

A CRITICAL ANALYSIS OF THE PROTECTION OF SHAREHOLDERS WHEN A
COMPANY ACQUIRES ITS OWN SHARES

by

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SUMMARY

The capital maintenance doctrine presupposes that a company's capital must not be returned to its shareholders. The doctrine was anchored on three rules, one of which was that a company cannot acquire its own shares as this amounted to a diversion of capital to the shareholders whose shares were acquired. This rule was partly rationalized as protecting the interests of shareholders. In South Africa the rule was embodied in s 85 of the Companies Act 61 of 1973. However, it was amended by s 9 of the subsequent Companies Amendment Act 37 of 1999 to provide that a company can acquire its own shares if certain substantive and procedural requirements were satisfied. Upon the enactment of Companies Act 71 of 2008, the requirements have not been substantially altered. They are partly geared towards protecting shareholders by ensuring that shareholders are treated equally and fairly. Moreover, the Johannesburg Securities Exchange Limited (hence the JSE Limited) was empowered by the Companies Act 61 of 1973 to promulgate requirements to be met when a company wishes to acquire its own shares. The Companies Act 71 of 2008 does not in express terms empower the JSE Limited to develop requirements to be met when a company wishes to acquire its own shares. However, the Act expressly requires that a listed company wishing to acquire its own shares must also comply with the requirements of the relevant exchange. Such requirements can therefore be deemed to subsist even amidst the new Act as an internal regulation of the JSE Limited. The said requirements are also partly aimed at protecting shareholders, largely by ensuring that adequate information is availed to shareholders to empower them to make informed decisions.

KEY TERMS

Acquisition; Capital; Companies Act; Company; Protection; Shares Exchange; Shareholder; Shares.

1 INTRODUCTION

As early as the nineteenth century, judges had already developed a principle that always required companies to maintain their share capital.¹ This principle is what is referred to as the common law capital maintenance doctrine. The doctrine directs that a company's capital should not be returned to its shareholders.² The conceptual reasoning is that an ordinary shareholder has rights to such dividends as the directors from time to time declare (whilst the company is a going concern), and in the event that the company is wound up, he would be entitled to a *pro rata* share of capital and surplus, in so far as that capital exceeds the company's liabilities. Therefore, it is in order to think of capital as an indefinitely deferred claim against the company, which is payable only when the company is wound-up and subordinate to the claims of the company's creditors and indeed the capital maintenance doctrine aims at ensuring that this position remains that way.³

In *Capitex Bank v Qorus Holdings Ltd and Others*⁴ the court discussed the basic rules of the capital maintenance doctrine where it opined that the doctrine rested on three rules,⁵ namely that the company cannot acquire its own shares;⁶ that the company cannot issue shares at a discount;⁷ and that the company cannot declare dividends otherwise than out of profit.⁸ Only the rule that the company cannot acquire its own shares will be explored in this study, with specific reference to shareholder protection.

¹ Armour J 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' 2000 (63) *MLR* 355-378, at 367.

² *Idem*, at 365.

³ *Idem*, at 365-6.

⁴ 2003 (3) SA 203 (W), at 306.

⁵ Also see Delport P 'Validity of Contracts for Purchase of Own Shares by Company' 2003 (66) *THRHR*, at 681-2; *Trevor v Whitworth* (1887) 12 App Cas 409 (HL), at 416-17.

⁶ This rule will be discussed in detail later in this dissertation.

⁷ 'The common law dictated that the amount of capital is provided for in the memorandum of association divided into a certain number of shares of a certain fixed amount. This cannot be changed by way of giving shares at a discount as it would serve to compromise the interests of creditors as shareholders would only be liable on the amount and value of shares which they hold' - see *Ooregum Gold Mining Co. of India Ltd v Roper* [1892] AC 125 (HL), at 133. 'However, a statutory exception to this common law rule was introduced in order to allow the issue of shares at a discount in certain circumstances with the sanction of the court and by special resolution. Beyond the ambit of this exception, the issue of shares at a discount still remains legally unacceptable' - see Cilliers HS *et al Cilliers and Benade Corporate Law* 3rd ed. (Butterworths Durban 2000), at 327.; Benade ML *et al Entrepreneurial Law* 4th ed. (LexisNexis Durban 2008), at 191; Section 81 of the 1973 Companies Act; Section 40 of the 2008 Companies Act.

⁸ 'This rule is concerned primarily with prohibiting the wrongful application of share capital and not so much with the concept of capital maintenance' - see Cilliers HS *op cit* note 7, at 345. The rule was upheld in *Guinness v Land Corporation of Ireland* (1883) 22 Ch D 349 (CA), at 375. 'Therefore the common law position is that dividends must be paid out of profit and any other manner of paying dividends would amount to a reduction of capital' - see MacIntyre E *Business Law* (Longman Education Harlow 2005), at

The rule that a company cannot acquire its own shares was codified in s 85 of the Companies Act⁹ (hence the 1973 Companies Act) and later substituted by s 9 of the Companies Amendment Act¹⁰ (hence the 1999 Amendment Act) to provide for a departure from the strict common law rule, enabling a company to acquire its own shares if certain requirements were met. These requirements are that a company has to be authorised thereto by its articles,¹¹ that the acquisition has to be authorised by a special resolution¹² and that the solvency and liquidity of the company has to remain unaffected.¹³

In the new Companies Act¹⁴ (hence the 2008 Companies Act), which has effectively repealed the 1973 Companies Act, the legislature has not interfered with the power of a company to engage a distribution, which the 2008 Companies Act defines to include the power of a company to acquire its own shares, save for improving and streamlining it, both in terms of the requirements to be met and the procedure to be followed.¹⁵

553. However, a statutory exception to this common law rule was created by providing in s 79 of the 1973 Companies Act that where shares are issued to finance construction works or the acquisition of plant which cannot produce profits for a lengthy period the company may during such period pay interest on paid-up share capital and then capitalise the interest. Such payment however, must have been authorised by the articles or by special resolution; sanctioned by the Minister and or for that period of time determined by him; rate of interest may not exceed six per cent and it must not be applied in reduction of the share capital on which it is paid. The rule against payment of dividends out of capital is designed to protect the creditors of the company, but the creditors do not have any power to prevent a proposed dividend out of the company's capital. It is in that regard that s 90 of the 1973 Companies Act permits any payments to shareholders provided that they are authorised by the articles and there are reasonable grounds to believe that after the payment the company will remain liquid and solvent.

⁹ 61 of 1973.

¹⁰ 37 of 1999.

¹¹ Section 85(1) of the 1973 Companies Act.

¹² Section 85(2) of the 1973 Companies Act.

¹³ Section 85(4) of the 1973 Companies Act.

¹⁴ 71 of 2008.

¹⁵ Section 46 read together with ss 48 and 1 of the 2008 Companies Act.

2 A COMPANY'S ACQUISITION OF ITS OWN SHARES

2.1 INTRODUCTION

It is prudent to commence by attempting to draw a distinction between 'acquisition' of own shares and 're-purchase' of shares. The foremost difficulty that one has to deal with is the fact that the two terms have a similar effect and can be used interchangeably depending on the context and depth in which one is using them. But at the very outset, a 'purchase' is a form of 'acquisition', just like would be 'a re-purchase', 'a re-acquisition', and 'a buy-back' of shares. However, strictly speaking a company cannot 'purchase' its own shares because a '... company cannot acquire rights against itself'.¹⁶ Consequently it has been observed as follows:¹⁷

[A] share is a bundle of rights. Where a company buys its own shares, one of these rights will be a right of action against itself. Obviously, the company cannot be the owner of a claim against itself... How can one acquire a right against oneself? To state the proposition is to demonstrate the absurdity. One possibility is that the acquisition of the share operates like the assignment of a debt to the debtor – it acts as a release of those rights.'

The 'acquisition' of own shares terminates the subsistence of the said rights of action and therefore strictly speaking a company cannot purchase its own shares.¹⁸ The concept in my opinion appears to be a battle of English and legal semantics where one may be saying two different things in English but meaning the same thing in law. But it cannot be gainsaid that the subject in question is law and the legal meaning or construction of the concepts must prevail.

As it has been stated, what it entails '...is the taking back by a company of shares issued by it and in return, the payment by the company of money or assets to the shareholder or shareholders concerned'.¹⁹ I concur with Jooste, '... that it is difficult to think of a single word that appropriately describes what is involved and consequently, that the word "acquisition" is more appropriate' as it envisages all the possible scenarios

¹⁶ Jooste R 'The Maintenance of Capital and the Companies Bill 2007' 2007 (124) SALJ 710-733, at 714.

