GARDNER v MARGO: A MISAPPLICATION OF SECTION 38 OF THE COMPANIES ACT

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INTRODUCTION

The notorious prohibition against the giving of financial assistance for the shares of a company contained in s 38 of the Companies Act 61 of 1973 arose yet again in the recent Supreme Court of Appeal case of *Gardner & another v Margo* 2006 (6) SA 33 (SCA), in a judgment handed down by Van Heerden JA. One of the issues before the court was whether a guarantee given by a company in respect of a sale of the shares of that company was a contravention of s 38. The court ruled that the guarantee given by the company had not constituted financial assistance. On a proper application of the principles laid down in *Gradwell (Pty) Ltd v Rostra Printers Ltd* 1959 (4) SA 419 (A) and *Lipschitz NO v UDC Bank Ltd* 1979 (1) SA 789 (A), it appears that the court may have misapplied the established legal principles. Had it not done so, it might well have reached a different conclusion as to whether the guarantee had constituted financial assistance.

THE FACTS

The first appellant, Gardner, and the second appellant, OTR Mining Ltd (OTR), a management and exploration company listed on the JSE Securities Exchange, had entered into a contract of mandate with Joubert on

26 February 1998 under which Joubert had instructed Gardner to sell a large number of Joubert's shares in OTR. In terms of the mandate, OTR had given a guarantee to Joubert that he would receive not less than R5 141 432 for the sale of his shares in OTR which were to be sold on his behalf by Gardner.

Joubert and Gardner were the founding members of OTR. Gardner was the managing director and chairman of OTR, while Joubert was its mining director. At the time the mandate was concluded, OTR was experiencing severe financial difficulties and the general perception, according to a confidential OTR Mining Security Year End Report dated 3 January 1998 (a mere seven weeks before the contract of mandate was entered into), was that 'OTR [was] not going to last long' (quoted in para 29 of the judgment). After the mandate had been concluded, Joubert ceded to Margo, a director of OTR, all his rights, title and interest in and to all claims which he had against Gardner and OTR under the mandate. Margo, in his capacity as cessionary, thereafter sued Gardner and OTR for payment of the unpaid proceeds of the shares in OTR which Gardner had sold, or allegedly sold, in terms of the mandate. In this regard Gardner had paid a substantial portion of the proceeds of the sale of the shares to OTR, and Margo accordingly contended that OTR was jointly and severally liable with Gardner for payment of that part of the proceeds of the shares which OTR had received from Gardner.

The main defence raised by Gardner and OTR was that on a proper interpretation of the mandate, Joubert had no residual rights under the mandate against either of them at the time of the cession to Margo, and that Margo accordingly had no rights as a cessionary against either of them. The court a quo rejected this defence and in the main upheld Margo's claim, and it was against this decision that Gardner and OTR subsequently appealed.

Margo further sought to hold OTR liable in terms of the guarantee that OTR had given to Joubert under the mandate and which had also been ceded to him. In effect, Margo contended on appeal that to the extent that he was awarded or recovered an amount that was less than the amount that OTR had guaranteed (that is, R5 141 432), OTR was liable to him for the payment of the difference. It was in answer to this contention that OTR asserted that the guarantee given by it to Joubert had constituted a contravention of s 38, in that it directly or indirectly constituted financial assistance by OTR for the purpose of or in connection with a purchase made or to be made of Joubert's shares in OTR within the scope of s 38, and that the guarantee was consequently invalid and unenforceable.

THE JUDGMENT

The interpretation of the mandate was the least controversial part of the judgment and is not of much relevance to this analysis. First, based on its interpretation of the mandate, the court upheld the contention of Gardner and OTR that under it Joubert was entitled to receive only 40 cents per share out of the proceeds of the shares sold on his behalf by Gardner, and that any

amount received in excess of 40 cents per share would be paid to OTR (paras 33–4). Secondly, in respect of a number of 'unaccounted shares' — which Margo contended that Gardner had sold, while Gardner and OTR denied the sale — the court found that Gardner had in fact sold the unaccounted shares, with the result that Margo did have a claim against Gardner for those shares, but at a rate of 40 cents per share only and not at the prevailing market rate as Gardner had claimed (para 42).

