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Dissertation Topic

Acquisition by a company of its own shares from the perspective of capital maintenance rules

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A dissertation to be submitted to the University of Namibia in partial fulfillment of the Bachelor of Laws Degree

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Dedication

This work is dedicated to the two important people in my life, my mother Amukugo Saima Namene and my partner Amkongo Lupanda Ligamena, for their guidance, support and encouragement and for always being there for me.

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The completion of this research owes a great deal to the contribution of others, whether by suggestion, technical assistance or words of encouragement.

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I wish to express my heartfelt thanks to My Grandmother Schikwambi Monica, for making copies of relevant documents that I used in my research. I express my sincere word of thanks to the Legal Assistance Centre (my sponsors), my mother Amukugo Namene and my friends Amkongo Lupanda and Hamutumwa Ndeulipula, their financial assistance made it possible for me to complete this research. A special word of thanks to the staff of UNAM and Polytechnic of Namibia Libraries for their friendliness and helpfulness. The documents in their institutions where invaluable, without this information my research would have been impossible.

Finally, I am greatly indebted to the Kapenda and Hanghome families; for allowing me to conduct my internet research and typing work on their home computers and the help they have given me, which I greatly appreciate. Thank you so much!

I, the , undersigned, hereby declare that the work contained in this dissertation for the purpose of obtaining my Bachelor of Laws degree is my own work and that I have not used any other sources than those listed in the bibliography and quoted in the references. I further declare that this dissertation has not been submitted at any other institution.

Signature:………………………….

Date:……………………..................

Supervisor’s Certificate

I, Mr. K. Kangueehi hereby certify that the research and writing of this dissertation was carried out under my supervision.

______________________________ ______________________________

Supervisor’s signature Date

Abstract

The purpose of the present research paper is to critically analyze s38 and most importantly to revisit the Companies Amendment Act, to look at how the relevant provisions deal with the question of the acquisition of own shares. The paper aims at finding answers to important questions on the proper interpretation and meaning of s38, what its effect is and further the different approaches to the construction of the said section.

The object, necessity and significance of the amendment of the provision by the Namibian Companies Act of 2004 will be discussed with exclusive reference to the South African Companies Act 37 of 1999.

Firstly, the research will look at the background and context of the problem, the paper will then state what the problem is and give the justification for the research as well as its main objective(s).T the methodology to be used in the research will also be pointed out. The research questions will be identified.

Secondly, the term capital maintenance rule and its different rules will be looked at.

Thirdly, an analysis of s38 will be done by asking, what its proper interpretation is; its effect; what the proper test should be etc.

Fourthly, the paper will look at how the relevant provisions of the Companies Amendment Act deal with the question of the acquisition of own shares. The object, necessity and significance of the Amendment will be discussed.

Finally, an attempt will be made to identify some of the defects and doubts in the Amendment Act and the author will try to find ways to fill these gaps. The concluding argument of this study is that the Legislature should clarify some of the ambiguous and uncertain provisions of the Companies Act, in order for the new Act to be a success.

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Chapter 1

Introduction and background

1.1 Problem statement

The common law rule prohibiting a company from acquiring its own shares as formulated in **Trevor v Whitworth**[1] was for many years one of the cornerstones of the principle of maintenance of share capital in Namibian and South African company law. The issued share capital was supposed to be a guarantee fund on which creditors could rely for payment of their claims and the company could not be allowed to divert these funds to anything but its stated objectives. This was hardly a realistic view in both Namibian and South African company law where no minimum share capital is prescribed and where companies are often incorporated with a share capital which is completely insufficient for its business needs. Added to this is the fact that a company may use its share capital for its business ventures and thus lose it in that way. Clearly, therefore, in most instances where payments of creditors, claims are at risk, creditors cannot rely on the share capital of the company to protect or secure their claims.