¹⁷ *Ibid.*

¹⁸ *Ibid.*

¹⁹ *Ibid.*

and will subsequently be used to refer to a situation where a company '... takes back its shares'.²⁰

2.2 WHY DO SHAREHOLDERS NEED PROTECTION WHEN A COMPANY ACQUIRES ITS OWN SHARES?

In the case of *Trevor v Whitworth*,²¹ a former shareholder claimed from the company the balance of the price of his shares which he had sold to the company before the company went into liquidation. The Court of Appeal by dismissing the claim a rule was founded which clearly prescribed that a company was not allowed to acquire its own shares.²²

The rationale for this rule as was clearly emphasized by Lord Herschell in *Trevor v Whitworth*²³ was that the paid-up share capital of a limited company constituted the fund to which creditors of a company had to look to for the satisfaction of their claims.²⁴ The creditors of the company expect that their debts ought to be made good from the share capital in the event that the company is unable to pay and a company should not therefore return the value of the shares to the shareholders.²⁵ It should be noted however, that the rule was not only intended to protect creditors, but was also meant to protect shareholders.²⁶

But why is it necessary to protect shareholders when a company acquires its own shares, even when it does not *prima facie* seem as if they would require any protection? The point of departure is that an acquisition of shares amounts to a change in the

²⁰ *Ibid*; Benade ML *op cit* note 7, at 189.

²¹ *Supra* note 5.

²² Gardner T 'Company Purchase of Own Shares under the Companies Bill 1990 – a sheep in wolf's clothing?' 1992 (22) *VUWLR* 159-192, at 159.

²³ *Supra* note 5.

²⁴ *Idem*, at 416.

²⁵ Van der Linde K 'A Company's Purchase of its Own Shares: A New Development' 1999 (7) *JBL* 67-71, at 68; Delpont R 'Transparency the Key to Share buy-backs' 1999 (154) *Finance Week* 13, at 13; *Re Exchange Banking Company, Flitcrofts Case* (1882) 21 ChD 519, at 534; 'The capital maintenance doctrine was regarded by the nineteenth century judges who developed it as a means of protecting corporate creditors against the 'extra' risks associated with limited shareholder liability' - see Armour J *op cit* note 1, at 367. The extra risk associated with limited liability is basically the risk that the shareholders are not liable beyond their respective share capital in the company and this capital therefore ought to be retained in the company.

²⁶ Armour J *op cit* note 1, at 363. The rule protected shareholders by ensuring that no capital would be returned to any one shareholder whatsoever and this averted the imminent danger of unequal treatment of shareholders particularly during the times when the company was in problems.

ownership of the company's shares, which can be used to alter control of a company or even to prevent any alteration of control.²⁷ It can also be used to manipulate the market price of the company's shares and promote market rigging where a company may acquire its own shares in an endeavour to speculate in its shares.²⁸

Moreover, share acquisitions have a great potential to perpetrate unequal treatment of shareholders holding a similar class of shares²⁹ and can also be used to defeat a shareholder's pre-emptive rights.³⁰ In simple terms, the power of a company to acquire own shares can be abused and if safeguards are not put in place well in advance the power can be utilised by a group of shareholders to appropriate to themselves an unwarranted advantage over their counterparts.³¹ Perceptively it is not sufficient to only afford protection to creditors but rather even the shareholders and the wider investing public should also be protected.³² Even the European Commission's High Level Group of Company Law Experts, which is responsible for the development of the company law policy of the European Union, has emphasized that the protection of shareholders and creditors forms an integral part of any company law system.³³

This rule that the company is not allowed to acquire its own shares was consequently admitted and became an integral part of the South African Company Law and was embraced as such in³⁴ *Ex-parte Vlakfontein Gold Mining Co. Ltd*,³⁵ *Cohen v Segal*,³⁶ and *Sage Holdings Ltd v The Unisec Group Ltd*.³⁷ However, in the course of time it has become obviously clear that this rule, as well as the other rules under the capital

²⁷ Cassim FHI 'The Reform of Company Law and the Capital Maintenance Concept' 2005 (122) *SALJ* 283-293, at 287-8.

²⁸ Cassim FHI 'The Repurchase by a Company of its Own Shares: The Concept of Treasury Shares' 2003 (120) *SALJ* 137-152, at 146.

²⁹ *Ibid*; Cassim FHI 'The New Statutory Provisions on Company Share Repurchases: A Critical Analysis' 1999 (116) *SALJ* 760-783, at 761.

³⁰ *Supra* note 27. The pre-emptive rights are the rights conferred by the articles of association upon shareholders in private companies to be offered, before any other person who is not a shareholder of that company, on specified terms, first refusal of the shares of any shareholder wishing to transfer his holding. This right is also provided for in s 39(2) of the 2008 Companies Act.

³¹ Cassim FHI *op cit* note 27, at 288.

³² Cassim FHI *op cit* note 27, at 287-8; Gardner T *op cit* note 22.

³³ See Snyman E (ed) *Reform of South African Corporate Law: Purchase by a Company of its Own Shares* (CRIC Bloemfontein 1998), at 285. This publication has been very instrumental in informing the company law of South Africa, and it cannot be gainsaid that the bulk of their proposals for reform have largely been borrowed from the company law of these countries.

³⁴ Delpont P *op cit* note 5, at 682.

³⁵ 1970 (2) SA 180 (T).

³⁶ 1970 (3) SA 702 (W).

³⁷ 1982 (1) SA 337 (W).

maintenance doctrine mentioned earlier, are not just a weak shield to shareholders but are also vague and in certain instances incomprehensible.³⁸ For instance the rule against acquisition of own shares contained serious flaws in respect of guarding against the company using back-door manoeuvres to acquire its own shares³⁹ or even the company protecting itself against manipulation of share prices.⁴⁰

The general philosophy adopted by the vast majority of common law jurisdictions has been that, separate legal personality and limited liability being privileges that were created by the state, all companies should be regulated by the state for the protection of the interests of creditors and the investing public.⁴¹ South Africa has not been an exception in this regard and has generally followed the approach of the more developed common law jurisdictions like the United Kingdom, United States of America, Canada, New Zealand and Australia.⁴²

In South Africa the capital maintenance doctrine was entrenched in s 85 of the 1973 Companies Act, which provided that a company was not capable of parting with its capital otherwise than in the normal course of its business operations. This meant that the company could not acquire its own shares as this could amount into a depletion of its share capital.⁴³ However, s 85 of the 1973 Companies Act was later amended by s 5 of the Companies Amendment Act⁴⁴ (hence the 1984 Amendment Act) and s 9 of the 1999 Amendment Act.

Upon the enactment of the 1999 Amendment Act the capital maintenance doctrine was radically changed as the amendment repealed in some respects, the capital maintenance requirement. The 1973 Companies Act (as amended) therefore, permitted companies to acquire their own shares subject to certain requirements. Under the 2008 Companies Act, the company is still allowed to acquire its own shares subject to it

³⁸ Cilliers HS *op cit* note 7, at 322.

³⁹ Davies PL *Gower and Davies' Principles of Modern Company Law* 7th ed. (Sweet & Maxwell London 2003), at 245-6. '[Moreover] for instance the doctrine did not envisage safeguards where shares were given to the company and held by a nominee for it; or if a company with uncalled capital forfeited shares for non-payment of any calls' – see Davies PL *idem*, at 246.

⁴⁰ *Supra* note 38.

⁴¹ Cassim FHI *op cit* note 27, at 284.

⁴² See Snyman E *op cit* note 33.

⁴³ Armour J *op cit* note 1, at 365-6.

⁴⁴ 70 of 1984.

fulfilling requirements that cannot be said to be fundamentally different from those in the 1973 Companies Act (as amended).

Since a company is now allowed to acquire its own shares, shareholders are no longer afforded any protection under the capital maintenance doctrine. Therefore, the obvious question that presents itself is - what protection is provided to shareholders when a company acquires its own shares?

Upon the substantial alteration of the capital maintenance doctrine as indicated above, the legislature has put in place measures geared towards protecting shareholders, for instance the substantive requirements provided for in s 85 of the 1973 Companies Act, as amended and subsequently in s 46 of the 2008 Companies Act, the liability of directors and shareholders as envisaged under s 86 of the 1973 Companies Act, as amended and subsequently in s 46 read together with s 77(3)(e)(vi) and s 48 read together with s 77(3)(e)(vii) of the 2008 Companies Act and the procedural requirements set out in s 87 of the 1973 Companies Act, as amended and subsequently in ss 114 and 115 of the 2008 Companies Act. Shareholders are also afforded protection in terms of the JSE Limited Listings Requirements in the event of share acquisitions by a listed company. These protective measures are analysed below.