On the more contentious issue of the guarantee that OTR had given to Joubert and that had subsequently been ceded to Margo, the court ruled that the guarantee did not fall foul of s 38. In determining this issue, the court stated as follows (para 47, our emphasis):

> 'In *Lipschitz NO v UDC Bank Ltd* this Court appears to have accepted the distinction drawn by Schreiner JA in *Gradwell (Pty) Ltd v Rostra Printers Ltd* between the "ultimate goal" of the transaction in question and its "direct object", and to accept that it is only the direct object of the transaction that is relevant. If the direct object is not the provision of financial assistance by the company for the purpose of or in connection with a purchase of its shares, then it is irrelevant that the ultimate goal of the transaction was to enable a person to purchase such shares. *Moreover, financial assistance within the meaning of s 38(1) is given only when the direct object of the transaction is to assist another financially — the s 38 prohibition is not contravened when the direct object of the transaction is merely to give another that to which he or she is already entitled*.'

The court applied the direct and ultimate object test laid down in *Lipschitz* (supra) to the facts of this case as follows (para 48):

> '[T]he guarantee given by OTR to Joubert was not intended to provide financial assistance to anyone in respect of the purchase of OTR shares. The direct object of the guarantee was to provide Joubert with some security for that to which he was entitled in terms of the mandate, i e part of the proceeds of the shares to be sold on his behalf by Gardner. In my view, the guarantee does not fall foul of s 38(1) of the Companies Act . . . .'

The court thus concluded that OTR was liable jointly and severally with Gardner for payment of the amount owing to Margo in respect of the 'unaccounted shares', but that since it had found that OTR was a guarantor and not a co-principal debtor, OTR was liable to pay Margo only in the event of Gardner's failing to do so. The court's reasoning on the validity of the guarantee in the light of s 38 is examined in more detail below.

THE PRINCIPLES OF SECTION 38

The relevant part of s 38 provides as follows:

> 'No company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares of the company. . . .'

In the classic case of *Gradwell* (supra) Schreiner JA stated that '[u]nless what was to be done would amount to giving of financial assistance within the meaning of the sub-section the purpose and the connection would not be important' (at 425G). It is clear from this statement that in order to determine whether s 38 has been contravened, it must *first* be determined whether financial assistance has been given by the company and, if it has, *only then* does the 'purpose' of the financial assistance become relevant.

This was made manifestly clear in *Lipschitz* (supra), where the court said (at 799E, our emphasis):

> 'The prohibition in the section comprises two main elements; one is the giving of financial assistance, the other is the purpose for which it is given (or the "in connection with" provision). The two elements are linked to form a single prohibition, but although so linked they are *vitally different* in concept.'

(See also *Lewis v Oneanate (Pty) Ltd* 1992 (4) SA 811 (A) at 816I–J, which confirmed this crucial proposition.)

The two elements of the prohibition in s 38 are discussed in turn below, namely the element of financial assistance and the purpose of the financial assistance.

(i) The first element: Financial assistance

'Financial assistance' includes the giving of a loan, a guarantee and the provision of security, but these three types of transactions are not exhaustive because the word 'otherwise' in s 38(1) is not construed eiusdem generis with a loan, guarantee or the provision of security (*Gradwell* (supra) at 425B). It is a catch-all phrase.

'Financial assistance' has not been defined in the Companies Act, 1973 but various tests have been formulated by the courts as a guide to determine whether a company's actions constitute 'financial assistance' within the scope of s 38 (compare the English Companies Act of 1985, which prohibits a number of forms of financial assistance in s 152). One such test formulated in *Gradwell* (supra) is the 'impoverishment test', which poses the question whether the company, in consequence of what it did for the purpose of or in connection with the purchase of its shares, has become poorer (*Gradwell* at 426A–C; *Lipschitz* (supra) at 798C–D). If the question is answered negatively the conclusion is reached that financial assistance has not been given by the company and the enquiry ends there. If, on the other hand, the financial position of the company has been adversely affected by the transaction in question, then the company must have given 'financial assistance' and the enquiry proceeds to the second element, being the purpose of the financial assistance.

However, as pointed out by the Appellate Division in *Lipschitz* (supra), the impoverishment test is not always appropriate (at 800G–801A). Importantly, the impoverishment test would not be relevant where a company gives a guarantee — as OTR did in *Gardner v Margo* — or where a company provides security, as these transactions do not '*per se* involve the actual or even probable disbursement or employment of the company's funds' (at 800H). However the failure of the impoverishment test does not mean that s 38 is not contravened; if a company gave a guarantee or provided security for the purpose of or in connection with the purchase of the company's shares, s 38 would be contravened since the section *'expressly provides* that the giving of a guarantee or the provision of security constitutes financial assistance' (at 801A, our emphasis; and see also *Jacobson v Liquidator of M Bulkin & Co Ltd* 1976 (3) SA 781 (T) at 788D–E).