The flagrant circumventions of the common law prohibition on a company buying in its shares in practice drew the attention of the Greene Committee in England, which therefore recommended the introduction of a prohibition against financial assistance by a company for the purchase of its own shares.[2] This prohibition, which is presently embodied in section 38[3] of the Companies Act of 1973, is drawn in the widest and most general terms and because of this, there is a great difference of opinion as to the precise content of the concept of the provision of financial assistance for the purchase or subscription of shares, as well as its application, particularly in complicated commercial transactions, and it consequently generates more than its fair share of commercial uncertainty[4]. Section 38 was regarded essentially as a statutory extension of the common

[1] (1887) 12 App Cas 409 (HL) 416.
[2] Cilliers et al. *Corporate Law 3rd Edition*. (2000) Butterworths: Durban, 323
[3] A company is prohibited from giving, 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.
[4] Cilliers (2000:330)

law prohibition laid down in **Trevor v Whitworth**[5] against the purchase by a company of its own shares. But in the course of time, it became evident that s 38 may have had objects other than the maintenance of the company's share capital.

1.2 Justification

The impetus for the research paper is the fact that the necessity and reasons for the prohibition against a company acquiring its own shares were increasingly called into question by commentators over the many years. They pointed out that the purchase by a company of its own shares was permitted in many legal systems[6]. In the United States, the capital maintenance concept has in varying degrees, been finally abandoned in other jurisdictions as an anachronism and together with it, the prohibition against a company acquiring its own shares has also fallen away. Other common law jurisdictions have also permitted companies to repurchase their own shares but unlike the United States have at the same time prohibited treasury shares[7], by requiring companies to cancel their reacquired shares, instead of holding them in 'treasury' for resale at a later stage. They are[8]:

- **New Zealand**: where it's Companies Act of 1993 permits companies to repurchase their own shares, but the shares are deemed to be cancelled on their acquisition, with the result that any result that any rights or privileges attaching to such shares are thereby extinguished.
- In **Australia,** the Corporation Act of 2001, permits companies to 'buy back' their own shares subject to certain restrictions and safeguards. In general the Act permits a company to buy back its own shares if this does not materially prejudice

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[5] 1987 12 App Cas 409 (HL), Court held that a company with limited liability had no power to purchase its own shares even though authority to so was conferred by its memorandum or article of association.

[6] South Africa and Namibia were one of the few countries that applied the principle of capital maintenance.

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

[8] Annual Survey of South African Law, Share repurchases (2001) Juta & Co. Ltd: Kenwyn At 144-145

the company's ability to pay its creditors and the company follows the procedures in the Act.

- In similar vein, s39(6) of the **Canadian** Business Corporation of 1985 provides that shares repurchased or redeemed by the corporation shall be cancelled, or if the articles limit the number of authorized shares, the shares reacquired are automatically restored to the status of authorized but unissued shares of that class.
- Similarly in **Singapore**, which only recently conferred on companies the power to repurchase their own share, repurchased shares are automatically deemed to be cancelled on their acquisition.[9]
- The **English** Companies Act of 1958 also requires shares which are repurchased or redeemed to be cancelled; with the issued share capital of the company being diminished by the nominal value of the repurchased or redeemed shares without reducing the company's authorized share capital.

Furthermore, the Close Corporations Act 26 of 1988 allows a close corporation to purchase a member's interest[10]. The Companies Amendment Act 37 of 1999 and Namibian Companies Amendment Act 28 of 2004 radically changed the capital maintenance rule and the perceived protection it afforded creditors. Experience has shown that capital maintenance is not only an imperfect way to protect creditors but that the rules (mostly English common law) that applied the principle were notoriously imprecise and uncertain.[11] It also contained serious flaws in respect of the ability of the company to protect itself against manipulation of share prices.

1.3. Purpose of repurchase

Repurchase provides an 'alternative' market for their shares for companies that are not listed on a stock exchange. In the Memorandum in the Objects of the Companies

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[9] Companies Amendment Act 138 of 1998
[10] Ss 39 and 40.
[11] Cilliers et al. *Corporate Law 3rd Edition*. (2000) Butterworths: Durban, 322.

Amendment Bill, 1999, the following reasons were given for the amendment of the Companies Act to permit a company to acquire its own shares: [12]

The principles of capital maintenance have undergone significant changes in almost all countries. The modern notion of capital maintenance is that companies may reduce capital including acquisition of their own shares, but subject to solvency and liquidity criteria. This has the advantage of affording protection to creditors whilst at the same time giving flexibility to companies to achieve sound commercial objectives. These aspects of flexibility and achievement of sound commercial objects have become extremely important since South Africa's re-entry into the global market.

