibid. Also see WA Paton 'Essentials of Accounting' (1938) Vol1 *Edward Brothers* 682 at 684.

valuable assets in the sense of one creating returns available for the creditors or shareholders upon liquidation.[134]

Notwithstanding, by common practice, treasury shares continued to be frequently treated as assets, property, or something of value. An investigation of balance sheets before the early 1940's revealed that 45 per cent of the companies in the United States showed treasury shares as assets.[135] Nevertheless, as judicial and legislative trends began to change to favour the position that treasury shares were not assets, so did the accounting principles. The practice among accountants turned away from treating treasury shares as assets, toward showing them in the company books as a deduction from the capital shares outstanding, which in effect was a reduction of stated capital.[136]

Regardless, unless the shares were actually cancelled, this was not completely true as the shares may have been resold at any time without a new compliance with the various statutory requirements.[137] Additionally, to carry shares of any class as an apparent deduction from stated capital was also a falsification that surplus had not been reduced, or in a case where there was not sufficient surplus to absorb the reduction, an admission or representation of an illegal reduction of stated capital.[138]

Moreover, by interpreting the transaction as a deduction of capital, accountants adopted the analysis of the transaction which had afforded English courts a principal objection to permitting a company to acquire its own shares.[139] English courts had ruled in no uncertain terms that a

---

[134]Note op cit (n130) 622.
[135]TH Sanders, HR Hatfield & WU Moore. *A statement of accounting principles* (1959) American Accounting Association 90.
[136]Note op cit (n130) 623.
[137]The New York Stock Exchange ruled that after January 29, 1934, in order to prevent abuses in purchase and resale of treasury stock, the extent of holdings of treasury stock must be reported to the Exchange monthly and notification given before each resale. Also see Holt and Morris, 'Some Aspects of Reacquired Stock' (1934) 12 *Harvard Business Review* 505.
[138]Hills 'Model Corporation Act' (1935) 48 *Harvard Law Review* 1334.
[139] Note op cit (n130)623.

corporation cannot purchase its own stock on the ground that there are statutes covering the manner of reduction of capital and that such a purchase would amount to capital reduction in an unauthorized manner, thereby making it much easier to avoid payment to, if not to defraud, creditors.

By showing treasury shares as a deduction of stated capital, companies acquiring their own shares ran a risk of an illegal reduction of capital. In contrast, by classifying the treasury shares as assets there was no reduction of capital.[140] Consequently, many companies continued to carry and record their treasury shares at cost, as assets, to avoid the explicit reduction of the owners' equity which was prohibited in law.[141]

What was showing on the balance sheets was therefore that treasury shares were being reported at cost, first on the assets side of the balance sheet and later as a reduction of shareholders' equity in a contra equity account.[142] Thus on one end, treasury shares were recorded as assets if they were held for resale or insurance, while on the other, they were recorded as a deduction from outstanding shares and stated capital account if they were intended for cancellation or retirement.[143] This inconsistency on balance sheets increased confusion. Treasury shares were neither assets nor were they a deduction from capital.

As an alternative to how they should be recorded in books, a proposal was made that treasury share transactions be handled by the creation of a new account entitled 'Surplus Applied in Acquisition of Treasury Stock,' with a debit to capital account and a credit to the account of the asset given for the shares.[144] The new account on the balance sheet would be shown as a

---

[140]NG Rueschhoff 'The Evolution of Accounting for Corporate Treasury Stock in the United States' (1978) *The Accounting Historians Journal* 2.

[141] Ibid. See also HW Ballantine op cit (n13) 539.

[142]Ibid. WA Paton op cit (n114) 281.

[143]Ibid 5.

[144] This entry would not have affected the capital share account, representing legal capital, and would not have appeared as an asset on the statement. Marple, 'Treasury Stock' (1934) 57 *Journal of Accountancy* 257 at 262, showing in accounting form the entries from

deduction from the stated surplus account. Upon subsequent sale of the shares, the procedure would be to debit the account of the assets received, credit the new account, and transfer the profit or loss to a capital surplus account.[145] By this method the assets expended for the shares would be reduced by the proper amount while the company holds the shares and consequently the financial statement of the company would accurately reflect its condition.[146]

This was a more desirable approach at the time yet it still had some errors resulting from the underlying presumptions.[147] The entire amount received from an investor in company shares is capital, in the broad sense of the term, and this fundamental rule applies regardless of the past history of a particular block of shares.[148] As emphasized above, treasury shares and other authorized shares are essentially homogeneous, and thus the reissue of shares previously outstanding is a capital raising transaction, on all fours with the initial use of shares to secure funds.[149]

Consequently, the practice of treating a part of the amount received from the investor as a surplus was intrinsically improper, even if legally sanctioned. The accountant knew this, instinctively, and tried to erase it by

---

purchase to resale, with profit, or loss. See also HW Ballantine 'Drafting a Modern Corporation Law' (1931) 19 *California Law Review* 465 at 480: '...and **by** the requirement of section 342a that when a corporation acquires its shares under authority of section 342 **(7)** the earned surplus shall be reduced **by** the amount of the purchase price, but the stated capital shall not be affected thereby.' See also Note op cit (n130) 625.

[145] Ibid.

[146] Ibid. An accurate accounting method was necessary because there was potential for courts, shareholders or the directors themselves to be innocently misled about the true assets and surplus of the firm For an interesting approach to the law and accounting in treasury stock transactions, **see** Montgomery 'Dealings in Treasury Stock' (1938) 65 *Journal of Accountancy* 466.

[147] WA Paton op cit (n114) 279.

[148] WA Paton op cit (n114) 279.

[149] Ibid. It is a pity that legal rules and conventional accounting procedures did not always confirm literally and rigorously this simple, common sense standard.

attaching a qualifying term, but the combination capital surplus was a conflicting mixture, a financial gallimaufry.[150]

In essence then, although there was an increasing tendency in financial reporting to avoid inclusion of treasury shares in corporate assets, the substitute procedures also had limitations. As a result, with no preferable option, accountants continued to observe it. Moreover, the courts themselves facilitated the interpretation of treasury shares as assets by continually referring to them as assets.[151]

Judicial decisions had not till this point, clarified the legal status of treasury shares. Indeed, it could more truthfully be said that the character of the transaction was becoming increasingly confused with succeeding decisions. However, it would have been simpler if treasury shares had not been originally classified as assets, so that asset recording principles probably would not have been used in reporting them.[152]

As it was, accountants were being particularly careful to use methods which would not mislead the lay public on true financial state of the company[153]. In doing so, there was a difference in what the law said treasury shares were and in what the accountant represented them to be.[154] Accountants by reason of the original erroneous concepts of treasury shares misinterpreted them by their entries on balance sheets. Yet it would have been simple enough if both the financial and legal effect of the purchase could have been understood.[155]

---

[150]Ibid 280.It was only a step from the labelling of a part of an initial investment as surplus to toleration of the view that the excess of the amount received from the reissue of acquired shares over the amount disbursed upon acquisition was a profit to the issuing corporation.
[151]*Glenn L Martin Co. v. United States,* (December 1937) 21 Federal Supplement. 562 at 564.
[152]NG Rueschhoff op cit (n140)6.
[153]Ibid 6.
[154]HW Ballantine op cit (n13) 539-540.
[155]Ibid.

3.3. TAXATION ON TREASURY SHARES

The ambiguous nature of treasury shares also caused considerable difficulty to the Federal Treasury Department in income tax cases.[156] The issue was whether a corporation that acquires its own shares and sells them at an increased price must include this increase over cost in computing its federal income tax.[157] In the beginning, the Board of Tax Appeals took the position that gains and losses from the purchase and sale of a company's own shares were not to be included in computing the federal income tax for the company.[158]

In the case before it, *Simmons & Hammond Manufacturing Co.,*[159] the company repurchased all of its shares held by three shareholders and resold it to two other shareholders for less than half the price it had paid. It sought to subtract this loss from its income. The Board held that it was a capital transaction and did not result in a realised loss to the company.[160] This decision followed the Revenue Act 1918.[161]

The Revenue Act 1918 prescribed that the sale of treasury share was a capital transaction and did not constitute income to the company.[162] Accountants and lawyers agreed that the earned income of a corporation could not be credited or charged with gain or loss under such circumstances as it would result in a distortion of company earnings, which were considered to be the result of business operations.[163]

However, in 1934, Internal Revenue regulations established that gains on sales of treasury shares were taxable income to the selling company.[164]

---

[156]NG Rueschhoff op cit (n140)3.
[157]Ibid.
[158]WL Roberts 'Taxation of Treasury Stock' (1949) 38 *Kentucky Law Journal* 337 at 339.
[159]*(1925)* 1 B.T.A. 803.
[160]Ibid.
[161]RE Carlisle 'Treasury Stock and Section 1032' (April 1955) *George Washington Law Review* 560-561.
[162]NG Rueschhoff op cit (n140)3.
[163]Ibid.
[164]NG Rueschhoff op cit (n140)3.

Under these regulations, when the treasury shares were first recorded at cost and later sold at a price unequal to the cost, a gain or loss resulted from the transaction.[165] Such gains were to be considered taxable company income although it could be avoided by cancelling the treasury shares and issuing other authorized shares.[166]

These regulations reduced the use of treasury shares and it was called one of the real errors in income tax history because a switch in accounting methods or records could have nullified the effect of the regulations.[167] In other words, this change in tax regulations was adopted from the confusion that was present in accounting principles and company law. The lack of unanimity regarding what constituted treasury shares, how to represent them in accounting and the conflicting opinions on a solution had similar effects in considering the taxation of treasury shares.[168]

3.4. CLARIFYING TREASURY SHARE COMPLEXITIES

In recent developments, there has been more clarity in this regard. To begin with, legally, treasury shares have been declared as non-assets of the company holding them and that whilst in treasury they are in a legal and practical limbo with no rights. Therefore, they are effectively side lined for tax and accounting purposes.[169] In this state, they have only a neutral role for legal, tax, accounting and market-control purposes.[170]

Further developments in the accounting and tax fields have been as follows:

---

[165]Ibid 4. See also WA Paton op cit (n114) 280.
[166]Ibid.
[167]CH Rankin 'Treasury Stock: A Source of Profit or Loss?' (March 1940) Accounting Review 70-71.
[168]NG Rueschhoff op cit (n140) 4; s.195(4)(b) and (c)
[169]FV Detlev *Basic Corporation Law* 3 ed (1989) 399. G Morse op cit (n38) 331.
[170] Morse op cit (n38) 323.

3.4.1. Accounting Alterations

The accounting practices are not as uncertain as they had been. As discussed, the issue had how to assimilate treasury shares into the accounting standard practices. Interestingly, it is the English courts that have attained the clarity in the matter.[171]

The United Kingdom Accounting Standards Board (ASB) has two publications[172] that provide for the accounting treatment of treasury shares in all instances except where they are transferred out to an employee share or option scheme.[173] The basic premise is that conceptually a company's holding of treasury shares gives rise to a reduction in the company's ownership interest, not assets.[174] It follows from this then that transactions in treasury shares do not give rise to gains or losses in the issuing company's profit and loss account or statement of total known gains and losses.[175] The same relates to the issuing company's consolidated financial statements.[176]

Accordingly, pertinent increases and decreases in the company's ownership interest should apply. Treasury shares must be subtracted from shareholders' funds and no gain or loss arising from the purchase, sale or cancellation of treasury shares should be recognised in the profit and loss account.[177] The amounts paid for the purchase and resale of treasury shares must be shown as distinct amounts in the reconciliation of movements in shareholders' funds.[178]

What is distinct in these principles outlined in the United Kingdom is the clarity the accounting practices now have. There has now been provided

---

[171]It is also the English courts who were very clear about reacquisition of shares.
[172]Ibid. These are available at *www.asb.org.uk/uitf.*
[173]G Morse op cit (n38) 323.
[174]Ibid.
[175]Ibid.
[176]Ibid.
[177]Ibid 324.
[178]Ibid.

for the accounting field, provisions that can guide the accountant in recording treasury shares in the company books.