Ultimately it cannot be denied that the power of a company to acquire its own shares is susceptible to abuse, as it may be used to enable one shareholder or a group of shareholders to obtain an unfair advantage over another shareholder or a group of shareholders.⁴⁵ For instance, where a company is dominated by a few shareholders the company can acquire their shares at a value in excess of their actual value and consequently pull down the value of the shares of the shareholders left behind.⁴⁶ Further a company with more appropriate information about the worth of its shares than a shareholder has, can purchase the shares of the shareholder at a price lower than their actual value, in consequence affecting the value of the shares of the remaining shareholders by increasing their value but at the expense of the selling shareholder.⁴⁷ Additionally, it can happen that the controlling shareholders can be given the

⁴⁵ Snyman E *op cit* note 33, at 89; Davies PL *op cit* note 39, at 257.

⁴⁶ Snyman E *op cit* note 33, at 89.

⁴⁷ *Ibid.*

opportunity to sell their shares and the minority shareholders excluded from the same benefit or they may be given the opportunity to sell their shares on more favourable terms.⁴⁸

⁴⁸ Davies PL *op cit* note 39, at 257.

3 SHAREHOLDER PROTECTION

3.1 INTRODUCTION

The bulk of the protection afforded to shareholders when a company acquires its own shares is embodied in the 1973 Companies Act and upon the enactment of the 2008 Companies Act that protection has been replicated. Similarly the JSE Limited Listings Requirements also affords the shareholders substantial protection. The protection afforded to shareholders varies in accordance with whether, as it has been asserted, the acquisition is an 'off-market' or a 'market' acquisition.⁴⁹ Market acquisitions have much fewer perils of abuse, for the simple reason that the JSE Limited Listings Requirements will be applicable and the acquisitions will be effected at a market price objectively determined by the prevailing market forces. If the acquisition is an off-market, the prospects will certainly be different because a shareholder who needs to sell his shares is likely to find that the company is the only potential and possibly viable purchaser and the shareholder will have to accept whatever the price that the company is prepared to pay.⁵⁰ What protection then is afforded to shareholders when a company acquires its own shares?

3.2 SHAREHOLDER PROTECTION IN GENERAL

As asserted earlier on, the 1973 Companies Act contains provisions that are geared towards protecting the shareholders of a company where the company proposes to acquire its own shares. This protection stems from the requirements that must be met in terms of ss 85-87.

The first requirement in terms of the 1973 Companies Act is that the company must be specifically authorized in its articles of association to acquire its own shares.⁵¹ Secondly, for an acquisition to be undertaken, an approval must be sought from the members of the company in the form of a special resolution.⁵² The justification for the requirement

⁴⁹ *Ibid.* 'If the shares are listed in the JSE Limited and the acquisition takes place there it is a market acquisition' – see Davies PL *ibid.*

⁵⁰ *Ibid.*

⁵¹ Section 85(1).

⁵² *Ibid.*

that the acquisition must be approved by special resolution is best expressed by Magner as follows:⁵³

‘The power in question undeniably has great potential for altering the nature of the company and therefore the shareholders as a body should be required to consider whether they want it to be available to the company.’

The special resolution can be either a specific approval targeting a particular acquisition or a general approval.⁵⁴ If the approval is a general one, it confers on the company an authority generally to acquire its own shares.⁵⁵ However, that authority is only valid up until the annual general meeting of the company is conducted but it can be withdrawn by a special resolution prior to the annual general meeting.⁵⁶

In order to draw a vivid comparison between the 1973 Companies Act and the 2008 Companies Act regarding the requirements for acquisition of own shares by a company, it is essential to note that the term ‘distribution’ as used in the 2008 Companies Act includes a direct or indirect transfer of money by a company, to or for the benefit of its shareholder in consideration for the acquisition of its own shares.⁵⁷ Therefore, all the requirements that must be met in order to effect any distribution in terms of the 2008 Companies Act, must also be met when a company acquires its own shares because ‘an acquisition of own shares’ by a company is a form of ‘distribution’.

Accordingly, the requirements that the acquisition of own shares must be authorized by the company’s articles of association followed by an approval by a special resolution of the shareholders, have been altered by the provisions of the 2008 Companies Act. The said provisions require that for a company to acquire its own shares, the decision to do so must be pursuant to an existing legal obligation of the company or a court order or be authorized by the board of the company by way of a resolution.⁵⁸

⁵³ Magner E ‘The Power of a Company to Purchase Its Own Shares: A Comparative Approach’ (1984) 2 *Company and Shares LJ* 79-105, at 95; Cassim FHI *op cit* note 29, at 764.

⁵⁴ Section 85(2) of the 1973 Companies Act.

⁵⁵ Section 85(3) of the 1973 Companies Act; Van der Linde K *op cit* note 25, at 68; Cassim FHI *op cit* note 22, at 288; Cilliers HS *op cit* note 7, at 325; Benade ML *op cit* note 7, at 189.

⁵⁶ *Ibid.*

⁵⁷ Section 1 of the 2008 Companies Act.

⁵⁸ Section 48(2)(a) read together with s 46(1)(a) of the 2008 Companies Act.

I submit that the reason for the departure from the requirement of an approval of shareholders by a special resolution is to accommodate commercial reality of the day, in the sense that a company must be in a position to make expedient decisions if it is to remain competitive. Acquiring an approval of shareholders can be time-consuming, clumsy and costly. The power of a company to acquire its own shares has further been enhanced by the 2008 Companies Act doing away with the requirement that it must be specifically authorized in its articles of association to do so. This I submit, can be justified on the basis that it is unwise to tie such an important decision on a document so precast and to merely leave it to the good judgment of the directors of the company and the other less stringent precautionary requirements.

The third requirement contained in the 1973 Companies Act is that the company must pass the liquidity and solvency test.⁵⁹ Accordingly, the company can only pay for the acquisition of its shares if there are no reasonable grounds for believing that it would after the payment be unable to pay its debts as they become due in the ordinary course of business (the liquidity test) and its consolidated assets, fairly valued, would not after payment be less than its consolidated liabilities (the solvency test).⁶⁰

This third requirement has substantially been replicated and enhanced by the succeeding provisions embodied in the 2008 Companies Act. Under the provisions of the 2008 Companies Act, a company cannot engage any proposed acquisition unless it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the envisaged acquisition.⁶¹ Furthermore, the board of the company must by resolution acknowledge that it has indeed applied the solvency and liquidity test and has reasonably concluded that the company will satisfy these immediately after completing the proposed acquisition.⁶²

As an improvement on the 1973 Companies Act, indeed the 2008 Companies Act goes an extra mile by providing that the board must by way of a resolution specifically

⁵⁹ Section 85(4)(a) and (b).

⁶⁰ *Ibid.* The section in effect imposes upon the directors of the company a heavy responsibility not to take unreasonable risks in repurchasing the shares of the company. The legislation was modelled on s 34(2) (a) and (b) of the Canada Business Corporations Act 1985 (RSC 1985 C-44). See Van der Linde K *op cit* note 25, at 69; Cassim FHI *op cit* note 29 at 765; Cassim FHI *op cit* note 27, at 288; *Supra* note 16.

⁶¹ Section 48(2)(a) read together with s 46(1)(b).

⁶² Section 48(2)(a) read together with ss 46(1)(c) and 4.

acknowledge that it had applied the solvency and liquidity test set out in s 4. Section 4 attempts to comprehensively elaborate how the solvency and liquidity test is to be applied particularly by setting out the considerations to be taken into account before the board can resolve that the company passes the test.

Notably however, the provisions of both the 1973 Companies Act and the 2008 Companies Act simply demand that the directors have 'reasonable grounds' for believing that the company is in fact liquid and solvent and to that end it would not be necessary that the company is actually liquid or solvent.⁶³ Therefore the directors would only incur liability if they were reckless or negligent in their evaluation of the liquidity and solvency of the company.⁶⁴ The above-mentioned provisions accordingly do not impose an absolute or strict liability on the directors whatsoever, and even the company itself does not incur any liability to its creditors or shareholders.⁶⁵

The fourth requirement under the 1973 Companies Act is that the shares in a company may not be acquired by the company if as a consequence of such acquisition there would no longer be any shares in issue other than convertible or redeemable shares.⁶⁶ The foregoing provisions have precisely been reiterated by the 2008 Companies Act which requires that a company may not acquire its own shares, if as a consequence of the acquisition there would no longer be any shares of the company in issue other than convertible or redeemable shares.⁶⁷

Moreover, the personal liability imposed on directors and the shareholders whose shares have been acquired when the liquidity and solvency test has not been passed, does also achieve the object of protecting the remaining shareholders.⁶⁸ The 1973 Companies Act imposes a joint and several liability on the directors of a company for a wrongful acquisition of shares. The liability envisaged is the liability to the effect that the directors who allow the company to acquire its own shares and make payments while

⁶³ Cassim FHI *op cit* note 27, at 288.

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*

⁶⁶ Section 85(9).

⁶⁷ Section 48(3).