In this regard it should be pointed out that our financial markets have entered into derivative activities on a large scale. Markets have weakened considerably and this can be attributed to, inter alia, market manipulations by international banks and other speculators with unlimited financial resources. This factor alone poses a fundamental danger to our economy.

There are inherent dangers in the impact of speculative derivative, futures and currency trading activities which are taking place in virtually developed investment markets and now also in both South Africa and Namibia. These activities if taking place in an unscrupulous way, can easily suppress the price of shares on the stock market. South Africa has now become a magnet for profitable trading by these speculators. This has resulted in the decline in the value of most leading South African/Namibian shares. Acquiring control of sound companies through these methods could lead to significant job losses and business closing down due to asset stripping and other irregular activities.

One of the accepted defenses against this negative action in the international market place is the ability of strong companies to repurchase and cancel their own shares which levels the playing field in relation to those speculators wishing to reduce the value of company's shares by indiscriminate market activities.

[12] South African Mercantile Law Journal (2000) 12. *Acquisition by a company of its own shares*. At 6

Allowing a company to acquire its own shares to support the market of its shares, thus preserving for its shareholders the value of their shares, is but one advantage. There are several other advantages, namely:

1. **Providing a market**

   Repurchase provides a means whereby a shareholder, or estate of a deceased shareholder, of a company whose shares are not listed can find a buyer. In the case of such activities, then, such selective repurchase provide a substitute for an active stock market. It has also been suggested that the ability to repurchase might help with the marketing of shares. The idea here is that a power to repurchase 'would make its easier for companies to "go public' without obtaining a Stock exchange listing, for the company would provide and alternative market'. The expense of listing, and the minimum size of issue that the stock exchange will list, are said to be 'grave handicaps in the way of small concerns wishing to market their shares'.

1. **Employee share schemes**

   Repurchase is useful in relation to employee share schemes[13] because it enables the shares of employees to be repurchased on their ceasing to be employed by the company. But this argument, Prof Gower states, has never been very seriously pressed, for it is possible, indeed usual, for such shares to be held in trust for the employees concerned, and there is nothing to prevent the company from financing the trustee's repurchase of shares.[14]

2. **Buying out dissident shareholder**

   This could prove useful in the case of closely held companies, rendering it unnecessary for the parties to invoke the court's power under s252 to order the company to repurchase shares. However, to permit large companies to rid

[13] It's a scheme for encouraging or facilitating the holding of shares in a company, for the benefit of bona fide employees or former employees or former employees of the company.

[14] See 38(1)(b)

themselves of a 'troublesome' member by repurchasing his shares will usually mean that the dissident shareholder will be a shareholder whose continued membership management finds inconvenient. And to rid themselves of such a shareholder, the management will almost certainly have to bribe him to go, paying him a considerable premium out of the company's funds.

In **Trevor v Whitworth**, Lord Herschell said: 'I can quite understand that the directors of a company may sometimes desire that the shareholders should not be numerous, and that they should be persons likely to leave them with a free hand to carry on their operations. But, I think it would be most dangerous to countenance the view that, for reasons such as these, they could legitimately expend the moneys of the company to any extent they please in the purchase of its shares'. in the same case Lord Macnaghten… expressed considerable alarm about any power that allowed management of a company to effectively suppress criticism of its performance through the simple expedient of 'buying off' the dissidents. Such a process is obviously destructive of shareholder democracy and subverts the whole notion of accountability of management to members. Proponents of the repurchase power seek to provide management with the capacity to silence criticism purchasing their shares, rather than making an effort to redress those criticisms.

3. **Allows a listed company to acquire small shareholders, such as 'odd-lots'**

   The Australian Companies and Securities Law Review Committee[15] suggested that share redemption power allows a listed company to acquire small shareholders, such as 'odd-lots', thus reducing the company's administrative overheads and allowing the relevant shareholders to sell without incurring material transactional costs.