3.4.2. Tax Alterations

Similarly, it has been important in clarifying the mystery surrounding treasury shares, to sort out the tax implications of putting shares into treasury, holding them in treasury and then either cancelling them or transferring them out of treasury.[179] Once again, the United Kingdom, achieved by including tax considerations in the second consultative document of the dti, implementing the tax proposals in the Finance Act 2003 and bringing those into force on the same day as the new company law regulations.[180] The Tax Revenue Board (TRB) subsequently adopted the same tax proposals in the Act and so did the Financial Services Authority (FSA). All regulatory bodies their use the approach set out in the Act that in so far as possible, treasury shares should not affect the existing share repurchase tax regime and should be as close to the existing regime as possible so that tax considerations should play no part in a company deciding whether and when to exercise the treasury share option.[181]

The existing regime is that where the amount paid to an individual shareholder on a reacquisition is in excess of the amount originally subscribed for the shares, that excess is treated as a distribution by the company to the shareholder.[182] As such, that will then attract a 10 per cent tax credit sufficient to negate a basic taxpayer's liability to income tax and reduce the higher rate tax rate to an effective 22.5 per cent of the grossed-up

---

[179] UKdti op cit (n97) para.6 and annex D.

[180] December 1, 2003, which was also the day for implementation of the takeover and listing rule changes and the accounting standards.

[181] Even though to achieve this, the tax regime contradicts the company law position as to the status of treasury shares by regarding them as having been cancelled when they have not been and also not as part of the company's issued share capital; although the latter is frequently also the fiction adopted in other areas such as the City Code, the Listing Rules and the knock-on effect on other parts of the Companies Act. See also G Morse op cit (n38) 321. See also s.195 of and Sch.40 of the Finance Act 2003.

[182] G Morse op cit (n38) 321. Section 209(2)(b)Taxes Act 1988 s.209(2)(b).

amount. However, in reality, the capital gains tax regime is more likely to apply in the case of these shares.[183]

For company shareholders there is no choice; distributions are not subject to company tax and the whole of the proceeds of a share repurchase is included in its chargeable gains.[184] This has been effected first by s.195 (2) and (3) of the Finance Act 2003, which provides that the company is not to be considered as acquiring any asset nor, for tax purposes, is it to be regarded as being a member of itself, even though it is registered as such in its own register of members.[185]

Furthermore, whilst the shares are being held in treasury the effect for tax purposes of their fictional cancellation is that the company's issued share capital is to be treated as if it had been reduced by the nominal value of the acquired shares, as would have occurred on a true cancellation.[186]

3.5. CONCLUSION

The modern law pertaining to accounting and taxation of treasury shares need not be uncertain. The United Kingdom has shown that a clear statutory guideline of how the taxation and accounting of treasury shares should be managed can be effective in clarifying the complexities that once surrounded treasury.

Additionally, this discussion has shown that whatever method a jurisdiction employs to handle treasury shares, they should not to be regulated in isolation of the company law but in agreement with other tax and accounting regulatory bodies.

With reference to the United Kingdom, it has been shown further that adopting treasury shares does not mean an overhaul reform to financial avenue of law. Most Financial bodies like the ASB and the FSA have simply

---

[183] G Morse op cit (n38) 323.
[184] Ibid.
[185] Section 162A (2) Companies Act 2006 (UK).
[186] G Morse op cit (n38) 321. See also s. 195(4) (a) Finance Act 2003 (UK).

aligned their approach to that set out in the Finance Act 2003 that in so far as possible, treasury shares should not affect the existing share repurchase tax regime and should be as close to the existing regime as possible so that tax considerations should play no part in a company deciding whether and when to exercise the treasury share option.[187]

The clarity now attained in these areas discredits complexity that the United States proposed as a reason for abandoning treasury shares. This is therefore not a valid reason that can be used against the incorporation of treasury shares in South Africa. In fact, there are several benefits in adopting treasury shares.

[187] Ibid.See also section 195 of and Sch.40 Finance Act 2003 (UK).

CHAPTER FOUR: THE COMMERCIAL VALUE OF TREASURY SHARES

4.1. INTRODUCTION

Beginning from the time the United States started using treasury shares, companies preferred using treasury shares for various reasons. Treasury shares could be used to gain working capital in new and projected enterprises. Organisers received fully-paid shares for their contributions of property or services, and they in turn donated some of these shares back to the company. The donated shares were then documented at their expected reissue price to the public which added to contributed capital even if the documented amount was below par value.[188] Banks and insurance companies also found treasury shares useful. Treasury shares of a debtor company were acquired by acceptance of the company's shares in payment of a debt owed. This occurred when debtor companies were required to purchase treasury shares as security for a loan or mortgage, and then defaulted.[189]

These were the main uses of treasury shares historically. However, as time progressed, so did the uses. The flexibility treasury shares offered was beneficial. A company could resale treasury shares at any price determined by the board of directors even though this was less than their original par value.[190] Furthermore, the purchase of treasury shares could support the market price of shares and effect company adjustments particularly when a retained earnings deficit existed. Additionally, they were a sound investment by the company because of the decline in prices in the United States during the 1920's.[191]

This chapter delves into a discussion of the various benefits of using treasury shares now provide in modern company law. The discussion will be

---

[188]NG Rueschhoff op cit (n140) 2.
[189]Ibid.
[190]Ibid 1.
[191]NG Rueschhoff op cit (n140) 1.

done in order to establish the commercial value to be gained in allowing companies to have treasury shares in South Africa.

4.2. BENEFITS OF USING TREASURY SHARES

4.2.1. Flexibility

As submitted in the introduction of this paper, in order for South African company law to be competitive in global markets, it must be adequately flexible to achieve legitimate economic and social objectives whilst at the same time guaranteeing proper minority shareholder and creditor protection.[192] The primary benefit of treasury shares is the flexibility they provide to a company in managing its capital structure, raising funds and disposing of shares. This section will expound on these respectively.

4.2.1.1. Management of Capital Structure

One of the main advantages of allowing companies to hold repurchased shares in treasury rather than cancelling them is to give the companies increased ability to manage their level of capital in the same manner as they manage other resources like land or labour.[193] Capital structure refers to how a company finances its operations and investments, either through debt or equity.

By managing the balance between debt and equity capital, companies would be able to reduce the average cost of capital over the business cycle. In addition, the speed and flexibility with which treasury shares could be resold through the market would allow companies to carry a higher level of debt, when this is measured to be cheaper than equity, as they would know that treasury shares could be resold comparatively quickly if interest rates

---

[192] G Morse op cit (n 38) 303.
[193]UKdti *Share buy-backs* (May 1998) URN98/713para 3.2-3.8.

rose and the companies' gearing were approaching a level higher than was considered appropriate.[194]

Moreover, in the instance that a company repurchases and holds its shares, reducing the amount of shares on the market allows the company some control over supply versus demand. Accordingly, the supply of shares that are held in abeyance in the company treasury are a tool that can be used for a number of targeted activities that require control over a valuable asset without having to authorize additional shares that dilute existing equity.[195] Consequently, the ability to regulate the capital structure gives the directors a greater control of the company, enabling them to manipulate the capital structure to suit the changes in the market.

4.2.1.2. Raising Funds

Treasury shares also give companies the choice of using their broker to resell treasury shares in small lots through the market at the full market price. This option is considered to be a valuable replacement, in appropriate market conditions, to methods such as rights issues and placings of shares which frequently involve the shares being underwritten and/or offered at a discount to the market price. Whilst issuing new shares at a deep discount provides companies with one mechanism to limit the need for underwriting, an additional option of avoiding underwriting costs by gradually selling treasury shares through the market as and when market circumstances allow is an additional advantage.[196]

In addition, there is the potential to reinstate the distributable profits used when shares are bought back. The distributable profits used to buy

[194]N Wesson & WD Hamman 'The Repurchase by a Holding Company of Treasury Shares held by Subsidiaries: A SA perspective' (2012) *(43) 4 S.Afr.J.Bus.Manage* 36This may seem unimportant, but investors sometimes look at the capital structure of a business when considering investment, and in some industries a structure weighted toward equity can be disadvantageous.
[195]Securities and Futures Commission of Hong op cit (n23) para 3.5.
[196]Ibid para 3.6.

back shares are lost when the shares are cancelled.[197] Purchases into treasury still amount to a reduction in shareholders' funds but, on the sale of shares out of treasury, the sale price will replace the distributable reserves up to the amount lost on their acquisition.[198] Any profit raised by the company on a sale of treasury shares must be accredited to the share premium account. [199]

Moreover, in countries like Italy, where there are no market makers,[200] companies can carry out trades in own shares to increase liquidity when it is lacking. In markets where elected market makers exist like the New York Securities Exchange, repurchasing companies compete with these intermediaries and may provide extra liquidity.[201] However, the trading activities of repurchasing companies are possibly more advantageous in markets like the Italian Stock Exchange where the endogenous liquidity offered by dealers may sometimes be too low and market makers are usually absent. In these markets, issuers can increase trading in own shares when endogenous liquidity is low and, successfully, act as distinctive market makers.[202]

4.2.1.3. Disposing of shares without the restrictions applicable to issues of new shares

Resale of treasury shares is more flexible than the issue (or reissue following a repurchase and cancellation) of shares in three main respects. Firstly, treasury shares are not subject to the rules which effectively prevent issues of shares at a discount to their nominal value.[203] By this is meant that treasury

---

[197]Ibid.

[198]Securities and Futures Commission of Hong op cit (n21) para 3.6.

[199]Ibid.

[200] Market makers are dealers in securities or other assets who undertake to buy or sell at specified prices at all times. See also A De Cesari et al 'Stock Repurchases and Treasury Share Sales: Do they Really Stabilise Price and Enhance Liquidity?' (2011) 17(5) *Journal of Corporate Finance* 1558-1579.

[201]Ibid.

[202]Ibid.

[203] Securities and Futures Commission of Hong op cit (n23) para 3.8.

shares may be sold at a discount to their nominal value although this may be limited to a discount percentage in different jurisdictions.[204]

Secondly, there is no need to comply with certain requirements relating to the allotment[205] of shares like for instance, the amount to be paid for shares and the method of payment and restrictions on types considerations. Thirdly, there is similarly no need to comply with any restrictions that appear in a company's MoI in relation to the issue of shares. For example, treasury shares may simply be resold by the directors without the need for shareholder approval on every occasion.[206]

Furthermore, as formerly stated, treasury shares could be resold without regard to shareholder of preemptive rights. This was considered one of the distinct advantages of treasury shares. However, more recently, and in various instances, treasury shares may have preemptive rights, which in essence do take away this advantage.[207]

The flexibility in disposal means that treasury shares can be resold through the market with a speed and flexibility.[208]

4.2.2. Management of Employee Share Schemes

An employee share scheme is a scheme for encouraging or enabling the holding of shares in a company, for the benefit of employees or former employees of the company.[209] The scheme usually involves the company setting up a trust which is provided by the company with money for the subscription for or the acquisition of shares in the company to be held for the advantage of employees. It involves existing shares as opposed to newly

---

[204]Ibid.
[205]Ibid.
[206]Athough the dangers attached to such use are many including abuse of power by the shareholllders. Securities and Futures Commission of Hong op cit (n23) para 3.8.
[207]N Adams op cit (n93).
[208]Securities and Futures Commission of Hong op cit (n23) para 3.8.
[209] MS Blackman et al op cit (n4) 5-50. See also section 743 of the English Companies Act 1985 and section 146A of 1973 Companies Act. See also FHI Cassim et al op cit (n2) 296.

issued shares usually structured by the company advancing funds to a separate trust for the purchase of the shares.[210]

Treasury shares offer an alternative to this procedure by streamlining the procedure.[211] A company can hold shares directly in treasury after repurchase and subsequently using them to cover the exercise of share options, or the distribution of shares thereby making trust arrangements unnecessary.[212] This would simplify the process and serve to promote and encourage employee share schemes. In other words, instead of ware-housing in a trust, shares acquired for an employee share scheme, such shares could be held by the company itself in the form of treasury shares. This is undoubtedly more cost effective.[213]

Aside from the advantage of cost effectiveness, using treasury shares in this manner has the advantage of not diluting the equity of existing shareholders since the unused equity stored in company's treasuries can fund a share option plan without having to authorise additional shares.[214] However, such use of treasury shares is currently only a fairly common practice in a few countries, of which South Africa is not yet one.[215]

4.2.3. Investment in Companies' Own Shares

Treasury shares enable companies to invest their own shares if they consider that the return from doing so would be higher than that which could be achieved from pursuing other business projects.[216] Treasury shares increase or decrease in value like any asset held by the company. Accordingly, they can provide an opportunity for companies to improve the returns for long

---

[210] Ibid.
[211] Securities and Futures Commission of Hong op cit (n23) para 3.9.
[212] Ibid.
[213] UKdti op cit (n97).
[214] Ibid.
[215] Ibid.
[216] Ibid.

term shareholders by acquiring the companies' own shares when they are undervalued by the market and reselling them for a profit at a later time.[217]