⁶⁸ Van der Linde K *op cit* note 25, at 69.

the company does not clearly satisfy the solvency and liquidity requirements are liable to restore the amount of the unlawful payment to the company.⁶⁹

Indeed the liability of the directors has been refined and enhanced by the succeeding provisions of the 2008 Companies Act. The 1973 Companies Act imposed a blanket liability on the directors and did not in express terms exclude a director who perhaps was not at the meeting that approved an acquisition, or who abstained from participating in the voting approving the acquisition or who voted against the acquisition if the director felt that the company did not satisfy the solvency and liquidity test. The Act only envisaged that such a director could be relieved of liability by the court having regard to all the circumstances of the case.⁷⁰

As a complete departure from this blanket liability, the 2008 Companies Act envisages that a director of a company shall only be liable for any loss, damages or costs sustained by the company as a consequence of the director having been present at a meeting or participated in the making of a decision in terms of s 74 (directors acting other than at meeting) and failed to vote against the distribution, despite knowing that the distribution was at a time when the company could not satisfy the requirements for solvency and liquidity.⁷¹

Moreover, the 2008 Companies Act provides that, a director of a company shall be liable for any loss, damages or costs sustained by the company as a consequence of the director having been present at the meeting or participated in the making of a decision in terms of s 74 (directors acting other than at meeting) and failed to vote against the acquisition by the company of any of its shares despite knowing that the acquisition was contrary to s 46 or s 48 (i.e. solvency and liquidity requirements and shares of the company in issue as a consequence of an acquisition are only convertible or redeemable shares).⁷²

Further, under the 1973 Companies Act, the selling-shareholder may also be ordered to repay the consideration received for the shares in contravention of the solvency and

⁶⁹ Section 86(1); *Ibid*; Cassim FHI *op cit* note 28, at 288.

⁷⁰ Section 248.

⁷¹ Section 46(6) read together with s 77(3)(e)(vi).

⁷² Section 48(7) read together with s 77(3)(e)(vii).

liquidity test. The Act empowers the director, who was found liable to apply to court for an order compelling a shareholder or former shareholder to pay to the company any money paid to him contrary to the solvency and liquidity test.⁷³

The succeeding provision under the 2008 Companies Act has altered the position albeit not substantially, with regard to the liability of the selling-shareholder. Accordingly, if a company acquires any shares contrary to ss 46 or 48 the company may apply to a court for an order reversing the acquisition and the court may order that the shareholder from whom the shares were acquired to return the amount paid by the company and the company to issue to the shareholder an equivalent number of shares of the same class as those acquired.⁷⁴ The power to seek orders from the court compelling a shareholder to pay money to the company has therefore been shifted from the directors to the company itself.

Yet another cogent protection afforded to shareholders under the 1973 Companies Act is that enshrined in the procedure that has to be followed when a company wishes to acquire its own shares.⁷⁵ The procedure is basically intended to prevent the abuse and discrimination that may be visited against shareholders holding a similar class of shares.⁷⁶ The procedure is therefore designed in such a way as to ensure shareholders are treated equally, particularly those that hold a similar class of shares.⁷⁷

Accordingly, the 1973 Companies Act envisages two types of procedures. Firstly is the tender offer coupled with an offering circular; this procedure applies to off-market transactions where the procedure entails an offer to acquire unlisted shares from all registered shareholders.⁷⁸ This procedure is regulated by the Act and in some cases also the Takeover Regulations.⁷⁹ Secondly is the type of procedure where the acquisition is in an open market. Although this procedure is envisaged by the Act, it is

⁷³ Section 86(2).

⁷⁴ Section 48(6).

⁷⁵ Section 87.

⁷⁶ Cassim FHI *op cit* note 27, at 290.

⁷⁷ *Ibid.*

⁷⁸ Section 87(1)(a); *Ibid.*

⁷⁹ These are the regulations prescribed by the Minister in consultation with the Takeover Regulation Panel, to provide for compliance with and enforcement of provisions respecting affected transactions and offers.

not regulated by the Act but by the JSE Limited Listings Requirements.⁸⁰ The 2008 Companies Act has however taken a different approach. The first procedure has been replaced with a board proposal that goes through certain approvals including a special resolution of shareholders.⁸¹ The second procedure is largely a replica of that envisaged in the 1973 Companies Act in that although it is envisaged in the Act it is not regulated by the Act but by the JSE Limited Listings Requirements.⁸² At this juncture we are only concerned with the first type of procedure.

3.3 SHAREHOLDER PROTECTION IN OFF-MARKET TRANSACTIONS

3.3.1 INTRODUCTION

If a company tenders to purchase its own shares in an off-market transaction, the company has to send a written offering circular to each registered shareholder offering to acquire shares from them.⁸³ The major significance of this procedure is to ensure that there is an equal treatment of all shareholders.⁸⁴ Within fifteen days from the date the circular is delivered or mailed to the shareholders of the company it has to be lodged with the Registrar of companies.⁸⁵ If the response on the offering circular is greater in number than the number of shares that the company intends to acquire, then the company has to acquire the shares *pro rata* from all the shareholders who offered to sell their shares.⁸⁶ Again it cannot be gainsaid that this requirement is indeed aimed at the fair and equal treatment of shareholders.⁸⁷ The registrar has to be notified within thirty days after the completion of the acquisition, of the date, number and class of shares that have been acquired by the company.⁸⁸

⁸⁰ Section 87(2)(b); Cassim FHI *op cit* note 26, at 290.

⁸¹ Section 114(1).

⁸² Section 99(3).

⁸³ Section 87(1)(a) of the 1973 Companies Act; Van der Linde K *op cit* note 24, at 70; Cassim FHI *op cit* note 28, at 762; Cilliers HS *op cit* note 7, at 325; Benade ML *op cit* note 7, at 190; Van der Linde K 'Share Repurchases' 2002 (10) *JBL*, at 27.

⁸⁴ Van der Linde K 'Share Repurchases' 2002 (10) *JBL*, at 27.

⁸⁵ Section 87(1)(b) of the 1973 Companies Act; Van der Linde K *op cit* note 24, at 70; Cassim FHI *op cit* note 28, at 762; Cilliers HS *op cit* note 7, at 325; Benade ML *op cit* note 7, at 190; Van der Linde K 'Share Repurchases' 2002 (10) *JBL*, at 27.

⁸⁶ Section 87(4) of the 1973 Companies Act; Cassim FHI *op cit* note 28, at 762; Cilliers HS *op cit* note 7, at 325; Benade ML *op cit* note 7, at 190; Van der Linde K 'Share Repurchases' 2002 (10) *JBL*, at 27.

⁸⁷ *Ibid.*

⁸⁸ Section 87(5) of the 1973 Companies Act; Van der Linde K *op cit* note 24, at 70; Cassim FHI *op cit* note 28, at 762; Cilliers HS *op cit* note 7, at 325.

When a company is facing financial crisis it can happen some shareholders are afforded the opportunity to sell back their shares while others are not.⁸⁹ This is an abuse of the power of acquisition and to prevent such abuse it is clearly desirable that any acquisitions by the company be made *pro rata*.⁹⁰ All shareholders of the class affected must have the equal rights to participate on equal terms.⁹¹

The above procedure has been altered by the 2008 Companies Act. Accordingly, the board can propose, and after the requisite approvals, implement any form of arrangement between the company and its shareholders.⁹² Such an arrangement can include a reorganisation of the share capital of the company by way of *inter alia*, acquisition of shares by the company.⁹³ To implement this however, the company must appoint an independent expert who must prepare a report for the board, which must be distributed to all shareholders concerning the proposed arrangement.⁹⁴ The said report must state prescribed information relating to the value of shares affected, identify the type and class of shareholders who will be affected, describe the significant effects the acquisition will have on the rights and interests of shareholders who will be affected, examine any significant adverse effects against the compensation the shareholders will receive and the probable beneficial and significant effect on the business prospects of the company and state the material interest of any director of the company or trustee for shareholders and its effect on such interests and shareholders.⁹⁵

I submit that the requirement for a report fulfils the object of protecting the shareholders by ensuring that there is adequate disclosure and in effect equipping them with adequate and relevant information in order to empower them to make informed decision.

After the board proposes that the company intends to acquire its own shares, the 2008 Companies Act envisages that the proposal has to pass through an approval process which is well endowed with checks and balances. The proposal has to be approved by a

⁸⁹ Cassim FHI *op cit* note 29, at 772.

⁹⁰ *Ibid.*

⁹¹ *Ibid.*

⁹² Section 114(1).

⁹³ Section 114(1)(e).

⁹⁴ Section 114(2) and (3).