4. **Enabling a company to trade in its own shares**

[15] Report to Ministerial Council, A Company's Purchase of its Own Shares, September 1987 (Aust)

If the repurchased shares are not cancelled, the company will be able to trade in its treasury shares and 'make money thereby': but, of course, it is generally accepted that trafficking by a company in its own shares is an unmitigated evil which should be prohibited in absolute terms. Prof Gower[16] said that 'trafficking in its own shares is not self-evidently a desirable corporate activity; he said that this is actually or potentially objectionable'.

5. **Buying up redeemable shares**

The Professor goes on to argue 'that there is a strong case for permitting repurchases of redeemable shares before the redemption date, because it might reduce temptation to redeem under a formal reduction scheme when, because of changes of interest rates, such shares have become more detrimental to the company and might enable shareholders to avoid being redeemed under such schemes on terms they regard as unfair'.

6. **Distribution of surplus assets, and adjustment of debt/equity ration (equity contraction)**

Repurchase of shares is usually considered to be unproblematic where its purpose is to return surplus funds to shareholders, who are then able to invest those funds more profitably elsewhere. If a company lacks internal investment opportunities which promise an adequate rate of return, and has cash balances on hand greater than needed to finance normal expansion requirements, that excess working capital can be employed to shrink the equity base through the repurchase of shares.

Repurchase is also a means by which the company can reduce its equity in relation to its debt and this will most obviously be accomplished where the company borrows in order to repurchase its shares. Clearly both return of surplus funds and substitution of debt for equity are valid financial objectives.[17]

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[16] Report by Prof LCB Gower. The purchase by company of its own share, ac consultative Document (1980)

[17] 5-52

7. **The 'good investment' theory**

Share repurchase are sometimes recommended as good investment for the company when management believes that the market is undervaluing their company's shares'. The repurchase is made to take advantage of perceived undervaluation to make a good investment for the benefit of the shareholders. This as Clarke puts it, is really 'a form of doubletalk'.[18]after the repurchase, the funds used for it will no longer be in the company or, in any sense, invested in its business operations.

8. **Purchases for use in acquisition programmes and stock plans**

MacCabe[19] holds that repurchasing assists companies engaging in takeovers and mergers by enabling them to take shares off the market to be reissued as consideration in takeovers and mergers without dramatically increasing the company have issued shares. The purpose for this exercise is to prevent dilution of the equity of non selling shareholders, usually a matter of concern only for the controlling shareholders.

9. **Repurchases to support the market for the company's shares**

In the memorandum to the Bill it is stated that 'allowing a company to acquire its own shares to support the market of its shares, thus also preserving for its shareholders the value of their shares, is but one advantage of the ability of companies to repurchase their shares.

The possibility of market manipulation is usually considered a most serious consequence of recognizing a right in companies to purchase their own share. Market repurchases at above the market price act as a signal to the market that management is confident that the shares will increase in value. This assumes at least three things: (1) That the company's management's bona fide belief that the market for the company's shares does not reflect their true value, is an acceptable

[18] R C Clarke Corporate law (1986) 627 Yale LJ 634
[19] MacCabe (1991:124)

indicator of undervaluation; (2) That such repurchases constitute a signal to the market by persons who know the true value of the company's shares; and (3) That the market is inefficient.[20]

10. Repurchases in order to avert a takeover

This tactic the Australian Companies and Securities Law review Committee states, have a number of strategic purposes: (1) Repurchases may increase the percentage of the target's shares owned by management or its supporters; (2) A repurchases may raise the price of the targets shares above the offer price, forcing the bidder to increase its offer or abandon its bid; (3) By means of repurchase, the target company may seek to rid itself of the liquid assets which makes it an attractive target in the first place, or to make itself an unattractive target by increasing its debt-equity ration; (4) Repurchase may also be resorted to where the target dilutes the voting power of a threatening block of shares by issuing new shares to a 'white knight', and grants the white knight an option to require the company to repurchase the shares at an advantageous price, or, by repurchasing shares, increases the voting strength of the shares issued to the white knight. Finally, (5) The repurchased shares may come from the bidder itself, which may agree, upon payment to it of a substantial premium over the market price unavailable to the other shareholders, as a condition of the sale to terminate its effort to control the target, usually referred to a 'greenmail'[21], 'green' as in the dollar bill, 'mail' as in black mail.