As emphasized in *Lipschitz* (supra), the purpose of the legislature in specifically including within the concept of 'financial assistance' the giving of a guarantee or the provision of security was to guard against a company's

merely exposing its funds to possible risk — as distinct from actually employing or depleting its funds — for the purpose of or in connection with the purchase of its shares (at 801C). Where, therefore, a company gives a guarantee or a loan or provides security for the purpose of or in connection with the purchase of the company's shares, s 38 would necessarily be contravened, *whether or not* the company has been impoverished. Where a company's actions fall into the category of 'otherwise', that is, it is not a loan, guarantee or security, then the impoverishment test according to *Lipschitz* (at 801) could still be applied in order to determine whether financial assistance has been given by the company.

(ii) The second element: The purpose of the financial assistance

If the first element of the prohibition in s 38 is satisfied, in that financial assistance has been given by the company, then in order to determine whether s 38 has been contravened it must still be determined whether the financial assistance was given 'for the purpose of or in connection with a purchase or subscription . . . of or for any shares of the company' within the meaning of the section.

The courts have drawn a distinction between the 'ultimate goal' of a transaction and its 'direct object', and have laid down that it is the direct object that is relevant in determining whether s 38 has been contravened, as opposed to the ultimate goal (see *Gradwell* (supra), *Lipschitz* (supra) and *Fidelity Bank Ltd v Three Women (Pty) Ltd* [1996] 4 All SA 368 (W)). In *Gradwell* Schreiner JA, in concluding that s 86*bis*(2) (the predecessor of s 38 in the Companies Act 46 of 1926) had not been contravened, stated (at 426D–E) that although the ultimate goal on the facts of that case was the prohibited purpose, namely the purchase of shares of the company, 'it was the direct object of the parties to pay off part of the loan account so as to leave a smaller amount to be purchased'. The decision in *Gradwell's* case was aptly summarized by Miller JA in *Lipschitz* as follows (at 800B–C):

> 'The ultimate finding was that the section had not been contravened because . . . the payment, although it would facilitate the purchase of the company's shares, which was the ultimate object, would be made with the direct (and legitimate) object of discharging an existing debt which was due and payable . . ..'

Before, however, the direct object can be said to be a legitimate one, it must be in the commercial interests of the company, a 'real and not fictitious' transaction (*Karnovsky v Hyams* 1961 (2) SA 368 (W) at 370B), or not an artificial one (*Belmont Finance Corporation v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393 (CA) at 403e–f), and it must accord with 'sound business methods' (*S v Hepker* 1973 (1) SA 472 (W) at 479H) and be in 'the ordinary course of business [of the company] and to advance its business' (ibid at 479G).

It is noteworthy that the analysis of the direct object and ultimate object of the transaction has a bearing only on the second element of the s 38 analysis, and not on the first element of whether there has been financial assistance. In the words of Miller JA in *Lipschitz* (supra) at 799C–F, our emphasis:

'It is important to note, however, that SCHREINER JA (at 426D–E) also observed that the partial discharge by the company of the loan account debt would not be "merely incidental" to the transaction and that, although the "ultimate goal" of the transaction was the purchase of the shares, "it was the direct object . . . to pay off part of the loan account".

The prohibition in the section comprises two main elements; one is the giving of financial assistance, the other is the purpose for which it is given (or the "in connection with" provision). The two elements are linked to form a single prohibition, but although so linked they are vitally different in concept. *The further observations of SCHREINER JA, to which I have just referred, have a direct bearing on the second of the two elements.'*

According to *Lipschitz* (supra) at 804G–H, the words 'in connection with' in s 38 appear to have been inserted in the section in order to cover a situation where, 'although the actual purpose of the company in giving financial assistance might not have been established, its conduct nevertheless stood in such close relationship to the purchase of its shares that, substantially if not precisely, its conduct was similar to that of a company which gave the forbidden assistance with the purpose described in the section'. In other words, the words 'in connection with' were inserted in s 38 to close possible loopholes (*Lipschitz* (supra) at 804H). In *Lipschitz* the court emphasized that where the purpose of the company in performing the act complained of is established, and that purpose is for something other than the purchase of the company's shares, there would in general, although there may be exceptions, be 'little or no room for a finding that . . . the act was nevertheless performed in connection with the purchase of the shares' (at 805B). In *Gardner v Margo* the court did not find it necessary to refer to this part of s 38.