In more practical terms, treasury share acquisition can, be indicative of companies having faith in their business fundamentals. This can boost investor confidence. For instance, with regard to company groups, a mature subsidiary company with stable operations and a cash surplus could commercially authorise a purchase of its holding company's shares and hold them.[218] Investing in research or new businesses (outside of the group), may not necessarily be commercially prudent and could result in the company becoming inactive. A subsidiary acquiring the shares of its holding company under such circumstances is arguably an efficient placement of the subsidiary's capital. However, there is a risk that an indirect share repurchase can be viewed with circumspection, given its intrinsic ability to mask the actual state of affairs.[219]

4.2.4. Encourages Repurchases

In practice, one of the factors discouraging companies from reacquiring their shares is the procedural requirements and expenses involved in issuing new shares. If, instead of cancelling the repurchased shares, a company is permitted to hold its repurchased shares in treasury, this reluctance to repurchase its own shares would disappear.[220]

4.2.5. Safeguard against Hostile Take Overs

Shares that are stored in the treasury are unavailable for acquisition in the event of a hostile takeover attempt. This equity can be reissued at any time, changing the ownership percentage that is required to control a vote to

[217]Securities and Futures Commission of Hong op cit (n23) para 3.7.
[218]Miller 'So Much Cash, so Few Options' (June 1998) *http://www.cfoeurope.com/199806e.html*; See also D Bhana op cit (n28) 242.
[219]Ibid. Securities and Futures Commission of Hong Kong Kong op cit (n23) para 3.5-3.8.
[220]Ibid.

replace the board or management.[221] In addition, management is also provided with additional equity that can be used in the event of a merger. These shares are an asset that can be stored for future use, benefiting the companies by increasing their ability to control their financial position.[222]

4.2.6. Tax Benefits

Another of the beneficial uses of treasury shares is to return capital to shareholders in a way that minimizes their tax obligations. Distributions of earnings to shareholders typically take the form of a dividend that is taxed at the corporate level when it is distributed and at the individual level when it is received.[223] However, a share repurchase is not a taxable event. The money used to repurchase the shares is not taxed, and the shareholder is taxed only on money received after the shares are sold and capital gains can be determined.[224]

4.3. CONCLUSION

The above exposition highlights the commercial value that treasury shares provide in modern company law.

Using treasury shares gives companies flexibility in managing their capital structure, raising funds and disposing of shares onto the market in a cost effective method than a fresh issue of share. In other words, treasury shares decrease the propensity of companies to react to the market while increasing their ability to act and influence the market.

Moreover, treasury shares serve to promote and encourage employee share schemes since they remove the necessity for a separate trust to be created for the purpose of holding shares for the scheme. This in turn,

---

[221]Securities and Futures Commission of Hong Kong Kong op cit (n23) para 3.5-3.8.
[222]Ibid.
[223]Ibid.
[224]Treasury Shares: The Practicalities' (2003) *Practical Law* available at *uk.practicallaw.com* accessed on 20th October, 2014.

streamlines the procedural process.[225] Additionally, treasury shares provide an opportunity for companies to invest in their own shares either directly or indirectly (by way of a subsidiary). Further, they encourage repurchases and safeguard against hostile takeover.

Based on these advantages, it can be concluded that an introduction of treasury shares into the South African law would increase the attractiveness of South Africa as a location in which to do business for both domestic entrepreneurs and international investors. For international investors, it would give South Africa an edge over the countries that do not have them, while for domestic entrepreneurs; it would simplify a lot of processes that are straitjacketed by the current law like the employee schemes.

Moreover, treasury shares would allow for flexibility and simplicity in the maintenance of companies which is one of the purposes of the Companies Act 2008. That would in turn create optimum conditions for the aggregation of capital for productive purposes and for the investment of that capital in other enterprises.[226]

Consequently, the financial health of companies would improve, and with it the economy of the country. There is therefore high commercial value attached to treasury shares and not at the cost of the purpose of the Companies Act 2008. In fact the flexibility presented by treasury shares resonates with the goals of Act as set out in Section 7.

However, in order for South African company law to legitimately adopt treasury shares and increase South Africa's competitiveness in global markets, it must not only be sufficiently flexible to achieve economic and

[225]Employee share schemes are good for the company because company shares have a higher upside potential (since they can appreciate significantly over time) than cash bonuses or salary increases. Availability of this sort of plan is therefore a significant enticement to recruit talented employees.

[226]As discussed in this chapter, there would be a decrease of costs from the avoidance of issue of new shares and employee share schemes thereby freeing money for more targeted goals of the company.

social goals but must simultaneously ensure proper minority shareholder and creditor protection. The next chapter will therefore discuss the dangers that surround treasury shares and any safeguarding measures that can be used to counter them.

CHAPTER FIVE: THE DANGERS OF TREASURY SHARES

5.1. INTRODUCTION

Despite the attractiveness of treasury shares for South Africa, there are potential risks that the advantages must be examined in contrast to, in order to ascertain whether they should be adopted. The protection of creditors and shareholders from the abuse of power by directors and the shareholders of a company have always been at the core of company law.[227] On the one hand, shareholders have demonstrated strong tendencies to act opportunistically at the expense of creditors, and they would, if they could, make excessive distribution payments to themselves. On the other hand, directors have shown a tendency to draw excessive salaries and other benefits from their companies to the detriment of company and shareholders.[228]

For decades, the classical rigidity of the capital maintenance doctrine was considered to be the most effective way to protect creditors and shareholders.[229] It restricted the freedom of a company to return to its shareholders the funds which were originally subscribed for its shares except where this was authorized by the Companies Act. Although this doctrine has now been discredited, company law experts have confirmed that the protection of shareholders and creditors still forms an integral part of any company law system.[230]

Thus, in order for South Africa to legitimately have set aside the capital maintenance doctrine, the regulatory framework had to have included a consideration of the restrictions and controls, which were

---

[227]E Ferran 'Creditors interests and "core" company law' (1999) 20 *Company Lawyer* 314 at 315.

[228]FHI Cassim 'The reform of company law and the capital maintenance concept: note' (2005) 122(2) *SALJ* 283 at 284.

[229]Ibid.

[230]Ibid.

necessary to ensure that the shareholders and creditors were not abused.[231] There had to be a fine balance between the flexibility offered by the new provisions of repurchases and distributions and the protection of shareholders and creditors. This balance has to also exist if treasury shares are to be adopted.

The discussion in this chapter aims to look at the potential possibilities of abuse that treasury shares have presented to the market from their inception. There was traditionally found to be a risk of abuse by directors, risk of stock watering, and circumvention of preemptive rights. In recent times, treasury shares further present an increased risk of market manipulation and directors misusing their powers.

Accordingly, any possible safeguards against the risks will be discussed in order to establish whether South Africa can legitimately adopt treasury shares. Should the dangers of using treasury shares outweigh the benefits, there can be no case made for the use of treasury shares in South Africa.

5.2.ABUSES OF TREASURY SHARES

5.2.1. Treasury Shares and Immorality (Abuse by Directors)

The morality of holding shares in treasury is questionable because it is closely allied with the idea of injury to others.[232]

By way of illustration, a picture can be presented of a city, showing the intersection of streets[233]. The huge figure of the company is shown, pacing forcibly along the streets. Alongside the company, the directors in control stride on their nimble legs, directing the course of the company sometimes along one street and sometimes down the intersecting avenue, in

---

[231]For example, the potential advantages of reacquisitions had to be weighed against the potential risks in order to protect the interests of the creditors and shareholders, and to prevent malpractices in the securities markets
[232]TH Deinzer op cit (108) 256.
[233]Ibid.

search of Profits. In the crowds of spectators are shareholders, creditors, and persons with no direct interest in the company or in its productive activities.[234]

The shareholders and the creditors who made possible the company's search for Profits are to a degree interested in giving the company the right to cross as the company is hunting for Profits. [235] A search for Profits in the outlying sections of the city might provide a chance for the directors to appropriate to their individual benefit a share of the Profits accumulated along the way, in breach of their trust to direct the activities of the company for the pro rata benefit of all the shareholders and for the protection of the creditors. The key emphasis here is therefore on keeping the company in those channels where its actions may be kept open to observation.[236]

The inference from this analogy is that a company should be prohibited from repurchasing, holding and reselling shares of its own because of the possibilities for individual gain to directors resulting in harm to shareholders and creditors. For instance, directors could utilise the share repurchase and resale mechanism as a way to manage the company's share price in such a way that benefits themselves rather than shareholders.[237] This might occur in relation to the exercise of share options, where directors may be tempted to arrange for the company to sell treasury shares after they have exercised their share options and sold their personal shares.[238]

---

[234]TH Deinzer op cit (108) 256.
[235]Ibid.
[236]Ibid.
[237]Ibid.
[238]Ibid. A share option is a right granted by a company to its employees or directors to acquire shares in it at a pre-determined price. Should this right be exercised before a treasury share sell then it is only for the advantage of the directors because of the pre-determined price. Whereas a sell of treasury shares is at any price set by the directors.

5.2.2. Stock Watering

In *Hospes v North Western Manufacturing & Car CO,*[239] Mitchell J observed that stock watering was one of the greatest abuses connected with the management of companies.[240]

Traditionally, treasury shares could be resold by the company at any price determined by the board of directors even if it was less than their original par value.[241] This gave rise to watered shares.[242] Watered shares are shares that are issued in return for property or services worth less than the par value. In other words, they are shares issued without corresponding pay-in assets valued at an amount equal to par ie shares not against assets but water.[243] Consequently, watered shares misrepresented the company's capital because they amounted to an overvaluation of the capital of the company. As a result, creditors of the company were entitled to recover compensation from the holders of watered stock under 'watered stock liability'.[244]

By using treasury shares however, liability could be avoided. When a company repurchased its shares after they had been issued, it could resell those shares at any price without giving rise to watered stock liability. The theory underlying this was that the shares remained issued even though they were held in the company's treasury.[245] As a result, their resale at less than par value did not water the company's share account. It followed therefore, that a purchaser of treasury shares would have had the assurance

---

[239]48 Minn 174 (1892), 50 NW 1117 at 1120.
[240]FHI Cassim op cit (n1) 139.
[241]A sale of treasury shares at a grossly undervalued price in order to enable a shareholder to obtain control of the corporation may of course he set aside.
[242]FHI Cassim op cit (n1) 141.
[243]Bayless Manning &JamesJ Hanks Jr *Legal Capital* 3 ed (1990) 24.
[244]Ibid. See also *Bing Crosby Mintte Maid Corporation v Eaton* (1956) 297 P 2d 5.
[245]FHI Cassim op cit (n1) 142.

that creditors of the company would have no claim.[246] While this may have been good for the shareholder, it did not protect the creditor.

Currently, since shares no longer have a par value[247] and thus no minimum price at which shares must be issued, there can no longer be any liability for watered shares.[248] However, although there can be no liability, an overestimation of the value of treasury shares by the directors would still result in stock watering leaving the creditor disadvantaged.

5.2.3. Market Manipulation

Permitting a company to repurchase and resell its own shares also creates conditions in which companies may influence a creation of a false market or manipulate its own share price, particularly for short term gain.[249] In other words, companies may deceive the market into believing the shares are worth more than they actually are.

One way of doing so would be by repurchasing outstanding shares.[250] This makes the remaining outstanding shares seem as though they are naturally increasing in value. If the firm's earnings are declining, a quickly executed share repurchase program can lead to an increase in share value.[251]

Manipulation is also a risk where a company seeks at a particular time[252] to give an impression of value which may not be justified by its performance. Using treasury shares, a company can manipulate or influence the company's earnings per share and other performance ratios. These

---

[246]Ibid.

[247]This has been abolished in the new Companies Act 2008.

[248]FHI Cassim op cit (n1) 142. Section 40 of Companies Act 2008 provides that the price at which shares may be issued is now a matter of the fiduciary duties of a director. In South Africa, this would mean that the directors of a company may determine what the adequate consideration of the shares would be. This determination would not be able to be challenged on any basis other than in terms of section 76 as read with section 77(2) of the Act which set out the conduct and liabilities of directors.

[249]Morse op cit (n38) 308.

[250]Securities and Futures Commission of Hong Kong op cit (n23) para 3.10-3.12.

[251]Ibid.

[252]such as when trying to secure further debt or equity finance

concerns, however, exist to a certain extent at present since repurchases of shares by companies are already permitted, albeit that the shares repurchased may not be held in treasury under the current law.