⁹⁵ Section 114(3).

special resolution adopted by shareholders who have a right to vote on the matter at a meeting properly convened for that purpose attended by shareholders who can exercise at least 25% of the voting rights on the matter.⁹⁶

Even if a resolution has been adopted as contemplated above, the 2008 Companies Act provides that a company cannot proceed to implement the resolution if it was opposed by at least 15% of the voting rights exercised on the resolution and a shareholder who voted against the resolution demands that the company seeks court approval or there was an application by a shareholder who voted against the resolution for a review of the transaction, unless the implementation of the resolution is approved by the court.⁹⁷ The 2008 Companies Act provides that where such an approval is required the company must either apply to court for approval and bear the costs of the application or treat the resolution as a nullity.⁹⁸

When a shareholder makes an application to the court for leave to apply for a review of the transaction by a company to acquire its own shares, the 2008 Companies Act provides that such leave can only be granted if the court is satisfied that the applicant is acting in good faith, he appears prepared and able to sustain the proceedings and the facts alleged, if proved, would support an order that the resolution is manifestly unfair to some shareholders; the vote was materially tainted by conflict of interest, inadequate disclosure, failure to comply with the Act, the Memorandum of Incorporation or any applicable rules of the company, or other significant and material procedural irregularity.⁹⁹

Where a company makes an application for approval of a resolution or a shareholder after being granted leave makes an application to have the transaction to acquire shares by a company reviewed, the 2008 Companies Act envisages that the court can set aside the resolution only if the resolution is manifestly unfair to some shareholders or the vote was materially tainted by conflict of interest, inadequate disclosure, failure to

⁹⁶ Section 115(1) and (2).

⁹⁷ Section 115(3).

⁹⁸ Section 115(5).

⁹⁹ Section 115(6).

comply with the Act, the Memorandum of Incorporation or any applicable rules of the company, or other significant and material procedural irregularity.¹⁰⁰

A shareholder who has voting rights is also entitled to seek relief in terms of dissenting shareholders appraisal rights¹⁰¹ under s 164 the 2008 Companies Act. Such a shareholder may only do so, if he had notified the company of his intention to oppose the special resolution to acquire its own shares and was indeed present at the meeting and voted against the resolution.¹⁰² The shareholder in the pursuit of his appraisal right, seeks an appraisal remedy. An appraisal remedy is the remedy of a dissenting shareholder to require his company to acquire his shares by purchasing them at a fair price that is either satisfactory to both the shareholder and the company or set by the court, if his company engages certain triggering actions.¹⁰³ Moreover, the 2008 Companies Act provides that a scheme of arrangement is one of those actions that can trigger the appraisal remedy,¹⁰⁴ and a scheme of arrangement is therein defined to include an arrangement between a company and a shareholder for the company to acquire its own shares.¹⁰⁵

3.3.2 AFFECTED TRANSACTION

Further protection of shareholders when a company acquires its own shares can be traced in the specific context where the acquisition is an affected transaction. The 1973 Companies Act defines an 'affected transaction' to include any transaction or scheme whatever form it may take which has the effect of vesting control of any company in any person in whom control did not rest prior to the transaction or scheme.¹⁰⁶ The 1973 Companies Act envisages that where an acquisition amounts into an affected transaction, it has to be regulated by the Securities Regulation Panel (hence the Securities Panel).¹⁰⁷

¹⁰⁰ Section 115(7).

¹⁰¹ An appraisal right is the right of a shareholder to be bought out by the company if he disagrees with resolutions approving fundamental changes.

¹⁰² Section 115(8).

¹⁰³ Beukes HGJ 'An Introduction to the Appraisal Remedy as Proposed in the Companies Bill: Triggering Actions and the Differences Between the Appraisal Remedy and Existing Shareholder Remedies' (2008) 20 *SA Merc LJ* 479-495, at 479.

¹⁰⁴ Section 164(2)(b).

¹⁰⁵ Section 114(1)(e).

¹⁰⁶ Section 440A.

¹⁰⁷ Section 440C(1).

The Securities Panel is a body corporate whose members are appointed by the Minister¹⁰⁸ and its function is to regulate, in a manner that it deems appropriate, all transactions or schemes which constitute affected transactions.¹⁰⁹ Accordingly, it is empowered to publish rules relating to the duties of the offeror and the offeree in such transactions.¹¹⁰ It is in this regard that the Securities Panel published the Securities Regulation Code on Takeovers and Mergers (hence the Code).

The Code contains rules to regulate all transactions and schemes which constitute affected transactions and rules relating to duties of the offeror and the offeree. It operates principally to ensure that in relation to affected transactions there is fair and equal treatment of shareholders by setting out the principles to be observed in the transactions. The principles are essentially a codification of the acceptable standards of commercial behaviour and which are deemed to have a universal application.¹¹¹

In its prescription of the general principles, the Code requires that in an acquisition all shareholders of the same class of shares of an offeree company should be treated similarly.¹¹² During an offer, the offeree company should ensure that all shareholders of a particular class that is the subject of the offer, are furnished with adequate, relevant and similar information¹¹³ and are given sufficient time to enable them to reach a properly informed decision.¹¹⁴ Once an offer is communicated, the board of the company cannot take any action without the approval of holders of the relevant shares in a general meeting.¹¹⁵ The approval is aimed at ensuring that shareholders of the relevant shares are not denied an opportunity to decide on the merits of the offer.¹¹⁶

Moreover, since an affected transaction normally gives rise to an obligation to make a general offer to all other shareholders of the relevant shares, if a company intends to acquire its own shares, it must ensure that before making the acquisition, it will continue

¹⁰⁸ Section 440B.

¹⁰⁹ Section 440C(1).

¹¹⁰ Section 440C(3).

¹¹¹ Section A(2).

¹¹² Section C(2)(1).

¹¹³ Section C(2)(2).

¹¹⁴ Section C(2)(4).

¹¹⁵ Section C(2)(7).

¹¹⁶ *Ibid.*

and be able to implement the acquisition.¹¹⁷ Indeed the endeavour for equal treatment of shareholders when a company acquires its own shares cannot be overemphasized. The Code ultimately prescribes that the underlying principle is that persons holding shares in the offeree company are entitled to dispose of their shares on terms in fact comparable to those of any affected transaction in the relevant securities.¹¹⁸

Under the 2008 Companies Act a similar protection is envisaged when a company acquires its own shares if the acquisition is an affected transaction¹¹⁹ engaged by a regulated company.¹²⁰ Where this scenario arises the company is subject to the authority of Takeover Regulation Panel (hence the Takeover Panel) and Takeover Regulations. The Takeover Panel is a juristic person or a body corporate established to function as an organ of the state within the public administration,¹²¹ whose function is *inter alia* to regulate affected transactions and offers in accordance with the 2008 Companies Act and Takeover Regulations.¹²² The Takeover Regulations are the regulations prescribed by the Minister in consultation with the Takeover Panel to provide for *inter alia* rules of compliance with the 2008 Companies Act in respect of affected transactions.¹²³

The 2008 Companies Act empowers the Takeover Panel to regulate an affected transaction or offer disregarding the commercial advantages or disadvantages of the transaction.¹²⁴ The regulation of the transaction is carried out with the all important objectives of ensuring the integrity of the marketplace and fairness to the shareholders, as well as the provision of necessary information to shareholders to the extent that it can facilitate them to make fair and informed decisions.¹²⁵

¹¹⁷ Section C(2)(10).

¹¹⁸ Section C(2)(11).

¹¹⁹ An 'affected transaction' can be defined to mean an arrangement between a regulated company and a shareholder for the company to acquire its shares. See s 117(1)(c)(iii).

¹²⁰ A 'regulated company' can be defined to mean a company to which authority of the Takeover Regulation Panel and the Takeover Regulations apply. Such would be a profit company if it is a public company, a state-owned company and a private company if the amount acquired exceeds 10% of the issued shares or if the Memorandum of Incorporation provides that the company shall be a regulated company - see s 117(1)(i) and 118(1).

¹²¹ Section 196.

¹²² Section 201.

¹²³ Section 120.

¹²⁴ Section 119(1).

¹²⁵ Section 119(1)(a) and (b).

Without limiting the generality of the afore-mentioned objects, the 2008 Companies Act provides that the Takeover Panel should regulate an affected transaction or offer in a manner that ensures that a shareholder will not enter into a transaction unless he is ready, able and willing to implement the transaction,¹²⁶ all holders of a particular class of voting shares are afforded equivalent treatment and holders of voting shares are given equitable treatment with due regard to the circumstances.¹²⁷ The Takeover Panel should also ensure that relevant information is not withheld from shareholders¹²⁸ and they receive the same information from the offeror during the course of affected transaction¹²⁹ and are provided with sufficient information and given sufficient time to reach a properly informed decision.¹³⁰

In carrying out its mandate, the 2008 Companies Act provides that the Takeover Panel may require the filing of any document relating to an affected transaction or offer for approval or otherwise if it is required to be prepared¹³¹ and issue clearance notices if it is satisfied that the offer or transaction satisfies the requirements of the 2008 Companies Act and the Takeover Regulations.¹³² The Takeover Panel can also initiate or receive complaints, conduct investigations and issue compliance notices with respect to an affected transaction or offer, in accordance with the provisions on remedies and enforcement under chapter 7 of the 2008 Companies Act and the Takeover Regulations.¹³³

The 2008 Companies Act envisages that the compliance order by the Takeover Panel contemplated above may, among other things prohibit or compel an action by a person, or order a person to divest himself of an acquired asset or to account for profits.¹³⁴ This is in order to ensure the integrity of the marketplace, the provision of necessary information to holders of shares and adequate time for them to obtain advice with

¹²⁶ Section 119(2)(a).