11. **Management buyouts and going private**

It provides a means for management buyout and 'going private' transactions. The insiders instigating such transactions frequently seek to reduce by means of a preliminary programme of repurchases, to be followed by a general offer, aimed at reducing the number of outstanding shares.

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[20] R C Clark Corporate Law (1986:629-630)

[21] 'Greenmail" describes a corporation's repurchase of its own stock from one or a small number of shareholders at a premium above market price, thereby eliminating a raider's potential bid for the target corporation, on severing its ties with a shareholder that poses a threat to the future policies of the corporation.

1.4 Research questions

1. What are the rules on capital maintenance?
2. What is the proper interpretation of s38 of the Companies Act of 1973?
3. What is the significance and object of the amendment to s38'?
4. Are there any problems or doubts to the amendment?

1.5 Methodology

The research will draw experience from published works in the topic. The library will serve as an important source of literature, legislation as well as transcript from the internet will also be utilized.

1.6 Chapter outline

Chapter 1: Introduction
Chapter 2: The capital maintenance rule
Chapter 3: Legislative qualifications to the common law rule: An analysis of 38
Chapter 4: Companies Amendment Act (Namibia and South Africa): significance and Object
Chapter 5: Conclusion: Doubts and defects

Chapter 2
The capital maintenance rule

2.1. The position at common law

The concept of capital maintenance is of fundamental importance to a proper understanding of company law.[22] Henry Ballantine[23] states that the company's issued or paid up share capital- the aggregate of the amounts reflected in a company's capital accounts- has been compared 'with a certain level marked by a gauge upon the corporate reservoir of assets', i.e. its net assets. Below that level is the company's capital fund. In its most general form, the capital maintenance rule sought to protect the creditors of companies by prohibiting the return of the company's capital fund to shareholders, otherwise than under a formal reduction of the company's issued share capital. Thus while the net assets standing above that level could be 'drawn off for the shareholders', 'the remaining supply had to be reserved for business purposes and for creditors'. That remaining supply- the capital fund- could be returned to the shareholders only after and to the extent that, the level was lowered, i.e. by reducing the company's issued share capital.

A reduction of the company's share capital thus decapitalised part of the company's paid-up capital, which part, no longer capital, could be returned to its shareholders. What a company could not de- what the capita maintenance rule prohibited-was to leave its issued share capital intact and, simply, return capital funds to its shareholders.[24]

In England , South Africa and Namibia, a reduction of share capital required compliance with statutory rules designed to ensure that, when a company reduced its share capital, both its shareholders and in particular, its creditors, were adequately protected, rules which were contained in the original ss83-90 of the 1973 Act until their repeal. Strictly speaking Blackman[25] says, these rules did not form part of the capital maintenance rule itself, for that rule merely insisted that capital funds be returned only under a formal reduction of share capital. But they did serve to justify the rule: if the legislature had gone to such lengths to protect creditors in the case of a capital reduction, it could hardly have intended that the company should be able to return capital funds to its members by other means.

[22] J.T. Pretorius. Capital maintenance doctrine in South African Corporate law.01 October 2000.
[23] Corporate Capital and Restrictions Upon Dividends Under Modern Corporations Laws (19535) 23 Caliph 229 234-235
[24]Blackman et al (2005) Commentary on the Companies Act. Juta & Co, Ltd: Landsowne. 5-104
[25] Blackman et al (2005:5-105)

The English Companies Act 1862 as enacted, made no provision for the reduction of share capital, the Act was amended in 1867 and provision was made to empower a company, by special resolution, 'to so far modify the conditions contained in its memorandum of association … as to reduce its capital. In **Trevor v Whitworth**[26] Lord Herschel explained that this by stating that, 'experience appears to have shown that circumstances might occur in which a reduction of the capital would be expedient. Accordingly, by the 1867 Act, provision was made enabling a company under strictly defined conditions[27] to reduce its capital'.