Further, shares that are stored in the treasury are unavailable for acquisition in a hostile takeover attempt. These shares can be reissued at any time, changing the ownership percentage that is required to control a vote to replace the board or management.[253] In addition, treasury shares also provide management with additional equity that can be used to facilitate a merger or avoid one. Treasury shares can be used in this way therefore to maintain management even when it is to the detriment of the company.[254]

Market manipulation is easily the worst abuse of treasury shares and while this risk already exists under the existing repurchase, cancellation and new issue rules, treasury shares accelerate the ease with which shares could be withdrawn from and replaced into the market and may thus aggravate the risk of manipulation.

It is true that these risks are hemmed in by the usual fraud and fiduciary qualifications. However, these may be insufficient when the burden of showing violations is on the plaintiff shareholder, especially where the company is large and the shareholder small.[255] Market manipulation would therefore be a reasonable reason why treasury shares are prohibited in many jurisdictions.

However, market manipulation is not an unmixed evil. Once a company's shares are listed on an exchange, it is a common rule of the financial world that the company must be prepared to support its shares on the market and protect them from becoming a football for professional manipulators. For a company to refuse to support its own shares may be fatal, since depressed prices on the stock exchange, even artificially

---

[253]Securities and Futures Commission of Hong Kong op cit (n23) para 3.10-3.12.
[254]Ibid.
[255] Securities and Futures Commission of Hong Kong op cit (n23) para 3.10-3.12.

depressed prices, sooner or later affect sales and credit standings. Thus, the argument for permitting a company to deal creatively on the exchanges in its own shares is the same as that which supports the existence of the exchange itself, the stabilising result realised by free trading.

5.2.4. Circumvention of Preemptive Rights

Furthermore, as previously discussed, the dictum in *Hartridge v. Rockwell*[256] stated that treasury shares were not subject to preemptive rights upon reissue. As such the resale of treasury shares could be used to circumvent preemptive rights.[257]

This presented several risks among which was that the company management could be able to reissue shares without giving minority shareholders an opportunity to buy, by issuing the shares and then repurchasing them.[258] Or, more commonly, the management could prevent the minority from growing by maintaining the existent capital structure.[259] However such conduct was subject to fiduciary duties of the directors and can still be presently effectively managed by provisions on fiduciary duties.

5.2.5. Insider dealing

Insiders are officers or employees of a body corporate or the body corporate itself. Insiders can also be those who receive, and deal, on the basis of relevant information provided by insiders who are connected to the body corporate although they themselves may not be connected.

In the context of treasury shares, decisions relating to resales of shares are in almost all circumstances taken by directors.[260] However, persons who are connected with a body corporate are insiders and are therefore prohibited from dealing with its securities where they have acquired

---

[256](1828). R.M. Charlt. 260.
[257]V Morawetz op cit (83) 186.
[258]Ibid.
[259]EE Nemmers Power of a Corporation to Purchase Its Own Stock (1942) *Wis. L. Rev.*161at 166.
[260]Securities and Futures Commission of Hong Kong op cit (n21) para 3.10-3.12.

information in connection with their positions which is not generally available, but if it were, would materially affect the price of the securities.[261] Therefore there is a risk that insiders can deal in the company's shares when they know that a resale is pending or deal when they are in the possession of relevant information.[262]

5.3. SAFEGUARDS AGAINST ABUSE

As a result of these potential dangers of treasury shares, one prominent issue arising from allowing treasury shares is whether and, if so, what restrictions should be used to prevent companies from unfairly exploiting the market and injuring shareholders, creditors and the public.[263] In this regard it is useful to draw reference from jurisdictions successfully regulating treasury shares.

5.3.1. Restrictions on the Company and Directors

At the outset, the voting and financial rights attached to treasury shares are neutralised. A neutralisation of these rights addresses the issue of companies having ownership in themselves and the attendant dangers of abuse of control by the company's directors if companies were able to vote for themselves and/or pay themselves whether directly or indirectly. [264]

In addition, the standard safeguards of company law can play an important role in curbing this abuse. These safeguards include disclosure of shares held in treasury, requiring shareholder approval for the resale of treasury shares and, more importantly, prohibiting the sale of treasury shares at price sensitive times.[265]

---

[261]Ibid.
[262]Ibid.
[263] G Morse op cit (n38) 316.
[264]Indirectly refers to its subsidiary.
[265]FHI Cassim op cit (n1) 146. Price sensitive times are those times when a company has inside information that will affect the price of its shares.

Consequently, in the United Kingdom for instance, a company's ownership of treasury shares is recorded, in the same way as any other holder of the shares, in the company's own register of members. Treasury shares cannot be registered in the register of members in the name of a nominee of the company. The treasury shares must be listed in the register of members in the name of the company itself as the shareholder.

By entering the company as the registered owner of the shares it does of course strictly become a member of itself, but that causes no theoretical problems since this self-membership is, in reality, purely nominal, as it is in every other jurisdiction, in that no ownership rights attaching to the shares can be exercised whilst they are in treasury.[266]

Furthermore, a disclosure obligation under the listing rules for all transactions involving shares coming in and out of treasury ensures that there is accountability by directors.[267]

5.3.2. Safeguards against Market Manipulation

Under the Stock Exchange Listing Rules there is a requirement prohibiting purchases by a listed company of its own shares after a price sensitive development has occurred or has been the subject of a decision until that information has been made public. In particular, a company may not purchase shares during the month before the preliminary announcement of the company's annual results or the publication of the interim report. Such a prohibition could also be applied in South Africa to treasury shares to avoid companies taking advantage of these circumstances.[268]

Further, The United Kingdom has restricted the creation of a false market by equating of disposals of treasury shares with disposals by directors of shares in their own companies so that in general there can be no

---

[266]G Morse op cit (n38) 313.
[267]Ibid. This is the case in the United Kingdom.
[268]Securities and Futures Commission of Hong Kong op cit (n21) para 3.10-3.12.

sales or transfers at any time when a director would be prohibited from disposing of company shares.[269]

Additionally, to avoid frustrations during takeover bids, target companies can be prohibited from transferring shares out of treasury either by sales for cash or to an employee share or option scheme during an offer period. This minimises the risk of target boards engaging in any frustrating action against the bid without the consent of its shareholders.[270] However, any prior contractual obligations or shareholder approval would be an exemption.[271]

The United Kingdom Department of Trade and Industry (UKdti)[272] also recommends that a safeguard of a 10 per cent limit of the issued share capital of the relevant class of share should be the maximum number of shares that can be held in treasury by a company so that the number of shares that can be open to abuse are limited.[273]

5.3.3. Safeguards against Circumvention of Preemptive Rights

To curb the dangers of circumvention of preemptive rights, a limit can be applied on the discount to market price on issues and sales from treasury. For instance, no sales from treasury can be made unless the opportunity is made available to all existing shareholders, at a discount of more than ten per cent to the middle price of those shares at the time of sale.[274]

Alternatively, preemptive rights could be made applicable to treasury shares.[275]

---

[269]G Morse op cit (n38) 316.
[270]Ibid 320.
[271]Ibid.
[272]UKdti op cit (n97)para 3.13.
[273] Ibid.
[274]Ibid 317. Disapplication of pre-emption rights. See also *Palmer's Company Law* (Sweet and Maxwell) paras 5.709.
[275]FHI Cassim op cit (n15) 162. Although there are provisions for shareholder rights of pre-emptive to be not applied provided that the proper procedure is followed. This requires shareholder consent to the disapplication of their pre-emptive rights. The Listing Rules of

5.4.CONCLUSION

The attractiveness of treasury shares for South Africa faces potential dangers that advantages of treasury shares must be examined in contrast to, in order to ascertain whether they should be adopted. This discussion has examined the risks of abuse of power by directors, stock watering, and circumvention of preemptive rights, market manipulation and insider dealing. All these have the potential to harm the company, the market, creditors and shareholders.

Indeed these risks are hemmed in by the usual fiduciary qualifications. Notwithstanding, these may be insufficient when the burden of showing violations is on the plaintiff shareholder, especially where the company is large and the shareholder small.[276], these may be a small comfort when the burden of showing violations is on the plaintiff shareholder, especially where the corporation is large and the shareholder small.[277] Market Manipulation would therefore be a valid reason why treasury shares are prohibited in many jurisdictions.

Accordingly, one prominent issue arising from adopting treasury shares is whether and, if so what restrictions, should be used to prevent companies from unfairly exploiting the market and injuring shareholders, creditors and the public.[278] In this regard, references were drawn from jurisdictions successfully regulating treasury shares.

The standard safeguards of company law can play an important role in curbing this abuse. These safeguards include disclosure of shares held in treasury, requiring shareholder approval for the resale of treasury shares

---

the Stock Exchange in the United Kingdom also provide for further safeguards to deter the worst abuses of treasury shares while at the same time preserving their flexibility. They contain important guidelines for a still developing future company law system.

[276] Securities and Futures Commission of Hong Kong op cit (n18) para 3.10-3.12.

[277]Ibid.

[278] Ibid.

and, more importantly prohibiting the sale of treasury shares at price sensitive time.[279]

Further the voting and financial rights attached to treasury shares are neutralised. A neutralisation of these rights addresses the issue of companies having ownership in themselves and the attendant dangers of abuse of control by the company's directors if companies were able to vote for themselves and/or pay themselves whether directly or indirectly.

Additionally, the treasury regime can be fortified with transparency practices that are equivalent to the transparency of any other shareholder. The total effect of these measures would be to deter the worst abuses of treasury shares while at the same time preserving their flexibility.

From this discussion, it can be concluded that the dangers of treasury shares can be effectively managed. The precedent in the United Kingdom shows that the measures adopted to safeguard against abuse would be the standard measures used to restrict abuse of repurchases. Similarly, the regulatory framework in South Africa can include a consideration of restrictions and controls that are necessary to ensure that shareholders and creditors are not abused by the use of treasury shares. A fine balance between the flexibility offered by treasury shares and the protection of shareholders and creditors can be made.

The next chapter will look at the current practical position of treasury shares in South Africa and the various jurisdictions that are successfully using treasury shares in order to acquire further knowledge on how recommendations for treasury shares can be made for South Africa.

---

[279] FHI Cassim op cit (n15) 162.

CHAPTER SIX: TREASURY SHARES FOR SOUTH AFRICA

6.1. INTRODUCTION

Section 35(5) of the Companies Act 2008 precludes the existence of treasury shares in South African company law.[280] According to this provision, repurchased shares must be cancelled as issued shares and become part of the authorised share capital of the company.[281]

However, the Act also makes an important concession to this rule by permitting a subsidiary to acquire and to hold a maximum of 10 per cent in the aggregate of the issued shares of any class of shares of its holding company.[282] Section 48(2)(b)(ii) correctly provides that shares while held by the subsidiary, may not exercise any voting rights attached to them since a company cannot exercise ownership rights of the shares.[283] To this extent therefore, South Africa does allow treasury shares albeit, indirectly. In actual fact, a study conducted on the use of treasury shares by subsidiaries in South Africa shows that a large number of companies are using them.[284]

This chapter will examine this concession in order to determine the current status of treasury shares in South Africa. Thereafter, the speculative reasons why despite their indirect use, they were not adopted into the Companies Act 2008 will be outlined in an attempt to strengthen the case for treasury shares for South Africa.

---

[280]FHI Cassim op cit (n15) 163.

[281]D Bhana op cit (n28) 247. See also FHI Cassim (n15)152. The New Zealand Companies Act, 1993 has a similar provision. As a general principle, it deems shares repurchased by a company to be cancelled on their reacquisition by the company, although in certain exceptional circumstances a company may be permitted to hold the reacquired shares instead of having to cancel them on their acquisition. In the same way, the Australian Corporations Act, 2001 requires the repurchased shares to be immediately cancelled on their acquisition and cannot thereafter be used as security for a loan nor be reissued.

[282]FHI Cassim (n15) 151. See also Companies Ac 2008 section 48(2) (b) (ii).

[283]Companies Act 2008 section 48(2) (b) (ii).Oddly, however, nothing is said of dividend rights, so presumably this would be permitted.

[284]N Wesson & WD Hamman op cit (n194) 43.

Thereafter, the experiences of treasury shares in jurisdictions that are successfully using them will be examined to highlight a few lessons that can be used in a proposal to adopt treasury shares for South Africa.