¹²⁷ Section 119(2)(b).

¹²⁸ Section 119(2)(c).

¹²⁹ Section 119(2)(d)(i).

¹³⁰ Section 119(2)(d)(ii).

¹³¹ Section 119(4)(a).

¹³² Section 119(4)(b).

¹³³ Section 119(4)(c).

¹³⁴ Section 119(5).

respect to offers, as well as to prevent actions by a company designed to impede, frustrate or defeat an offer.¹³⁵

However, the Takeover Panel can exempt an offeror from the application of any of the provisions above as well as the Takeover Regulations.¹³⁶ The 2008 Companies Act envisages that such exemption can only be applicable if there is no reasonable potential of the affected transaction prejudicing the interests of a shareholder, if the cost of compliance relative to the value of the affected transaction is disproportionate or if exempting is reasonable and justifiable in the circumstances.¹³⁷ Such exemption must however take into account the principles and purposes of the provisions relating to the authority vested in the Takeover Panel and the Takeover Regulations.¹³⁸

Further protection of shareholders under the 2008 Companies Act can be found in the general requirement that any person making an offer that is an affected transaction or offer must comply with all reporting or approval requirements and those prescribed in the Takeover Regulations.¹³⁹ This position remains so, save where the Panel has granted the person an exemption from such requirements.¹⁴⁰ Such a person should also not give effect to an affected transaction unless the Takeover Panel has either issued a clearance notice or granted an exemption for the transaction.¹⁴¹

Protection to shareholders when a company acquires its own shares is also traceable in the provisions of the 1973 Companies Act relating to mandatory offers. The Act envisages that where, in an affected transaction the shares of an offeree company are to be transferred to a person as a consequence of which the person acquires shares comprising of 90% of the shares in the company or of any class of shares, he must within a month from the date of acceptance give notice in the prescribed manner to the remaining shareholders who have not accepted the offer.¹⁴² Any remaining shareholder may within three months from the date of the notice require the offeror to acquire his

¹³⁵ *Ibid.* Read together with s 119(1)(c).

¹³⁶ Section 119(6).

¹³⁷ Section 119(6)(a) and (b).

¹³⁸ Section 119(6)(c).

¹³⁹ Section 121(a).

¹⁴⁰ *Ibid.*

¹⁴¹ Section 121(b).

¹⁴² Section 440K(3)(a). See also s F rule 8.1 of the Code.

shares.¹⁴³ Where a shareholder demands that his shares be acquired, the offeror is bound to acquire the shares on the same conditions as the shares of the shareholders who had earlier accepted the offer.¹⁴⁴

The 2008 Companies Act contains similar provisions relating to mandatory offers. Where a company acquires its own shares and as a consequence a person is able to exercise the prescribed percentage¹⁴⁵ of the voting rights a day after the completion of the acquisition, he must give notice to the holders of the remaining shares.¹⁴⁶ In the notice he must state that he is in a position to exercise at least the prescribed percentage of the voting rights and that he is offering to acquire the remaining shares.¹⁴⁷ A month after giving the notice, the person must deliver a written offer to the remaining shareholders to acquire the remaining shares on terms determined in accordance with the Act and Takeover Regulations.¹⁴⁸

Shareholder protection can also be inferred from the provisions of the 1973 Companies Act on compulsory acquisitions. If an offer for the acquisition of shares under an affected transaction is accepted within four months from the date of making the offer by shareholders of not less than 90% of the shares or any class of shares, the offeror may at any time within two months after the date of such acceptance give notice in the prescribed manner to the other shareholders who have not accepted the offer, that he desires to acquire their shares.¹⁴⁹ Where such notice is given, the offeror is entitled and bound to acquire those shares on the terms on which under the affected transaction the shares of the other shareholders who had accepted the offer, were acquired.¹⁵⁰ However, six weeks from the date of the notice to acquire, a shareholder who did not accept the offer can apply to court seeking orders that the offeror is not entitled to acquire his shares or conditions of acquisition different from those of the offer be imposed.¹⁵¹

¹⁴³ Section 440K(3)(b).

¹⁴⁴ *Ibid.*

¹⁴⁵ Minister may prescribe a percentage of not more than 35% of the voting shares.

¹⁴⁶ Section 123(3).

¹⁴⁷ Section 123(3)(a) and (b).

¹⁴⁸ Section 123(4).

¹⁴⁹ Section 440K(1)(a).

¹⁵⁰ *Ibid.*

¹⁵¹ *Ibid.*

Moreover, the 2008 Companies Act also confers a similar protection to shareholders, by the requirements of compulsory acquisitions and squeeze out. The regulated company should wait for four months from the date when it offers to acquire any class of shares, to see if the offer has been accepted by holders of at least 90% of that class of shares, other than those held before the offer by the offeror, a related or inter-related person, or persons acting in concert, or a nominee or subsidiary of any such person or persons.¹⁵² Two further months thereafter, the offeror can notify the holders of the remaining shares that the offer has been accepted to that extent and that he wishes to acquire all remaining shares of that class.¹⁵³ After giving the notice the offeror is bound to acquire the shares concerned on the same terms that applied to shares whose holders accepted the original offer.¹⁵⁴ However, within thirty business days after receiving the notice contemplated above, a shareholder can apply to court seeking an order that the company is not entitled to acquire his shares in that class or the conditions of acquisition different from those of the original offer be imposed.¹⁵⁵

Any money payable in respect of the compulsory acquisition and squeeze out but still held by the regulated company must be deposited into a separate interest earning bank account with a banking institution registered under the Banks Act.¹⁵⁶ The deposits must be held in trust by the company for the shareholder entitled to the shares in respect of which the consideration is held and the deposit must be paid to him on demand with interest as at the date of payment.¹⁵⁷ If the shareholder fails for more than three years to demand payment of the amount held in terms prescribed above, the amount, together with any accumulated interest, must be paid to the benefit of the Guardian's Fund of the Master of the High Court, and it is held and dealt with in accordance with the rules of that Fund.¹⁵⁸

In conclusion I submit that the 1973 Companies Act and the 2008 Companies Act have adequate provisions whose objective is to protect the shareholders. Comparatively, the provisions of the 1973 Companies Act have not been substantially altered by the 2008

¹⁵² Section 124(1).

¹⁵³ Section 124(1)(a).

¹⁵⁴ Section 124(1)(b).

¹⁵⁵ Section 124(2).

¹⁵⁶ Section 124(7). Also see s 440K(4) of the 1973 Companies Act.

¹⁵⁷ *Ibid.*

¹⁵⁸ Section 124(8).

Companies Act. The procedure for acquisition under the 1973 Companies Act is that the company has to send a written offering circular to each registered shareholder offering to acquire shares from them so that shareholders can enjoy equal opportunity. This has been altered by the 2008 Companies Act which requires that the board may propose, and after the requisite approvals, implement any arrangement between the company and its shareholders. Protection of shareholders with regard to affected transactions in the form of the bodies that are empowered to regulate the transactions, compulsory acquisitions and mandatory offers are substantially the same for both the 1973 Companies Act and the 2008 Companies Act save for the fact that the latter Act is evidently more comprehensive, refined and streamlined.

3.4 SHAREHOLDER PROTECTION IN MARKET TRANSACTIONS

As discussed earlier, the 1973 Companies Act envisaged two procedures when a company wishes to acquire its own shares.¹⁵⁹ We have already looked at the first procedure and our concern now is with the second procedure where the acquisition is in an open market. Where the acquisition is in an open market the JSE Limited Listings Requirements come into play.

Under the 1973 Companies Act, the obligation to distribute an offering circular when a company wishes to acquire its own shares is not applicable to companies listed on a stock exchange within the Republic of South Africa.¹⁶⁰ However, the JSE Limited was empowered to publish requirements that must be met if a listed company acquires its own shares in terms of the 1973 Companies Act.¹⁶¹

In pursuance of the said power vested in the JSE Limited, it developed Listings Requirements which invariably regulate the procedure for acquisition of own shares by a company. Notably, under the JSE Limited Listings Requirements 'the Act' is defined to mean '...the Companies Act No. 61 of 1973, as amended, or any law that may replace it wholly or in part from time to time.'¹⁶² This therefore implies that upon the enactment of

¹⁵⁹ Section 87.