The court in *Gardner v Margo* cited the *Fidelity Bank* case (supra) at 378j–381f as authority for the proposition that if the direct object is not the provision of financial assistance by the company for the purpose of or in connection with a purchase of its shares, then it is irrelevant that the ultimate goal of the transaction was to enable a person to purchase such shares (*Gardner v Margo* para 47). With respect, however, the court in *Fidelity Bank* did not lay down any such proposition. The court in *Fidelity Bank* affirmed (at 379h–i) the statement made by Miller JA in *Lipschitz* case at 800B–C and quoted above, and agreed furthermore with Professor Beuthin in his note 'More about financial assistance' (1980) 97 *SALJ* 477 at 478, where it is stated that:

'[B]efore the more direct object envisaged by the Appellate Division can be said to be a "legitimate one" in the sense intended, and before a transaction can be said to be "a perfectly normal transaction according to sound business methods", it must be one which the company could legitimately have entered into in its own commercial interests and which it did in fact enter into in its own commercial interests' (quoted in *Fidelity Bank* at 379j–380a).

APPLICATION OF SECTION 38 TO THE FACTS OF *GARDNER v MARGO*

With respect, the court in *Gardner v Margo* appears incorrectly to have conflated the two elements of s 38 and formulated the direct and ultimate object test in such a way that it combines the two elements of s 38 in a rather misleading manner. This appears from the statement of the court that *'[m]oreover, financial assistance within the meaning of s 38(1) is given only when the*

direct object of the transaction is to assist another financially' (para 47, our emphasis).

It is clear from the authorities cited above that the proper approach is that a court must first determine if financial assistance is present before the 'purpose' of the financial assistance (which is the second element of the test) can even be examined. It is a two-step procedure. In examining the direct object it is not to be determined whether the direct object constitutes financial assistance, since financial assistance will already have been established. The point of the direct and ultimate object test is to determine the 'purpose' of the financial assistance, and in so doing, to determine whether the direct object is legitimate. If so, then (as explained above) it is irrelevant that the ultimate object is the purchase of the company's shares. If not, then the ultimate object cannot be disregarded. To examine whether the direct object constitutes financial assistance for the purpose of a purchase of the company's shares (as the court did) is, with respect, to confuse the two elements of s 38 that were so lucidly set out in *Lipschitz* (supra).

To apply the principles of s 38 to the facts in *Gardner v Margo*, OTR had given a *guarantee* of R5 141 432 to Joubert for the sale of its shares. As discussed above, since a guarantee is explicitly prohibited by s 38 it is beyond doubt that OTR had given financial assistance to Joubert, and it is further beyond doubt that the impoverishment test would not be relevant.

The second step is to determine whether the guarantee by OTR to Joubert was given for the purpose of or in connection with the purchase of OTR's shares. It was arguably not in the commercial interests of OTR, or in accordance with sound business methods, for OTR to give a guarantee of nearly R5 million to a seller of shares in the company at a time when it was in severe financial difficulties. In fact, from the date of OTR's listing (22 September 1997) to 28 February 1998 the company had reported an operating loss of over R4,4 million with a revenue of only R599 000, nowhere near the net income of R4 131 million for the previous financial year ending February 1998 that had been forecast in its pre-listing statement (see para 28 of the judgment). As the court pointed out, based on OTR's dire financial state of affairs at the time of the sale of the shares, it was 'not a very appropriate time, from OTR's perspective, for its mining director to decide to sell his shares and retire from the company' (para 29). Surely, then, the provision of the guarantee by OTR to Joubert could a fortiori not have advanced the business of OTR.

Interestingly, and as pointed out by the court (para 26), the amount of the guarantee given to Joubert by OTR (R5 141 432) was exactly equal to the total number of shares covered by the mandate (12 853 580) multiplied by an amount of 40 cents per share. OTR had thus given a guarantee to Joubert that he would receive *all* the proceeds (and not merely a part of the proceeds) of the shares to be sold on his behalf by Gardner. This immediately lends itself to the irresistible inference that Joubert had agreed to sell his shares in OTR only on the assurance that he would receive 40 cents per share, failing which *OTR itself* would be required to make good the difference.

Indeed, based on the evidence presented to the court in *Gardner v Margo*, the court stated that it was probable that Joubert had wanted to 'bail out' of OTR as quickly as possible, 'before the true state of the company's operations and finances filtered through to the market causing the share price to plummet' (para 32). The court found that Joubert was, on a balance of probabilities, fully aware at the time of the mandate of the dire state of OTR's mining activities and that its severe financial problems had not yet been reflected in the share price quoted on the JSE Securities Exchange (para 30). Joubert would no doubt have been concerned that the sale of his shares would obtain a price less than 40 cents per share had news of OTR's true state of affairs entered the market.