6.2. THE CURRENT STATUS OF TREASURY SHARES IN SOUTH AFRICA

As previously defined:

> 'treasury shares are fully paid issued shares of a company that have subsequently been reacquired by that company whether by way of purchase, redemption, forfeiture, donation or otherwise, and which the company, instead of having to cancel on their reacquisition, is permitted to reissue, or rather to resell, for what they will fetch on the market. '[285]

Currently, South African company law continues to accept the proposition of treasury shares being a fiction that have no value to the company until resale and to harbour reservations about allowing a company to traffic in its own shares. In terms of section 35(5) of the Companies Act, a company is required to cancel all shares that it has directly repurchased. By this provision, the legislature seeks to impede the risks attendant on treasury shares by means of an absolute prohibition of such shares.[286]

Notwithstanding, on closer analysis, one finds that the legislature effectively permits an indirect holding of up to 10 per cent of the issued shares of the holding company of what is effectively a type of treasury share since the subsidiary does not cancel the acquired shares. According to Section 48(2)(b) of the Companies Act 2008, in the context of an indirect share repurchase by a holding company via its subsidiary, the shares so acquired equally constitute treasury shares, albeit indirectly. [287]

---

[285] See also FHI Cassim (n1)137. the risks and benefits of the power of a subsidiary to acquire its holding company's shares are essentially premised on the fact that the shares so acquired would be held by the subsidiary and not cancelled. In fact,

[286] See Loubser 2000 *SA Merc LJ* 7; Wainer 2001 *SALJ* 138**.**

[287] Ibid.D Bhana op cit (n28) 244.

Generally accepted accounting practices reiterate this position in where treasury shares include shares reacquired by the issuing company's subsidiary. In addition, the JSE Securities Exchange South Africa rules interpret section 48 in a similar manner in its reference to the listed shares held by the subsidiary in its holding company as 'treasury securities'.[288] Consequently, South African company law's general policy on indirect treasury shares is most pertinent to the question of whether to permit direct treasury shares.[289]

The advantages in this instance are similar to those discussed under the direct repurchase of treasury shares. There is the same benefit of an increased flexibility to companies operating in a group context.[290] Secondly, a subsidiary acquiring its holding company's shares as opposed to a company purchasing its own shares presents a taxation advantage. Whilst the latter purchase would constitute a dividend as defined in the Income Tax Act[291] and thus attract secondary tax on companies, the former would not amount to a dividend and would therefore avoid secondary tax on companies.[292]

On the other hand, to allow a subsidiary to acquire and hold shares in its holding company is to encourage simulated behaviour that enables a masking of the true state of affairs, thus increasing the potential for abuse. For instance, consider the scenario of an increase in dividends of the holding and subsidiary companies by the process of 'round-tripping' of dividends.[293]

---

[288]JSE Rules for listed company share re-acquisitions para 5.75.
[289]D Bhana op cit (n28) 245.
[290]Ibid.
[291] Ibid 241.
[292]The meaning of a dividend expressly includes share buy-backs in terms of section 85. Moreover, the definition's wording does not seem to accommodate an indirect share reacquisition by implication.
[293]See Delport (2001) *SA Merc LJ* 124 and *Unisec Group Ltd v Sage Holdings Ltd* 1986 3 SA 259 (T) 265-266**.** Round-tripping of dividends can happen when a subsidiary (especially a wholly-owned subsidiary) is a member of its holding company. When the holding company declares a dividend, the subsidiary, as a member, will receive portion of the dividend. The subsidiary in turn pays the dividend received as a dividend thus returning it to its holding company. The holding company will then in turn declare a dividend of such dividend received and the cycle continues until the whole dividend is distributed to the shareholders

Whilst an increase in dividends usually denotes an increase in earnings of the individual companies, in the case of a 'round-tripping' of dividends, the increased dividends are a sham which masks the true state of affairs from creditors and minority shareholders alike.

Such a loophole for treasury shares would not have been possible historically. Under the old capital maintenance regime, a company could not circumvent a direct prohibition by effecting the prohibited action indirectly via its subsidiary; the legislature aimed to close such loopholes.[294] Yet since such practices were discarded, the legislature expressly introduced this loophole via section 89 read with section 39 of the amendment of 1999 and more recently, section 46 of the Companies Act 2008.

It appears therefore that the law on treasury shares is inconsistent. On the one hand direct treasury shares are prohibited. On the other hand, indirect treasury shares are allowed, irrespective of both having similar benefits and risks. In fact, an exploratory study by Bester *et al.*[295], found that the repurchase of treasury shares by the holding company comprised 393 999 684 (17.1 per cent) of the total share repurchase of the 33 JSE listed companies included in the sample, for the period 1 July 1999 until the 2008 financial year end of the companies.

The purpose of the study was to establish whether the repurchase of treasury shares by a holding company is a regular occurrence for JSE listed companies. The study concluded that the repurchase of treasury shares is an acquisition method used extensively by JSE listed companies.[296] This method

---

(other than the subsidiary) of the holding company. It is important to note that round-tripping can also occur when a holding company is a direct member of itself, i e, the holding company buys back its own shares and does not cancel them but holds them in treasury.

[294]D Bhana op cit (n28) 248.

[295]PG Bester et al 'share buy-backs for a selection of JSE-listed companies: An exploratory study' (2010) 41(4) *South African Journal of Business Management* 47-58.

[296]N Wesson & WD Hamman op cit (n194)42.

however has proven to be unique to the South African repurchase environment.[297]

Therefore, the legislature needs to be especially meticulous in ensuring that the law is coherent and well structured so that no legal loopholes emerge. The law should be consistent in its policy that all treasury shares whether direct or indirect be enacted if there is to be an actual alignment of the legislature's treatment of holding and subsidiary companies. Any deviations from such policy, must receive careful consideration and justification.[298]

It is less than desirable that the legislature failed to mention indirect treasury shares and provide an explanation for their need. The legislature's failure to anticipate this implication of the previous section 89 and current section 46 can be attributed to the general absence of a coherent legislative policy on the basic treatment of holding and subsidiary relationships.[299] However, South African company law needs to reconcile its position on indirect and direct share repurchases. It must engage with the concept of treasury shares and formulate a coherent policy.

Aligning the law to the treatment of treasury shares by subsidiaries would be preferable. Indirect treasury shares have been in existence since the 1999 amendment. This system has therefore been up and running in South Africa and the only question which seems to remain is why it is taking so long to introduce treasury shares given their current use.

---

[297]Other jurisdictions do not allow it. In the USA, restrictions are imposed on a subsidiary company being used as an instrument to acquire, hold and resell shares of its holding company, as this would facilitate avoidance of treasury share regulations. Similarly, in English law, the prohibition on subsidiaries being members of their holding companies remains in place notwithstanding the recognition of treasury shares. This principle implicitly prefers the standpoint that the complexities attendant on regulating the potential for abuse in allowing an indirect holding of treasury shares via a subsidiary outweigh any potential benefit in allowing such practice.

[298]D Bhana op cit (n28) 248-249.

[299]D Bhana op cit (n28) 248-249.

6.3. REASONS AGAINST ADOPTION OF TREASURY SHARES IN SOUTH AFRICA

6.3.1. Lack of International Precedent

In light of the current status of treasury shares in South Africa, it is curious that there has been no re alignment with the methods employed between direct and in direct reacquisition of treasury shares. In addition to the complexities and disadvantages that prejudiced many jurisdictions against their use, another reason they have not been adopted would simply be lack of international precedent. Firstly, in reality only a small number of countries have adopted treasury shares. It is possible that their dangers still override their benefits for many jurisdictions.

Secondly, the indirect treasury shares have not been enacted internationally so that the employment of such in South Africa presents a unique situation. As long as indirect treasury shares are not acknowledged, it is possible that they are not viewed as treasury shares. However, this paper does suggest that they are treasury shares and other bodies like JSE concur. [300]

Notwithstanding, the lack of international present is insufficient reason to no adopt treasury shares. Given their inherent flexibility, jurisdictions will in future adopt them. They are an essential asset to have in a competitive market.

6.3.2. Key participants in the South African company law reform process

The company law reform process was led by a project manager, who was assisted by the chief policy adviser and the chief drafter.[301] In addition to

---

[300]N Wesson & WD Hamman op cit (n194) 43.
[301]TH Mongalo op cit (n31) xiii.

these three, the team consisted of six working groups divided according to priority areas identified for consideration.[302]

The primary function of the working groups was to recommend broad principles for the drafting of the relevant provisions within the specified area of consideration. Once these broad principles were formulated, they were then referred to specialists who were divided into a local reference team, and an international reference team.

In order to minimise the composition of the working groups and to facilitate the working process, some members of the local and international reference teams also assisted in the work of the working groups. Also, depending on the expertise of members, some of them served in more than one working group. This unfortunately increased the work for individual parties, increasing the possibility for some policies to be overlooked or analysed with haste.

Further, the membership of the working groups was constantly altered as some members withdrew due to the pressures of their demanding professional lives.[303] In the end, the committees worked very effectively with a few constant members who were able to consider a broad range of issues and implications of their recommendations to other areas of corporate law under consideration for reform. Again this would have resulted in lack of coherency in some policies or indeed raise the question on whether the treasury shares concept was considered at all.

6.3.3. Precaution

Finally, treasury shares may have been considered but they may still have been prohibited because their prohibition has a salutary of removing a source of temptation to fraud or abuse. In other words, a man cannot cut

---

[302]Ibid. The groups were corporate formation; corporate finance; corporate governance; business rescue and mergers and takeovers; not-for profit companies; and administration and enforcement.

[303] TH Mongalo op cit (n31) xiii.

himself if he has got no knife.[304] But one might argue that the use of a razor or an axe might accomplish the same result. However, the adequacy of such a remedy is seriously questioned. A certain amount of market activity having manipulative results may be indulged in without providing a cause for action by a shareholder.[305]

Moreover, in light of the legitimate advantages to be gained by a company in certain circumstances by holding its issued shares, like the broad social advantage of increased business activity that benefits the public at large too, prohibition of the treasury shares does not appear to be a reasonable solution. Treasury shares should only be restricted where they could potentially frustrate creditors, minority shareholders, and the public. This is but one of the lessons that can be gleaned from international precedent.

6.4. LESSONS FROM INTERNATIONAL PRECEDENT

It was the intention of the reform in South Africa to adopt international trends and in recent times, there have been several jurisdictions that have pioneered the adoption of treasury shares:

6.4.1. Malaysia

This was one of the first countries to swing in favour of treasury shares. Malaysia, though strongly prejudiced by English as well as Australian company law, sought very early to modernise and update certain company law concepts and practices.

Accordingly, in the 1990's as the repurchase boom was experienced around the world, the Malaysian Companies Act 125 of 1965 too was amended by Section 67A of the Companies Amendment Act, 1997, to permit companies to purchase their own shares. The new statutory provisions required the repurchased shares to be cancelled upon their acquisition by the

---

[304]TH Deinzer op cit (108) 256.
[305]Ibid.

company. However, unlike many jurisdictions, this was not the end of the reform[306]. The Malaysian Companies Act, 1965 was once again amended a year later in 1998, by the Companies (Amendment) Act 1022 of 1998 and by Act 1043, Companies (Amendment) (No 2) Act, 1998 to introduce treasury shares.

By these amendments, listed companies were for the first time permitted to retain repurchased shares in the treasury instead of having them cancelled.[307] The Act permitted treasury shares to be distributed to shareholders as share dividends or to be resold on the market at the discretion of the directors, which was subject to the fiduciary duties of directors.[308] This was done to safeguard against improper use of the shares by directors.

An important provision of the Act though, was that if the treasury shares were to be subsequently cancelled, the issued share capital of the company must be reduced by the number of shares that are cancelled, and the amount must be paid into a capital redemption reserve fund.[309] Thus the cancellation of the shares was deemed not to constitute a reduction of share capital which made the transaction legally correct.[310] In addition, treasury shares were required to be carried in the books of the company at cost without any revaluation for escalation in the fair value or market price of the shares. This therefore simplified the accounting and tax challenges previously incurred in earlier days of treasury shares.