¹⁶⁰ Sections 87(2)(b) and 87(4); Pretorius JT *et al Hahlo's South African Law through the cases* 6th ed (Juta & Co Ltd Lansdowne 1999), at 124.

¹⁶¹ Section 87(6); Cilliers HS *op cit* note 7, at 325-6; Van der Linde K *op cit* note 25, at 70.

¹⁶² See page 1 of the Definitions to the JSE Limited Listings Requirements

the 2008 Companies Act, the JSE Limited Listings Requirements are perpetually applicable.

In the advent of the 2008 Companies Act, when the shares of a company are listed on the JSE Limited, any offer relating to the shares is generally restricted if it is engaged otherwise than in accordance with the JSE Limited Listings Requirements.¹⁶³ Further, a person cannot issue, distribute, deliver a letter of allocation unless it is accompanied by all documents that are required and have been approved by the JSE Limited.¹⁶⁴

Moreover, the Securities Services Act,¹⁶⁵ through which an exchange licence is issued to a person who engages in the business of buying and selling of shares, empowers an exchange to develop Listings Requirements.¹⁶⁶ These Listings Requirements must prescribe *inter alia* the requirements which issuers of listed shares and of shares which are intended to be listed, as well as such issuers' agents, must comply with; the standards of conduct that issuers of listed shares and their directors, officers and agents must meet; the standards of disclosure and corporate governance that issuers of listed shares must meet and the details relating to the listed shares as may be necessary.¹⁶⁷

The need to protect not only creditors but also shareholders and the investing public is clearly acknowledged and recognized in the JSE Limited Listings Requirements when a company acquires its own shares.¹⁶⁸ The JSE Limited Listings Requirements therefore, set out the procedure and requirements that a listed company that wishes to acquire its own shares must comply with.¹⁶⁹ They are fundamentally aimed at ensuring proper disclosure.¹⁷⁰

¹⁶³ Section 99(3)(a)(i).

¹⁶⁴ Section 99(4).

¹⁶⁵ 36 of 2004.

¹⁶⁶ Section 7 – 'listing requirements' means the requirements, determined by an exchange, that must be met before a security may be traded, or may continue to be traded, on that exchange.

¹⁶⁷ Section 12(1).

¹⁶⁸ Cassim FHI *op cit* note 27, at 288. For instance the JSE Limited Listings Requirements restrict the price at which the company may acquire its shares. See paras 5.69(e) and 5.72(d).

¹⁶⁹ Van der Linde K *op cit* note 78, at 29.

¹⁷⁰ *Ibid.*

The JSE Limited Listings Requirements envisage two types of share acquisitions, namely a specific acquisition and a general acquisition.¹⁷¹ A specific acquisition of shares refers to where there are terms that are approved by shareholders in a general meeting in respect of a particular acquisition which is normally valid until such time as the approval is amended or revoked by a special resolution.¹⁷² A general acquisition of shares on the other hand, refers to terms generally approved by shareholders by giving a renewable mandate, which is normally valid until the company's next annual general meeting or for fifteen months from the date of resolution whichever period is shorter, to the directors of the company to acquire its shares subject to the JSE Limited Listings requirements and to any other restrictions set out in the mandate.¹⁷³ However, a general restriction for either of the two forms of acquisitions is that a company cannot in the aggregate within any one financial year acquire shares in excess of 20% of the company's issued share capital of a particular class of shares.¹⁷⁴

In respect of a specific acquisition, which includes an offer to all shareholders *pro rata* to their existing holdings (a *pro rata* offer) and an offer from shareholders who are specifically named (a specific offer) the company can only make such an acquisition if it satisfies some specific requirements.¹⁷⁵ First the company will have to satisfy itself that it is properly authorised thereto by the articles of association.¹⁷⁶ An approval must also be given by way of a special resolution by the shareholders excluding any shareholder and their associates participating in the acquisition.¹⁷⁷

Even more importantly and before the shareholders can pass the special resolution mentioned above, the directors must issue a statement assuring the shareholders that at least twelve months following the acquisition, the company will enjoy a sound liquidity and solvency status and its share capital and reserves and working capital will be adequate for ordinary business purposes.¹⁷⁸ The company must make a *pro rata* offer which must remain open for twenty one days and effected in accordance with timetable

¹⁷¹ Para 5.67.

¹⁷² Para 5.67(a).

¹⁷³ Para 5.67(b).

¹⁷⁴ Para 5.68.

¹⁷⁵ Para 5.69.

¹⁷⁶ Para 5.69(a).

¹⁷⁷ Para 5.69(b).

¹⁷⁸ Para 5.69(c).

S in schedule 24 of the JSE Limited Listings Requirements.¹⁷⁹

If the acquisition is from a related party,¹⁸⁰ and the price at which the shares are acquired is at a premium to the weighted average traded price of the shares over a period of thirty business days prior to the date the price of the acquisition is agreed in writing, then the acquisition should be accompanied by a statement by the directors that the acquisition is fair insofar as shareholders are concerned, that they have been so advised by an independent expert acceptable to the JSE Limited and moreover, before making the statement referred to above, the directors must obtain a fairness opinion (to be included in the circular) prepared according to the requirements of independent fairness opinions under schedule 5 of the JSE Limited Listings Requirements.¹⁸¹ Where the company has not traded for thirty business days it must consult the JSE Limited for a ruling on the fair price of its shares.¹⁸²

Once a company makes an announcement that it intends to make a specific acquisition, it must pursue the proposal, unless it is permitted not to do so by the JSE Limited.¹⁸³ A company is also not allowed to acquire its shares during a prohibited period,¹⁸⁴ unless it has put in place an acquisition programme where the dates and quantities of shares to be traded during the relevant period are fixed (not subject to any variation) and full details of the programme have been disclosed in an announcement over Securities Exchange News Service (hence SENS) prior to the commencement of the prohibited period.¹⁸⁵

There are also documents which must be submitted to and approved by the JSE Limited before an approval is granted for an acquisition of shares.¹⁸⁶ These documents are namely the circular; the application for de-listing complying with schedule 22 of the

¹⁷⁹ Para 5.69(d).

¹⁸⁰ See description of 'related party' in paras 10.1 to 10.3 of the JSE Limited Listings Requirements.

¹⁸¹ Para 5.69(e).

¹⁸² *Ibid.*

¹⁸³ Para 5.69(g).

¹⁸⁴ Para 3.67 –'prohibited period' means a closed period; any period when there exists any matter, which constitutes unpublished price sensitive information in relation to the issuer's shares (whether or not the director has knowledge of such matter).

¹⁸⁵ Para 5.69(h).

¹⁸⁶ Para 16.32.

JSE Limited Listings Requirements; original copies of any exchange control¹⁸⁷ approvals required; original copies of any experts' consents¹⁸⁸ appearing in the circular; and the appropriate documentation and listing fee.¹⁸⁹ The said documents must be submitted to the JSE Limited in accordance with timetable S in schedule 24 of the JSE Limited Listings Requirements.¹⁹⁰

Further, there are documents that the company must publish regarding an acquisition of shares. Essentially, the said documents are the circular, which must include the contents of all circulars,¹⁹¹ general information relating to directors, management, major shareholders, share capital of the company, preliminary expenses, responsibility statement and litigation, statements regarding the reason, method by which the company intends to acquire its shares, number of shares to be acquired and the price to be paid, names of shareholder(s) from whom the shares are to be acquired and current shareholding(s) of such shareholder(s), a statement of the board of directors confirming that the solvency and liquidity of the company will remain unaffected after acquisition, statement as to the date(s) of acquisition(s) of shares, number and value of shares acquired, sources of funds utilised and a statement by the board of directors confirming whether the acquisition is fair insofar as the shareholders are concerned and that the board of directors have been so advised by an independent expert acceptable to the JSE Limited.¹⁹² The said documents must be acted upon in accordance with timetable S in schedule 24 of the JSE Limited Listings Requirements.¹⁹³

With respect to a general acquisition of shares, a company can also only make the acquisition if it satisfies some specific requirements.¹⁹⁴ Such an acquisition can only be effected through the order book operated by the JSE Limited trading system and it should be done impromptu i.e. without any prior understanding or arrangement between

¹⁸⁷ See para 16.25.

¹⁸⁸ See para 7.F.7.

¹⁸⁹ See para 17.

¹⁹⁰ Para 5.70.

¹⁹¹ See para 11.1.

¹⁹² Paras 11.23-11.25.

¹⁹³ Para 5.71.