On a proper interpretation of the Companies Act, in particular its share capital provisions, the House of Lords in **Trevor v Whitworth[28]** held that a company with limited liability had no power to purchase its own shares even though authority to so was conferred by its memorandum or article of association. Thus, not only did the capital reduction provisions provide the only means by which a company could reduce its share capital, but, also, a company could not return capital funds to its shareholders without reducing its share capital, as, fro example, by returning them by way of a 'dividend'. This then was the capital maintenance rule. Thus although the capital maintenance rule has often been spoken of as a 'common law rule', strictly speaking that is not correct. The rule was 'implied from the structure of statutory provisions relating to such companies and their capital'. And, indeed, the rule could have had no other basis, for the company is a creature of statute.

The capital maintenance rule was primarily intended for the protection of the company's creditors. The same view was stated by Hoffmann J in **Aveling Barford Ltd v Perion Ltd**[29] in that the rule that capital may not be returned to shareholders is a rule for the protection of creditors and evasion of that rule within what... Slade LJ had in mind in

[26] (1887) 12 App Cas 409

[27] They generally required the confirmation of the court and, where the reduction of the share capital was to be followed by a return of capital funds to shareholders, the consent of the company's creditors, or the securing or payment of their claims.

[28] (1887) 12 App Cas 409

[29] (1989) BCLC 626 633

Rolled Steel Products (Holdings) Ltd v British Steel Corporation[30], when he spoke of a fraud on the creditors. Limited liability denies creditors' recourse to the company's shareholders when the company cannot pay its debts, forcing them to rely exclusively on the company's assets.

The capital maintenance rule entitled them to assume that no part of that capital would be paid out except in the legitimate course of business or under a reduction of share capital authorized by the Companies act. Creditors took the risk that the company might loose part or all of its paid up capital in carrying on its business, but, as Lord Herscell put it, they had 'a right to rely, on the capital remaining undiminished by … the return of any part of it to the shareholders'. Boshoff J in **Cohen v Segal**[31] stated that, 'the capital may be spent or lost in carrying on the business of the company, but it cannot be reduced except in the manner and with the safeguards provided by the statute'.

The term capital maintenance was of course somewhat misleading. Capital maintenance rules are about the priority of creditors' claims to those of shareholders in insolvency. Hence they restrict transfers out of capital to shareholders. They do not require the company to maintain a specified level of net assets. The capital of a limited company is not a debt owing by it to its shareholders, and if the capital is diminished or lost in the course of the company's trading, the company is under no legal obligation either to make it good, or on that ground only wind up its affairs, stated Lindley LJ.[32] A similar view was held by Lord Watson in the **Trevor v Whitworth** case when he said: 'Paid up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to, a limited company, naturally relied upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has subsequently been paid out, except in the

[30] (1986) Ch 246 296
[31] 1970 (3) SA 702 (W) 705-706
[32] Verner v General & Commercial Investment Trust (1894) 2 Ch 239 264-265 (CA)

legitimate course of business. The company's paid –up capital constituted the total sum that its shareholders were required to put at risk.[33]

In **Barclays Bank Plc v British and Commonwealth Holdings Plc**[34] the court held that any agreement in substance provided for a company to return or pay capital to its members was illegal and could not be enforced unless some specific statutory authority for its return could be found. Further in **S v De Jager**[35] it was held that such returns were usually said to *ultra vires* and hence void. The application of this principle and any subsequent illegality was not limited to payments which on their face and according to the characterization given to them by the parties were returns of capital, it being always a matter for the court to conclude according to the evidence relevant to the question whether in substance and effect the payment was a return of capital.[36]

2.2. The different rules of capital maintenance

From the general prohibition certain particular rules were deduced namely:

(i) **Prohibition of the payment of dividends[37] out of capital[38]**

In the **Re Mercantile Trading Co**[39] case it was held to follow inevitably from the general prohibition of the return of capital to members others than on winding-up or in accordance with the statutory procedure for the reduction of share capital.[40] The payment of a dividend out of capital was an ultra vires payment. To this rule the provisions of s78, permitting a company in certain

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[33] Blackman et al (2005:5-105)
[34] (1996) 1 BCLC 115 (ChD and CA)
[35] 1965(2) 616 (A) 624-625
[36] Re Halt Garage (1964) Ltd (1982) 3 All ER 1016
[37] Usually it's defined as a division of the company's profits among its member, for the purpose of this prohibition dividend had a wider meaning; it included any payment or benefit given to its members.
[38] Money subscribed pursuant to the memorandum of association, or what is represented by that money, together with premiums obtained on the issue of shares, the capital redemption reserve fund, capitalized reserves, and money borrowed to pay dividends where the company had not earned profits equal to the amount borrowed.
[39] (1869) 4 Ch App 475
[40] Verner v General & Commercial Investment Trust (1894) 2 Ch 239 264 (CA)

circumstances, and subject to a number of restrictive conditions, to pay 'interest' on share capital, provided an exception.