6.4.2. Singapore

The Singapore Companies Act was amended in 2005 by the Companies (Amendment) Act 2005. This amendment abolished the concepts of par value

---

[306]P Omar 'Malaysia: Company Law Reforms' (2000) 21 *Company Lawyer* 289; Also See FHI op cit (n16)158.
[307]section 67(A)(3A) of the Companies Act, 1965, as amended(UK).
[308]section 67A(3B) of the Companies Act, 1965, as amended(UK).
[309]section 65(A)(3E) of the Companies Act, 1965, as amended(UK).
[310]P Omar op cit (n349) 289.

and authorised share capital. It reformed the capital maintenance regime and introduced new share buyback provisions which permitted companies to hold treasury shares instead of requiring the shares to be cancelled. The Act permits companies to sell their treasury shares for cash, or to transfer the shares to an employee share scheme, be used as consideration for the acquisition of shares or other assets of another company or to cancel its treasury shares.[311]

6.4.3. The European Union

The European Community's Second Company Law Harmonisation Directive permits companies other than private companies in the European Union to hold up to a maximum of 10 per cent of the company's subscribed capital.[312] Article 22(1) (b) of the directive states that if the treasury shares should be included as an asset on the balance sheet of the company, a reserve of the same aggregate from its distributable profits must be transferred to a non-distributable reserve which must be included in its liabilities. On the resale of these treasury shares then, the reserve would revert to a distributable reserve[313]. This clarification is done to counter the accounting and tax complexities. Additionally, companies are also required to release in their annual report the number of shares so acquired, the amount paid by the company for its shares, the reason for the reacquisition and the number of reacquired shares held by the company so as to safeguard against potential fraud.[314]

---

[311]FHI op cit (n15)158. See also section 76(K) of the Singapore Companies Act 2005 as amended.
[312]FHI op cit (n15)158. The Directive explicitly provides that so long as the shares are held by the company, no voting rights may be exercised in respect of such shares (Article 19(1) (b). However, there is no mention of dividend rights or of treasury shares not being counted for quorum or other threshold requirements
[313]Ibid 162.
[314]Ibid. Article 22(2) of the Second Company Law Directive.

6.4.4. The United Kingdom

Sections 160(4) and 162(2) of the English Companies Act, 1985, which apply respectively to shares redeemed and shares repurchased by the company, required the shares bought back to be cancelled. In order to introduce more flexibility to companies in managing their capital structure and to reduce the cost of raising new capital, new sections 162A-162F, were introduced into the Act.[315]

These sections provide for an option for companies that have repurchased their own shares out of distributable profits to hold up to 10 per cent of the nominal value of the issued share capital of the company for resale or for the aim of an employee share scheme, or simply for cancellation at a subsequent date[316]. Section 727 of the Companies Act 2006 enables a company to hold its treasury shares indefinitely or to subsequently cancel them or to sell them for a cash consideration.[317] The right conferred on companies to sell their treasury shares for cash is intended to facilitate speedy action by the company without having to be burdened by shareholder authorisation and other similar formalities and restrictions.[318]

In order for a company to be able to retain shares in treasury, there are three prerequisites that ought to be satisfied. Firstly, the repurchased shares must be 'qualifying shares' as defined in the Companies Act, 2006.[319] That is, the shares must be those of a company that is incorporated in England provided that such shares are either listed on the London Stock Exchange (LSE) or are traded on the Alternative Investment Market established under

---

[315]Ibid 160. The regulations are presently located in Chapter 6, sections 724 to 732 of the Companies Act, 2006 (UK)
[316]Ibid 160.
[317]FHI op cit (n15)161. To the extent that the proceeds from the sale of its treasury shares are equal to or are less than the purchase price paid by the company for its shares, the proceeds must be regarded as realised profits of the company accessible for distribution to shareholders.
[318] Caution needs to be adhered to here because of potential for director abuse.
[319]Section 724(2) (a) to (d).

the rules of the LSE, or are officially listed on a stock exchange or traded on a regulated market in another European Union member country.[320]

If shares held by a company in treasury cease to be qualifying shares, section 162E (1) requires an immediate cancellation of the shares. This listing limitation is quite restrictive; for example, neither New Zealand nor the Singapore proposals make any such restriction. Conversely, whilst Malaysia also limits qualifying shares to shares acquired and sold through, and in accordance with, the rules of the relevant stock exchange, this is only because that is the only way a company can acquire its own shares in the first place.[321]

The second prerequisite is that the repurchase has to be funded out of distributable profits or what was in the past earned surplus and not capital.[322] The alternative funding option allowed by the repurchase sections was the proceeds of a fresh issue of shares. However, this was rejected on the grounds that it was highly unlikely that companies would wish to acquire treasury shares out of such funds and that, if allowed, it would cause difficulties for the accountants and lead to capital maintenance complications.[323]By limiting the treasury option to purchases out of distributable profits there is no such consequences.

In contrast, Singapore allows for treasury shares not only to be funded out of the proceeds of a fresh issue but also out of capital where that is allowed under the preexisting acquisition rules. In such a case the amount of the share capital must be reduced accordingly. Nonetheless, the United Kingdom funding limitation is more advantageous as it allows for a much

---

[320]G Morse op cit (n38) 307. This requirement excludes private companies from the facility of holding treasury shares. It also excludes are unlisted public companies since their shares are not publicly traded on a regulated market. This is in line with all the other jurisdictions that have treasury shares. The option is not offered to private companies, perhaps because regulation would be harder to maintain for them.
[321]G Morse op cit (n39) 307.
[322]section 724(1)(b)) of Companies Act, 2006 (UK).
[323]G Morse op cit (n38) 307.

simpler accounting treatment of the consideration received by the company if it chooses to resell the treasury shares.[324]

The last prerequisite is that the maximum number of treasury shares retained by a company at any time must not exceed 10 per cent of the nominal value of the issued share capital of the company.[325]If the company has a diverse class of shares, the maximum limit is 10 per cent of the nominal value of shares of that class.[326] Each class of shares is thus subject to a limit of 10 per cent. Treasury shares in excess of the 10 per cent cap are not per se invalid but must nevertheless either be disposed of or cancelled within twelve months of the violation.[327] It is quite unfortunate that this cap exists presently, as it serves no obvious use. Moreover, the other jurisdictions do not have it. It might be argued to have been done to curtail potential abuse of treasury shares.

6.5. CONCLUSION

Section 35(5) of the Companies Act 2008 precludes the existence of treasury shares in South African company law.[328] According to this provision, repurchased shares must be cancelled as issued shares and become part of the authorised share capital of the company.[329]

However, South Africa makes an important concession to the rule against treasury shares by permitting a subsidiary to acquire and to hold a maximum of 10 per cent in the aggregate of the issued shares of any class of

---

[324]Ibid.
[325]Section 725(1) of the Companies Act 2006 (UK).
[326]Section 725(2) of the Companies Act 2006 (UK).
[327]Section 725(3) of the Companies Act 2006 (UK).
[328] FHI Cassim op cit (n15) 163.
[329]D Bhana op cit (n28) 247. See also FHI Cassim (n15)152. The New Zealand Companies Act, 1993 has a similar provision. As a general principle, it deems shares repurchased by a company to be cancelled on their reacquisition by the company, although in certain exceptional circumstances a company may be permitted to hold the reacquired shares instead of having to cancel them on their acquisition. In the same way, the Australian Corporations Act, 2001 requires the repurchased shares to be immediately cancelled on their acquisition and cannot thereafter be used as security for a loan nor be reissued.

shares of its parent company.[330] This concession consequently adopts the indirect use of treasury shares in South Africa. In actual fact, an exploratory study by Bester *et al.,* has found that the repurchase of treasury shares by subsidiaries is being used by a large number of companies in South Africa.[331]

It is therefore curious that despite their indirect use, they were not been adopted into the Companies Act 2008. Perhaps one reason might be the lack of persuasive international precedent for both the use of direct and indirect treasury shares. Indirect use especially is unique to South Africa.[332]The legislature therefore might not have been aware that it is in fact already using treasury shares.

Further, the committee on the reform was constantly altered as some members withdrew due to the pressures of their demanding professional lives and consequently only worked with a few constant members who were able to consider a broad range of issues and implications of their recommendations to other areas of corporate law under consideration for reform. A few policies might therefore have been overlooked.

Moreover, holding treasury shares is closely allied with the idea of injury to others so that the morality of it can be questioned. However, it has been shown that the morality argument turns on weighing of the advantages of allowing a company to acquire shares of its own shares with the possibility of harm resulting to investing shareholders and to the public from a company's activity in its own shares on the market and it is the submission of this paper that the advantages outweigh the risks.

That position is apparent within the jurisdictions that have adopted the treasury shares. Malaysia, Singapore, The European Union and the United Kingdom have all shown that with considerable restrictions, the risks

---

[330]Ibid.

[331]N Wesson & WD Hamman op cit (n194)43.

[332]. It has been disregarded by other jurisdictions like the United Kingdom which interestingly allows for direct treasury shares.

of treasury shares can be curbed. This is precedent that South Africa can follow.

In conclusion therefore, this paper states that it was an error to omit treasury shares in reforming the Companies Act. The inherent flexibility of treasury shares, among other advantages, qualified them for incorporation into the Act. Accordingly, equipped with lessons from other jurisdictions, this paper will recommend various ways, the use of treasury shares can be incorporated into law.

CHAPTER SEVEN: CONCLUSION

7.1. SUMMARY

Treasury shares were historically controversial because it proved challenging to reach a definite conclusion or set of conclusions regarding their legal nature. However, as the concept has evolved and matured, several conclusions concerning their nature have surfaced.

First, treasury shares, unlike regular shares, do not enjoy the essential features of share ownership. In other words, no incidents of shareholdership are enjoyed by a company as a holder of its own shares. Accordingly, treasury shares do not enjoy any rights of participation in net assets upon liquidation, preemptive rights, voting rights nor dividend rights.[333] The only right that treasury shares enjoy fully is the right to reissue or resold once they are repurchased.

Secondly, as a juristic person, a company possesses its own legal personality and therefore has the right to acquire rights and incur obligations that are distinct from those of the directors and shareholders of the company. However, in terms of treasury shares this right is restricted. In many jurisdictions, a company cannot acquire treasury shares and subsequently no obligations are attached to them. Consequently, they are not really shares in the strict sense of the word. As Ballantine stated, their existence as issued shares is fictitious , a creation of something out of nothing and using the term 'shares', is but one way of describing the special rules and privileges that apply to them.[334] When held by the company, treasury shares are fundamentally homogeneous to all authorised shares not yet outstanding; they merely represent an instrument for raising funds.[335]

---

[333] WA Paton op cit (n114) 278.
[334] FHI Cassim op cit (n 15) 153.
[335] FHI Cassim op cit (n1)139. See also HW Ballantine op cit (n13) 536.

Thirdly, it has finally been accepted that treasury shares are *sui generis;*[336] they cannot be correctly described as unissued shares, issued shares, cancelled shares, outstanding shares, assets, or non-assets.

Accepting treasury shares for what they are and treating them as such has resulted in the disappearance of much of the uncertainty that surrounded the nature of treasury shares. It is no longer necessary to attempt to fit them into one of the established categories. The peculiar characteristics of treasury shares are embraced for what they are and dealt with accordingly.

Additionally, for complexities that existed in the fields of accounting and tax, the clarity in the nature of treasury shares has meant clear guidelines on how to record treasury shares can now be drafted. Historically, it had been uncertain how treasury shares should be represented on the balance sheet.[337] Upon company balance sheets they appeared as current assets, investment assets, unclassified assets, and on the other hand as deductions from earned surplus, from stated capital, from aggregate net worth, and from various arrangements of different elements of net worth.

On the other hand, while it had initially been stated that treasury shares were not true assets and therefore a company realised no gain or loss from the purchase or sale of its own shares,[338] the Board of Tax Appeals and the federal courts in the United States subsequently, allowed losses incurred in an exchange of company assets for previously issued shares to be treated as losses for income tax purposes.[339]

---

[336]FHI Cassim op cit (n1)139. See also HW Ballantine op cit (n13) 536.
[337]Ibid 19.
[338]*Houston Bros. Co. v. Commissioner of Int. Rev.*, (1930)21 B. T. A. 804. See also JAS op cit (n50) 625.
[339]Ibid.

These uncertainties have been resolved. In the United Kingdom for instance, the ASB has produced two publications[340] that provide for the accounting treatment of treasury shares in all instances except where they are transferred out to an employee share or option scheme.[341]

Further, the ASB and FSA have aligned their approach to that set out in the Finance Act 2003 that in so far as possible, treasury shares do not affect the existing share repurchase tax regime and are as close to the existing regime as possible. Thus tax considerations play no part in a company deciding whether and when to exercise the treasury share option.

The clarity now attained in these areas, discredits complexity that the United States proposed, as a reason for abandoning treasury shares. This is therefore not a valid reason that can be used against the incorporation of treasury shares in South Africa.

In fact, there are now more reasons why South Africa should adopt treasury shares. Using treasury shares gives companies flexibility in managing their capital structure, raising funds and disposing of shares onto the market in a cost effective mode than a fresh issue of share. This in turn enables companies to decrease their propensity to react to the market while increasing their ability to act and influence the market.