¹⁹⁴ Para 5.72.

the company and the counter party.¹⁹⁵ Any reported trades are strictly prohibited.¹⁹⁶ Even with this requirement in place, the company must be specifically authorized thereto by its articles of association¹⁹⁷ and the shareholders must approve the acquisition by a special resolution which is valid until the next annual general meeting or for fifteen months from the date of the resolution, whichever period is shorter.¹⁹⁸

Acquisition(s) should not be made at a price exceeding 10% over the weighted average of the market value of the shares for the five business days immediately preceding the date of acquisition.¹⁹⁹ If the company shares have not traded in the five days referred above, the JSE Limited should be consulted for a ruling on the price of the shares.²⁰⁰ During the period of acquisition the company is not allowed to appoint only one agent to effect the acquisition(s).²⁰¹ It is also not allowed to acquire shares during a prohibited period²⁰² unless it has put in place an acquisition programme where the dates and quantities of shares to be traded during the relevant period are fixed (not subject to any variation) and full details of the programme have been disclosed in an announcement over SENS prior to the commencement of the prohibited period.²⁰³

There are also some documents which must be submitted to and approved by the JSE Limited before an approval is granted for an acquisition of shares. These documents are namely²⁰⁴ the circular; the application for de-listing complying with schedule 22 of the JSE Limited Listings Requirements; original copies of any exchange control²⁰⁵ approvals required; original copies of any experts' consents²⁰⁶ appearing in the circular; and the appropriate documentation and listing fee.²⁰⁷ The said documents must be submitted to the JSE Limited in accordance with timetable S in schedule 24 of the JSE

¹⁹⁵ Para 5.72(a).

¹⁹⁶ *Ibid.*

¹⁹⁷ Para 5.72(b).

¹⁹⁸ Para 5.72(c).

¹⁹⁹ Para 5.72(d).

²⁰⁰ *Ibid.*

²⁰¹ Para 5.72(e).

²⁰² *Supra* note 184.

²⁰³ Para 5.72(g).

²⁰⁴ Para 16.32.

²⁰⁵ See para 16.25.

²⁰⁶ See para 7.F.7.

²⁰⁷ See para 17.

Limited Listings Requirements.²⁰⁸

Further, there are documents that the company must publish regarding an acquisition of shares. Essentially, the said documents are the circular, which must include the contents of all circulars,²⁰⁹ general information relating to directors, management, major shareholders, share capital of the company, responsibility statement and litigation, statement of board of directors regarding utilization of authority sought, a statement of the board of directors confirming that the solvency and liquidity of the company will remain unaffected after acquisition, statement as to the date(s) of acquisition(s) of shares, number and value of shares acquired, sources of funds utilised, effect on earnings per share and value of shares and the date on which shares will be cancelled and the listing terminated if applicable.²¹⁰ The said documents must be acted upon in accordance with timetable S in schedule 24 of the JSE Limited Listings Requirements.²¹¹

As observed above, the provisions of the JSE Limited Listings Requirements when a company acquires its own shares are principally aimed at ensuring adequate and proper disclosure so that shareholders are empowered to make informed decisions. Further, the general requirements of authorization by the company's articles and approval by shareholders are aimed at protecting shareholders against any form of manipulations.

With respect to specific acquisition, a very notable protection is the requirement that the directors must put in place a statement that the solvency and liquidity of the company will remain unaffected for a period of twelve months after the date of approval and the company will be able to undertake its ordinary business purpose for that period. This is aimed at instilling confidence in the shareholders that the business of the company will remain on course even after the acquisition.

²⁰⁸ Para 5.73.

²⁰⁹ See para 11.1.

²¹⁰ Paras 11.26-11.27.

²¹¹ Para 5.74.

Further, the requirement that shares may not be acquired above certain prices is also an important form of protection to shareholders. It ensures that share prices are not exaggerated and therefore the resources of the company are not unnecessarily depleted for the benefit of the selling shareholders.

The requirement that shares may not be acquired during the prohibited period is also an important protective measure. Prohibited period has been described as a period when there exists any matter, which constitutes unpublished price sensitive information in relation to the company's shares.²¹² Acquisition during such a period would certainly jeopardize the position of shareholders. This is certainly the position because shareholders would find themselves making decisions informed by panic and they could easily sell their shares at very unfair prices.

Moreover, the myriad of documents that have to be approved by the JSE Limited before approval of acquisition for shares is granted and the numerous other documents regarding acquisition of shares that must be published by the company are geared towards ensuring that shareholders get adequate and relevant information to enable them to make informed decisions. This clearly is an important protection to shareholders.

²¹² *Supra* note 184.

4 CONCLUSION AND RECOMMENDATIONS

It is indeed widely accepted that the company law of a given country must protect not only the creditors but also the shareholders. I submit that the main justification for the alluded protection is to curtail the potential abuses attendant to a company acquiring its own shares. The shareholder protection mechanisms in place are fundamentally aimed at ensuring that shareholders are treated equally and fairly and that the process of any such acquisition is engaged in a fair and transparent manner.

In conclusion, indeed it cannot be overemphasized that the foregoing measures as provided for in the 1973 Companies Act and the 2008 Companies Act once it comes into force, are geared towards achieving integrity and fair play at the shares market and that these are designed to ensure adequate provision of relevant information in order to help shareholders to make fair and informed decisions.

The 1973 Companies Act requires that any acquisition must be specifically authorized in the articles of association of the company, it has to be approved by the members by way of a special resolution and the company must pass the liquidity and solvency test before it can acquire its shares. Moreover, the personal liability that may be netted against the directors and the selling shareholders where the acquisition is in contravention of the above provisions also seeks to protect shareholders. Further, the procedure prescribed by the Act, that the company has to send a written offering circular to each registered shareholder offering to acquire shares from them ensures that shareholders are treated equally. With regard to affected transactions the Act establishes a body to regulate the transactions and provides for compulsory acquisitions and mandatory offers in a bid to accord shareholders equal opportunities.

Importantly, the 2008 Companies Act altered only a few requirements and its provisions are largely the same as those of the 1973 Companies Act except that the 2008 Companies Act is more comprehensive, refined and streamlined. Its provisions are clear and straightforward and are that for a company to acquire its own shares, the decision to do so must be pursuant to an existing legal obligation of the company or a court order or to be authorized by the board of the company by way of a resolution. As explained earlier, for the board to authorise an acquisition it should reasonably appear that the

company will satisfy the solvency and liquidity test. The board also has to acknowledge that it has applied the solvency and liquidity tests as set out in the Act and reasonably come to the conclusion that the company will satisfy the solvency and liquidity test immediately after completing the proposed acquisition. Moreover the personal liability imposed on directors and the shareholders whose shares have been acquired in the event that liquidity and solvency requirements have not been satisfied does also achieve the object of protecting the remaining shareholders. Finally, the procedure designed under the Act with regard to specific requirements for reporting standards, required disclosures, approvals for various transactions and mandatory offers and acquisitions are ultimately intended to protect the shareholder by ensuring integrity and fair play in the shares market.

With regard to the JSE Limited Listings Requirements it is submitted that the requirements are indeed sufficiently comprehensive and sophisticated to provide the desired protection to shareholders.

However, upon the enactment of the 2008 Companies Act which has now effectively repealed the 1973 Companies Act,²¹³ I now delve into recommendations for reform to the 2008 Companies Act. A few recommendations for reform follow:

1. Section 48(6) imposes a blanket liability on the selling shareholder. It should be amended to provide that the selling shareholder would only be liable if he knew or ought reasonably to have known that the company was acquiring shares contrary to ss 46 or 48. This is in recognition of the fact that not all shareholders are sophisticated enough to understand these technical legal requirements and the directors should therefore shoulder the higher burden of liability. This would ensure that the directors are more careful in their duties.
2. Sections 46(6) and 48(6), which establish the liability of directors and shareholders in the specific context when a company acquires its own shares, should be amended to provide that any interested person can apply to the court

²¹³ See s 224(1) of the 2008 Companies Act.

to have them held liable. The interested person would however be accompanied by the burden of establishing that they are indeed interested persons.

3. Similarly, s 157 which establishes the persons entitled to make an application or bring a matter before a court *inter alia* should be amended to include any interested person, provided that such a person will have the burden of establishing his or her interest before he or she can proceed with the application or matter before the court.

Finally, I submit that the procedure in place for the acquisition of shares under the 2008 Companies Act is adequately protective of shareholders as it is endowed with mechanisms that ensure that shareholders are treated equally, adequate information is relayed to shareholders so that they can make informed decisions and that the acquisition process is fair and transparent save only for the proposed amendments.

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LIST OF ABBREVIATIONS

CRIC – Co-ordinating Research Institute for Corporate Law

JBL – Juta’s Business Law

JSE – Johannesburg Securities Exchange

LJ - Law Journal

LR – Law Report

MLR – Modern Law Review

SA Merc LJ – South African Mercantile Law Journal

SALJ – South African Law Journal

SENS – Securities Exchange News Service

THR-HR – Tydskrif Vir Hedendaagse Romeins - Hollandse Reg (Journal for Contemporary Roman Dutch Law)

VUWLR – Victoria University of Wellington Law Report