The court found further that Joubert was willing to accept a fixed price per share which was less than the prevailing market price of the shares in OTR at the time, and that the price of 40 cents per share had been negotiated between Joubert and Gardner on the basis of the amount of money which Joubert had estimated he would require for his retirement, an amount of approximately R5 million, divided by the number of shares which Gardner was to sell on Joubert's behalf (para 32). The court found that this was borne out by the amount of the guarantee given to Joubert by OTR in respect of the shares covered by the mandate (ibid). After considering the above evidence the court ruled that the direct object of the guarantee was to provide Joubert with some security for that to which he was entitled in terms of the mandate (para 48), and therefore that the guarantee given by OTR to Joubert did not fall foul of s 38.

But there is no indication in the judgment that the court had examined whether the purpose of the financial assistance was really legitimate. It is respectfully submitted that had it done so, it might well have come to a different conclusion as to whether the guarantee had constituted financial assistance for the purpose of the purchase of shares in OTR, contrary to s 38. It failed to do so directly as a result of its misapplication of the test laid down in *Gradwell* and *Lipschitz*.

In this regard, it would appear from the facts of the case that Joubert had agreed to sell his shares in OTR only if he could be certain that he would receive 40 cents per share, failing which *OTR* would be required to make good the difference. It seems in this case that the direct and ultimate object were the same, namely to provide financial assistance to Joubert, by means of a guarantee, for the purchase of the shares held by Joubert in OTR. Based on the facts of the case, it was unlikely that Joubert would have been prepared to sell his shares in OTR in accordance with the terms of the mandate unless he was given some sort of assurance or guarantee that he would receive the balance of the sum of R5 141 432 *from OTR* if the sale of the shares failed to fetch such a sum, which was the amount that Joubert had required for his retirement.

A similar situation occurred in *Goss v EC Goss & Co (Pty) Ltd* 1970 (1) SA 602 (D), in which the share seller had agreed *in principle* to the sale of her shares for an amount of R12 000. Subsequently R800 of the purchase price

was paid by the share purchaser, the balance to be payable *by the company* whose shares were the subject of the sale, in monthly amounts of R200 for four years and eight months, in terms of a contract of service on the understanding that the share seller would not actually be called upon to do any work whatsoever (*Goss* at 605B–C). The court in *Goss* had no hesitation in striking down the financial assistance provided by the company 'under subterfuge of the service contract' (at 608B) for the purchase of its own shares. It is submitted with respect that a similar approach ought to have been adopted in *Gardner v Margo*.

The issue of whether Joubert and Gardner had committed the offence of 'insider trading' was not raised in court, but it appears from the facts of the case that Joubert and Gardner had contravened the Insider Trading Act 135 of 1998 (ITA). (The ITA has since been repealed by the Securities Services Act 36 of 2004, but at the time of the sale of Joubert's shares by Gardner the ITA was still in force.) The fact that OTR was experiencing severe financial problems, of which Joubert and Gardner, as directors of OTR, were fully aware, constitutes 'inside information' since the confidential (or non-public) information, if made public, would be likely to have a material effect on the price of OTR's securities (see s 1 of the ITA). This is borne out by the court's statement that Joubert had wanted to 'bail out' of OTR as quickly as possible 'before the true state of the company's operations and finances filtered through to the market causing the share price to plummet' (para 32). According to s 2(1) of the ITA, an individual is guilty of an offence if he knows that he has inside information and deals directly or indirectly for his own account or for any other person in the securities to which such information relates or which are likely to be affected by it. This is what Gardner appears to have done; that is, he sold shares in OTR, for the account of Joubert, at a time when he knew that he possessed inside information. Joubert likewise had sold his shares in OTR, indirectly through Gardner as his agent, at a time when he knew that he possessed inside information.

THE PROVISION OF FINANCIAL ASSISTANCE TO A SELLER OF SHARES

In *Gardner v Margo* financial assistance in contravention of s 38 was alleged to have been given to Joubert, who was the *seller* of the shares in OTR. At first blush it may seem unusual for financial assistance to be given to a seller rather than to a purchaser of the shares. In *Karnovsky v Hyams* (supra) the court, in dealing with s 86*bis*(2) of the Companies Act 46 of 1926, stated that it 'is relevant to the enquiry to answer the question whether *either the purchaser or the sellers* have been financially assisted in the transaction' (at 370D, our emphasis).