Moreover, treasury shares serve to promote and encourage employee share schemes since they remove the necessity for a separate trust to be created for the purpose of holding shares for the scheme. As a result, the procedural process of setting up a scheme is streamlined.[342] Treasury shares also provide an opportunity for companies to invest in their own shares

---

[340]G Morse op cit (n38)321.These are available at *www.asb.org.uk/uitf.*
[341]G Morse op cit (n38)321.
[342]Employee share schemes are good for the company because company shares have a higher upside potential (since they can appreciate significantly over time) than cash bonuses or salary increases. Availability of this sort of plan is therefore a significant enticement to recruit talented employees.

either directly or indirectly (by way of a subsidiary) and finally, they encourage repurchases and safeguard against hostile takeovers.

Based on these benefits, it can be concluded that an introduction of treasury shares into the South African law would increase the attractiveness of South Africa as a location in which to do business for both domestic entrepreneurs and international investors. For international investors, it would give South Africa an edge over the countries that do not have them, while for domestic entrepreneurs; it would simplify a lot of processes that are straitjacketed by the current law like the employee schemes.

Moreover, treasury shares would allow for flexibility and simplicity in the maintenance of companies which is one of the purposes of the Companies Act 2008 and what the dti envisioned the Act to do. Treasury shares in this way would facilitate the creation of optimum conditions for the aggregation of capital for productive purposes and for the investment of that capital in other enterprises.[343]

Consequently, the financial health of companies would improve, and with it the economy of the country. There is therefore high commercial value attached to treasury shares and not at the cost of the purpose of the Companies Act 2008.

However, it would be remiss not to mention that in order for South African company law to legitimately adopt treasury shares and increase South Africa's competitiveness in global markets, it must not only be sufficiently flexible to achieve economic and social goals but must simultaneously ensure proper minority shareholder and creditor protection.

This paper has discussed the dangers of abuse of power by directors, stock watering, circumvention of preemptive rights, market manipulation

---

[343]As discussed in this chapter, there would be a decrease of costs from the avoidance of issue of new shares and employee share schemes thereby freeing money for more targeted goals of the company.

and insider dealing. All these have the potential to harm the company, the market, creditors and shareholders. Nonetheless, of these dangers, market manipulation is easily the worst abuse of treasury shares and while this risk already exists under the existing repurchase, cancellation and new issue rules, treasury shares accelerate the ease with which shares could be withdrawn from and replaced into the market and may thus aggravate the risk of manipulation.

Of course, these risks are hemmed in by the usual fiduciary qualifications. Notwithstanding, these may be insufficient when the burden of showing violations is on the plaintiff shareholder, especially where the company is large and the shareholder small.[344] Market manipulation would therefore be a valid reason why treasury shares are prohibited in many jurisdictions including South Africa.

For these reasons, one prominent issue arising from adopting treasury shares is whether and, if so, what restrictions should be used to prevent companies from unfairly exploiting the market and injuring shareholders, creditors and the public.[345] In this regard, references were drawn from jurisdictions successfully regulating treasury shares.

The standard safeguards of company law can play an important role in curbing this abuse. These safeguards include disclosure of shares held in treasury, requiring shareholder approval for the resale of treasury shares and, more importantly, prohibiting the sale of treasury shares at price sensitive times.[346]

Further the voting and financial rights attached to treasury shares are neutralised. A neutralisation of these rights addresses the issue of companies

---

[344] Securities and Futures Commission of Hong Kong op cit (n18) para 3.10-3.12.

[345] FHI Cassim op cit (n1) 146. Price sensitive times are those times when a company has inside information that will affect the price of its shares.
G Morse op cit (n38) 316.

[346] FHI Cassim op cit (n1) 146.

having ownership in themselves and the attendant dangers of abuse of control by the company's directors if companies were able to vote for themselves and/or pay themselves whether directly or indirectly.

Additionally, the treasury regime can be fortified with transparency practices that are equivalent to the transparency of any other shareholder. The total effect of these measures would be to deter the worst abuses of treasury shares while at the same time preserving their flexibility.

In view of the safeguards that can be employed to counter these dangers, the advantages of treasury shares, the clarity of their nature and the recent favourable shift in the attitude towards treasury shares, it is curious that South Africa did not adopt treasury shares in the Companies Act 2008. The information presented in this paper was available and yet Section 35(5) of the Companies Act 2008 precludes the existence of treasury shares in South African company law.[347] According to this provision, repurchased shares must be cancelled as issued shares and become part of the authorised share capital of the company.[348]

Importantly however, South Africa makes a concession to the rule against treasury shares by permitting a subsidiary to acquire and to hold a maximum of 10 per cent in the aggregate of the issued shares of any class of shares of its parent company.[349] As a result, this concession adopts the indirect use of treasury shares in South Africa. In actual fact, an exploratory

---

[347] FHI Cassim op cit (n15) 163.

[348] D Bhana op cit (n28) 247. See also FHI Cassim (n15)152. The New Zealand Companies Act, 1993 has a similar provision. As a general principle, it deems shares repurchased by a company to be cancelled on their reacquisition by the company, although in certain exceptional circumstances a company may be permitted to hold the reacquired shares instead of having to cancel them on their acquisition. In the same way, the Australian Corporations Act, 2001 requires the repurchased shares to be immediately cancelled on their acquisition and cannot thereafter be used as security for a loan nor be reissued.

[349] Section 725(1) of the Companies Act 2006 (UK).

study by Bester *et al*., has found that the repurchase of treasury shares by subsidiaries is being used by a large number of companies in South Africa.[350]

It is therefore even more curious that despite their indirect use, treasury shares were not adopted into the Companies Act 2008. Perhaps one reason that is unique to South Africa might be the lack of persuasive international precedent for both the use of direct and indirect treasury shares. Indirect use especially is distinctive to South Africa.[351] The legislature therefore might not have been aware that it is in fact already using treasury shares. However, the lack of international precedence need not deter the adoption of treasury shares. Malaysia, a country whose law was heavily influenced by the English and Australian Acts was one of the first countries to swing in favour of treasury shares. It sought very early to modernise and update certain company law concepts and practices.

Secondly, the committee chosen for the reform was constantly altered as some members withdrew due to the pressures of their demanding professional lives and consequently only worked with a few constant members who were able to consider a broad range of issues and implications of their recommendations to other areas of corporate law under consideration for reform.[352] A few policies might therefore have been overlooked.

Lastly, holding treasury share is closely allied with the idea of injury to others so that the morality of it can be questioned. However, it has been shown that the morality argument turns on the weighing of the advantages of allowing a company to acquire and hold shares of its own shares with the possibility of harm resulting to investing shareholders and to the public from

---

[350]N Wesson & WD Hamman op cit (n194)43.

[351] It has been disregarded by other jurisdictions like the United Kingdom which interestingly allows for direct treasury shares.

[352] TH Mongalo op cit (n31) xiii.

a company's activity in its own shares on the market and it is the submission of this paper that the advantages outweigh the risks.

That position is apparent within the jurisdictions that have adopted the treasury shares. Malaysia, Singapore, The European Union and the United Kingdom have all shown that with considerable restrictions, the risks of treasury shares can be curbed. This is precedent that South Africa can follow.

In conclusion therefore, this paper concludes that it was an error to omit treasury shares in reforming the Companies Act 2008. The inherent flexibility of treasury shares, among other advantages, qualified them for incorporation into the Act. Accordingly, equipped with lessons from other jurisdictions, this paper recommends the following:

7.2. RECCOMENDATIONS: THE WAY FORWARD

The treasury share question in South Africa calls for vision, perhaps courage and more hard work[353]. However, the recent company law reform has shown potential of South Africa company law to be visionary and revolutionary. By adopting various trends from several jurisdictions, the law moved from rigidity to flexibility in one overhaul. Adopting treasury shares would just be an extension of the work already began by abandoning capital maintenance practices. Whether this is done immediately or in the next five years, treasury shares have survived for close to a century and they will continue to do so. At the rate that they are being acknowledged in other jurisdictions, they are part of the future of company law too.

The first recommendation therefore is that South Africa should speedily incorporate treasury shares into the Act. Indeed this amendment would come closely after an overhaul of the law. However, one lesson that can be gleaned from Malaysia is the speed with which it adopted its treasury shares after recognising their importance. The Malaysian Companies Act 125

---

[353]FHI Cassim op cit (n15) 158.

of 1965 was amended by Section 67A of the Companies Amendment Act, 1997, to permit companies to repurchase their own shares and cancel them upon their acquisition by the company. However, unlike many jurisdictions, this was not the end of the reform[354]. The Malaysian Companies Act, 1965 was once again amended a year later in 1998, by the Companies (Amendment) Act 1022 of 1998 and by Act 1043, Companies (Amendment) (No 2) Act, 1998 to introduce treasury shares.

Secondly, in incorporating the treasury shares, there is no need to overhaul the Companies Act 2008. The various jurisdictions, especially the United Kingdom provides a reference point that no substantive changes would have to be made. For instance, in the United Kingdom, no significant changes were made to the wording of the preexisting share repurchase sections and no additions nor subtractions to the procedures whereby companies may purchase their own shares. The acquisition part of the transaction was also unaffected by the changes. Further, it was advised that nothing in the company's MoI should provide for a more burdensome regime for treasury shares.[355] A similar guideline could be used in South Africa. Section 35(5) could just be slightly altered to permit treasury shares.

Furthermore South Africa would not have to impose safeguards that are identical to other jurisdictions. International precedent has shown that while the dangers are the same, each jurisdiction has implemented safeguards that are suitable to it. For instance, the United Kingdom has applied more stringent laws than Singapore or Malaysia.

The United Kingdom allows for treasury shares to have preemptive rights. Attaching preemptive rights to treasury shares enables shareholders to assert their legal and equitable remedies where there is bad faith or a breach of the directors' fiduciary duties. Without this safeguard, there is an

---

[354]P Omar op cit (n349) 289; Also See FHI op cit (n15)158.
[355]G Morse op cit(n38) 309.

increased potential for abuse of treasury shares.[356] Directors can by a secret purchase of treasury shares, the sale of which are wholly in their control, increase their voice in the control of the company or obtain the shares at an inadequate price.[357] Shareholder's preemptive rights are the only sure protection against the dilution of shareholders' interests because the courts have shown an inclination to protect a director's breach of fiduciary duty. It is often difficult to prove that directors were acting fraudulently, and it is too expensive a procedure for the small shareholders to bring a suit without certainty of recovery.[358]

In addition, the United Kingdom also has three prerequisites that a company must fulfil in order to qualify for the treasury share option. One such prerequisite is that the maximum number of treasury shares retained by a company at any time must not exceed 10 per cent of the nominal value of the issued share capital of the company.[359]If the company has a diverse class of shares, the maximum limit is 10 per cent of the nominal value of shares of that class.[360] Each class of shares is thus subject to a limit of 10 per cent. Treasury shares in excess of the 10 per cent cap are not per se invalid but must nevertheless either be disposed of or cancelled within twelve months of the violation.[361]

It is quite unfortunate that this cap exists presently, as it serves no obvious use. Moreover, the other jurisdictions do not have it. Such restrictions can be more onerous that a regular repurchase it is proposed that such extents of restrictions would be too much because they would discourage the use of treasury shares. However, if South Africa was hesitant to adopt treasury shares, this would be a recommended option so that the use of treasury shares would be highly monitored.

---

[356] V Morawetz op cit (84) 187.
[357] Ibid.
[358] Ibid.
[359]Section (s 725(1)) of the Companies Act 2006(UK).
[360]Section 725(2) of the Companies Act 2006 (UK).
[361]Section 725(3) of the Companies Act 2006(UK).

Alternatively, the Act could just align the indirect and direct use of treasury shares. Consequently, the tax, accounting and JSE regulations that currently apply to 'treasury securities' would just be slightly altered for direct treasury shares use.

7.3. CONCLUSION

This system is now up and running in United Kingdom and several other jurisdictions and the only question which seems to remain in their minds is why it took so long to introduce treasury shares given the admirably simple, or unduly limited, approach taken. There really seem to be no dragons, saving the possibility of confusion f treasury shares, as the law in this area continues to develop. However, this is so often the case in many areas of law and the fact that, that is a known problem means that it can easily be avoided.[362]

It might still be open to debate whether treasury shares ought to be permitted in South African law, but, in view of the minor technical differences between treasury shares and authorized but unissued shares which result from a cancellation of repurchased shares, coupled with the strong moral case for repurchases and the advantages of treasury shares, a strong case for permitting treasury shares can be formulated. There seems to be no valid argument to the contrary.[363]

Granted, the United States' use of the shares has shown that there has been a lot of complexity associated with the use of treasury shares, not only in Company Law but in Tax and Accounting regulations too. However, instead of opting to disregard their advantages because of this, South Africa can opt to draw valuable lessons from the experience of treasury shares in the United States, so that repeating the mistakes of the past is avoided. Indeed, treasury shares may carry with them some potential for abuse, and it

---

[362] G Morse op cit(n38) 309.
[363] FHI Cassim (n15) 163-164.

is this danger that has caused many jurisdictions to disallow them. But treasury shares also offer advantages.

This paper has built a case for the introduction of treasury shares in South Africa. An introduction of treasury shares would be a further indication of the breakup of the traditional straitjacket concept of capital maintenance as it was understood for almost a century.

CHAPTER EIGHT BIBLIOGRAPHY

8.1. BIBLIOGRAPHY

8.1.1. Primary Sources

8.1.2. Cases

Allen v Lagerberger (1888)10 Ohio Dec. Repr. 341, 20 Bull. 368.

Bing Crosby Mintte Maid Corporation v Eaton (1956) 297 P 2d 5.

Birch v Cooper re Bridgewater Navigation Co (1889) 14 App Cas 525 (HL) 543.

Borg v International Silver Co 11 Fed (1925) (2d) 147.

Borland's Trustee v Steel Brothers & Co Ltd (1901) 1 Ch 279

Bradbury v English Sewing Cotton Co. Ltd. (1923) A.C. 744 (H.L.).

Cooper v Boyes (1994) 4 SA 521 (C).

Eidman v. Bowman, (1871) 58 Ill. 444.

Glenn L Martin Co. v. United States (December. Md. 1937)21 F. Supp. 562.

Gustin v. Merrill (1906) 144 Mich. 498.

Hartridge v Rockwell (1828) RM Charlt (Ga.) 260.

Hindustan Lever Employees Union v. Hindustan Lever Ltd. ALLER 1995 SC 470.

Hospes v North Western Manufacturing & Car CO 48 Minn 174 (1892), 50 NW 11.

Houston Bros. Co. v. Commissioner of Int. Rev., (1930)21 B. T. A. 804.

Inland Revenue Commissioners v Crossman (1937) AC 36.

Liquidators Union Share Agency v Hatton (1927) AD 240.

Ohio Ins. Co. v. Nunnemacher (1860)15 Ind. 294.

Pullman v Railway Equipment (1897) Co 73 111 App 313.

Schmidt v. Pritchard (1907)135 Iowa 240 112 N. W. 801.

Simmons & Hammond Manufacturing Co. (1925) 1 B.T.A. 803.

Stone v. Envelope Co. (1920) 119 Me. 394, 111 Atl. 536.

Trevor v. Whitworth (1887) 12 App Cas 409 (HL).

Titus v. Paul St. Bank (1919) 32 Idaho 23, 179 Pac. 514.

Unisec Group Ltd v Sage Holdings Ltd 1986 3 SA 259 (T).

8.1.3. Legislation

California Corporation Code of 1977.

Canada Business Corporations Act, 1985.

Companies Act 125 of 1965 (Malaysia).

Companies Act 1965 (United Kingdom).

Companies Act 2006(United Kingdom).

Companies Act 42 of 1967 (Singapore).

Companies Act No 105 of 1993(New Zealand).

Companies Act No 71 of 2008(South Africa).

Finance Act 2003 (United Kingdom).

Model Business Corporation Act 1969 (United States).

The constitution of the Republic of South Africa 1996 .

The Corporations Act, No 50 of 2001 (Australia).

The European Community's Second Company Law Harmonisation Directive Dir.77/91 [1977] O.J. L26/00.

8.2. Secondary Sources

8.2.1. Books

Bayless Manning &JamesJ Hanks Jr *Legal Capital* 3 ed (1990) 24.

Cassim, FHI et al *Contemporary Company Law* 2 ed (2012). Juta.

Davies, G *Gower's Principles of Modern Company Law* 6 ed (1999). Sweet & Maxwell.

Davies, PL *Gower & Davis: the principles of modern company law* (2008). Sweet & Maxwell.

Delport, De Koker & Pretorius *Cilliers and Benade Corporate Law* 3 ed (2000) LexisNexis Butterworths.

Detlev, FV *Basic Corporation Law* 3 ed (1989) Foundation Press.

Gower, LCB *Modern Company Law* (1979) Sweet & Maxwell.

Hamilton, RW & RA Booth *Corporation Finance, Cases and Materials* (1984).

Morawetz, I *Private Corporations* 2 ed (1886) Little, Brown.

Pretorius et al *Hahlo's South African Company Law through the Cases: A Source Book: A Collection of Cases on Company Law with Explanatory Notes and Comments* 6 ed (1999) Juta.

Scott, WR *The constitution and finance of English, Scottish and Irish joint-stock companies to 1720*. Vol 1(1912) Cambridge: University Press.

Vagts, DF *Basic Corporation Law* 3ed (1989) Foundation Press

8.2.2. Journals

Ballantine, HW (1946) 'The curious fiction of treasury shares' 4 *California Law Review* 536.

Ballantine, HW 'Drafting a Modern Corporation Law' (1931) 19 *Calif. L. Rev.* 465 Montgomery 'Dealings in Treasury Stock' (1938) 65 *Journal of Accountancy* 466.

Bester, RPG et al 'share buy-backs for a selection of JSE-listed companies: An Exploratory study' (2010) 41(4) *South African Journal of Business Management*.

Bhana, D 'The company law implications of conferring a power on a subsidiary to acquire the shares of its holding company' (2006) 17(20 *Stellenbosch Law Review* 232.

Blackman, MS et al *Commentary on the Companies Act* Vol 1 (Original Service 2002).

Bowles 'Treasury Shares on the Balance Sheet'(1934) 8 *Journal of Accountancy* 98.

Carlisle, RE 'Treasury Stock and Section 1032' (April 1955) George Washington Law Review.

Cassim, FHI 'The Right of a Company to Purchase its Own Shares' 1985 *THRHR* 318.

Cassim, FHI 'The Challenge of Treasury Shares: corporate formation and corporate finance: part I' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 151.

Cassim, FHI 'The New Statutory Provisions on Company Share Repurchases: A Critical Analysis' (1999) 116 *SALJ* 760.

Cassim, FHI 'The reform of company law and the capital maintenance concept: note' (2005) 122(2) *SALJ* 283.

Cassim, FHI 'The repurchase by a company of its own shares: the concept of treasury shares' (2003) 120(1) *SALJ* 136.

De Cesari, A et al 'Stock Repurchases and Treasury Share Sales: Do they Really Stabilise Price and Enhance Liquidity?' (2011) 17(5) *Journal of Corporate Finance* 1558-1579.

Deinzer, TH 'This Treasury Stock Question' (1937) 12(3) *the Accounting Review* 256.

Delport, PA. 'Company Groups and the Acquisition of Shares' *S. Afr. Mercantile LJ* 13 (2001)121.

Dugan 'Repurchase of Own Shares for New Zealand' (1987)17 *Univ of Victoria Wellington LR*179 180.

Edma, BG 'Treasury Shares and Pre-Emptive Rights: Schwartz v. Marien' (1976) 26 *Buff. L. Rev.*

Ferran, E 'Company Law reform in the UK' (2001) *Singapore Journal of International & Comparative Law* 516.

Ferran, E 'Creditors interests and "core" company law' (1999) 20 *Company Lawyer* 314.

Garrett, R 'Treasury shares under the Model Business Corporation Act' (1960) 15 *Bus Law* 916.

Hills 'Model Corporation Act'(1935) 48 *Harv. L. Rev.* 1334.

Hills, GS 'Federal taxation v corporation law' (1936-1937) 12 *Wisconsin LR* 280.

Holt and Morris 'Some Aspects of Reacquired Stock' (1934) 12 Harvard Business Review 505.

Israel, CL 'Corporate Purchase of Its Own Shares Are There New Overtones' (1964-1965) 50 *Cornell LQ* 620.

JAS 'The Legal Status of Treasury Shares'(1937) *University of Pennsylvania Law Review and American Law Register* 622.

Kottler, H 'Treasury Stock; A Corporate Anomaly' 1 *Clev. Marshall L. Rev* 9.

Loubser, Anneli 'Recent Developments in Corporate Law: Part 1' *S. Afr. Mercantile LJ* 12 (2000)1.

Marple, 'Treasury Stock' (1934) 57 *Journal of Accountancy* 257.

Mongalo TH 'An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) *Acta Juridica: Modern company law for a competitive South African economy* xiii.

Morawetz, V 'The Preemptive Right of Shareholders'(1928) *42 Harvard Law Review* 186.

Morse, G 'The introduction of treasury shares into English law and practice' (2004) 3 *Journal of business law*303.

Nemmers, EE Power of a Corporation to Purchase Its Own Stock (1942) *Wis. L. Rev.*161.

Note 'The Legal Status of Treasury Shares' (1937) *University of Pennsylvania Law Review* 622.

Nussbaum, A 'Acquisition by a corporation of its own stock' (1935) 35 *Columbia LR* 971.

Oditah, F ‘ Takeovers, Shares Exchanges and the Meaning of Loss’ (1996) 112 *LQR* 424.

Omar, P ‘Malaysia: Company Law Reforms’ (2000) 21 *Company Lawyer* 289.

Paton, WA ‘ Postscript on Treasury Shares’ (1969) *Accounting Review* 277.

Paton, WA ‘Essentials of Accounting’ (1938) Vol 1 *Edward Brothers* 682

Rankin, CH ‘Treasury Stock: A Source of Profit or Loss?’ (1940) *Accounting Review* 71.

Roberts, WL ‘Taxation of Treasury Stock’ (1949) 38 *Kentucky Law Review* 337.

Rudolph, EG ‘Accounting for Treasury Shares under the Model Business Corporation Act’ (1959) 73 *Harvard Law Review* 323.

Rueschhoff, NG ‘ The Evolution of Accounting for Corporate Treasury Stock in the United States’ (1978) *The Accounting Historians Journal* 2.

Sabri, NR ‘Using treasury “repurchase” shares to stabilize stock markets’ (2003) 8(4) *International Journal of Business* 426.

Sabri, NR *A Treasury" Repurchase" Share as a Stabilizing Instrument in the World Stock Markets* (2001) Working Paper 1.

Sanders,TH, HR Hatfield & WU Moore ‘A statement of accounting Principles’(1959) *American Accounting Association* 90.

Wesson, N & WD Hamman ‘The Repurchase by a Holding Company of Treasury Shares held by Subsidiaries: A SA perspective’ (2012) *(43) 4 S.Afr.J.Bus.Management.*

8.2.3. Internet Sources

Adams, N ' Treasury Shares: More Efficient Management of Share Capital?' (2003) *Practical Law*. Available at *uk.practicallaw.com* accessed on 20th October, 2014.

Hofmeyr, C et al 'Key Aspects of the New Companies Act' (2012) Cliffe Dekker Hofmeyr, available at *http://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/legal/sectors/downloads/Cliffe-Dekker-Hofmeyr-Key-Aspects-of-the-New-Companies-Act.pdf* available on 9th October 2014.

Miller, 'So Much Cash, so Few Options' (June 1998) *http://www.cfoeurope.com/199806e.html.*

Securities and Futures Commission of Hong Kong *Consultation Paper on Treasury Shares* (SFCHK November, 1998) para 3.5-3.8 available at *http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/doc?refNo=98CP6#Arguments%20in%20favour%20of%20treasury%20shares* accessed on 19th November 2014.

Stein, C 'The Most Significant Changes to South Africa's Company Laws Brought about by the Companies Act, 2008' (2010) *Bowman Gilfillan Attorneys* available at *http://www.bowman.co.za/FileBrowser/ContentDocuments/NewCompanies-Act-Brochure.pdf* accessed on 9th October, 2014.

Treasury Shares: The Practicalities' (2003) *Practical Law* available at *uk.practicallaw.com* accessed on 20th October, 2014.

8.2.4. Department of Trade and Industry Papers

Department of Trade and Industry(dti) *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform*. GN 1183 of 2004 GG26493 (May 2004).

Department of Trade and Industry (dti). *Integrated Manufacturing Strategy* (April 2002) 2.

United Kingdom Department of Trade and Industry Consultative Document(UKdti) *Treasury Shares (URN* 01/500, Sep 2001).

UKdti *Share buy-backs* (May 1998) URN98/713.

8.2.5. Thesis

Rice, DG 'The Legal Nature of the Share' (1955, unpublished dissertation) 2.