Similarly, in *Chaston v SWP Group plc* [2003] 1 BCLC 675 the English Court of Appeal stated that s 151 of the English Companies Act, 1985 (the English equivalent of s 38) is not restricted to assistance given to purchasers (at 689d–e).

Although in the earlier English case of *MT Realisations Ltd (in Liquidation) v Digital Equipment Co Ltd and related actions* [2002] 2 BCLC 688 Laddie J had expressed the view (at 696i) that in order to fall within the ambit of s 151 of the 1985 Act the financial assistance must be given by the target company (or its subsidiaries) to the *purchaser*, the appeal court did not find it necessary to express a view on this issue when the matter went on appeal. The statement of Laddie J is in conflict with the earlier English case of *Armour Hick Northern Ltd v Armour Trust Ltd* [1980] 3 All ER 833 (Ch) at 837g–h, where, in examining whether financial assistance to a seller of shares was prohibited by s 54 (the predecessor of s 151 of the English Companies Act of 1985), the court cited with approval the following dictum of McInerny J in the Australian case of *E H Dey Pty Ltd v Dey* [1966] VR 464 at 470 (our emphasis):

> 'In my view, the prohibition is not confined to financial assistance to the purchaser: it is directed to financial assistance *to whomsoever given*, provided that it be for the purpose of a purchase of shares or in connexion with a purchase of shares.'

The weight of authority therefore leans towards the view that s 38 prohibits financial assistance whether given to the purchaser or the seller of the shares. Based on *Karnovsky v Hyams* (supra) it is very likely that our courts would follow this point of view.

Section 38 does not specify that financial assistance given only to a purchaser of shares is prohibited. The section merely prohibits financial assistance given by a company for the purpose of or in connection with a purchase or subscription made by any person for the shares of the company. It is accordingly submitted that financial assistance given by a company, whether to a purchaser of shares of the company or to a seller of shares of the company, would be caught by the general proscription in s 38(1) against the giving of financial assistance for the shares of the company.

In *Lewis v Oneanate (Pty) Ltd* (supra) Nicholas AJA stated (at 818A–C) that:

> 'The object of a provision such as s 38(1) is the protection of the creditors of a company, who have a right to look to its paid-up capital as the fund out of which their debts are to be discharged. . . . The purpose of the Legislature was to avoid that fund being employed or depleted or exposed to possible risk in consequence of transactions concluded for the purpose of or in connection with the purchase of its shares.'

This statement was approved in *Peters NO v Schoeman* 2001 (1) SA 872 (SCA) para 9, and (curiously) in *Gardner v Margo* (para 45). In its origin, s 38 may have been seen as a natural extension by statute of the capital maintenance rule and as contravening the rule in *Trevor v Whitworth* (1887) LR 12 App Cas 409 (HL) that a company may not purchase its own shares (F H I Cassim 'The reform of company law and the capital maintenance concept' (2005) 122 *SALJ* 283 at 291; see also the (as yet) unreported judgment of the Witwatersrand Local Division in *Ex parte Standard Bank Group Ltd* (case no 04/17352) and *Liberty Group Ltd* (case no 04/19223) handed down on 5 June 2006, para 16). Although the two prohibitions are related they are distinct from one another, and the prohibition against financial assistance by a company for the purchase of or subscription for its shares has little to do with

the capital maintenance rule (Cassim op cit at 291; *Standard Bank Group Ltd* (supra) para 16). As stated by Cassim (op cit at 292),

> 'in essence, s 38 simply ensures that persons who purchase shares in a company do so out of their own funds and not by plundering the resources of the company to the prejudice of the creditors and minority shareholders. . . . The underlying philosophy of s 38 is that corporate funds must be used for proper corporate purposes.'

Surely, if the purpose (or one of the purposes) of enacting s 38 was to protect the creditors and minority shareholders of the company, there is no reason why transactions under which a company gives financial assistance to a *seller* of shares of the company for the purpose of or in connection with the purchase of the company's shares should not be equally condemned, as these transactions would in all likelihood, as in the case of financial assistance that is given to a purchaser of shares of the company, be subject to the same potential abuse of the funds of the company.

CONCLUSION

It is suggested with respect that the court in *Gardner v Margo* conflated and misapplied the principles laid down in *Gradwell* and *Lipschitz*. It is submitted that, had the court applied the principles correctly, it could well have come to a different conclusion on the question whether the guarantee given by OTR to Joubert had constituted financial assistance in contravention of s 38.