(ii) Prohibition of the purchase by a company of its own shares

The primary purpose of this prohibition was the protection of creditors; but they were also for the protection of both present and future shareholders. As far as creditors were concerned, the purpose of the rules was to turn the concept of capital into a rigid yardstick fixing the minimum values of the net assets which must have raised initially and then, as far as possible, retained in the business, this meant that the creditors of the company may depend on the share capital being used to discharge any claims against the company before such capital, or any portion of it, was repaid to the shareholders. In this context, the share capital could have been seen as a sort of guarantee fund for creditors. As far as shareholders were concerned, the rules gave some protection against action by the directors that might diminish the value of their shares. The prohibition preventing the company from trafficking in its own share.[41] To this prohibition there were exceptions[42], none of which left the company's creditors unprotected, or enabled the company to traffick in its shares.

(iii) Subsidiary prohibited from being a member of its holding company

The rule that prohibited a company from purchasing its own share was further extended by s39(1) of the Act which, to prevent the indirect return of capital, prohibited a subsidiary from being a member of its holding company, and rendered void any allotment, issue or transfer of shares of a company to its subsidiary.[43]

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[41] Sage Holdings Ltd v Unisec Group Ltd 1982 (1) SA 337 (W) 348-349

[42] (i) s252(30 empowers the court, with the view to bringing an end to the matters complained of, to make an order for the purchase of by of its members, and for the reduction accordingly of the company's capital; (ii)a company may redeem redeemable preference shares out of profits or the proceeds of a fresh issue of shares; and (iii) Certain Acts regulating professions permit a company formed in terms of the Act, to purchase shares held in it, provided that its articles permit it to do so.

[43] Inland Property Development Corporation (Pty) Ltd v Cilliers 1973 (3) SA 259 (T) 264-266

(iv) Prohibition of issue of shares at discount

From the principle that capital could not be returned to the shareholders otherwise under formal reduction, it was held in **Ooregum Gold Mining Co of India v Roper**[44] to follow that nothing but payment and payment full could put an end to the shareholder's liability; and hence par value shares could not be issued at a discount, i.e. a company could not issue shares as fully paid up, for consideration less than their nominal value. Section 81 provides an exception to this rule by permitting, subject to certain conditions, a company to issue at discount shares of a class already issued.

2.3. Present position

The South African Act 1973 departed from the British model in abolishing the unlimited company as a viable form of company; the main type of company, a company having a share capital, now has as a corporate attribute that a shareholder is not responsible for the debts of the company and that accordingly he stands to lose no more than the amount paid by him for shares in the company.[45] However before a company can be issued with a certificate to commence business it must lodge, inter alia, a statement of opinion of each director to the effect that the capital of the company is adequate for its purposes or, if he is of the opinion that it is inadequate, the reasons therefore and the manner in which and the sources from which the company is to be financed; a company issuing a prospectus may not proceed to the allotment of shares until it has received the minimum subscription in cash.[46]

2.4. Shortcomings of the rules and rational for legal intervention

Experience has shown that the capital maintenance rules did very little to protect the interests of creditors, especially since the Companies Act did not prescribe a minimum

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[44] (1892) AC 125 (HL)

[45] Cilliers (1973:289)

[46] Pretorius J.T. South African Company Law through cases- A source book 6th Edition (1999:121) Juta & Co: Kenwyn

capital for either a public or private company. These rules were also very difficult to enforce and very often both innocent and bona fide transactions fell foul of its provisions. These rules also contained serious flaws in respect of the ability of the company to protect itself against manipulation of share prices. [47] The difficulties that small companies face in trying to raise equity investment also presented problems. Many small businesses are family of concerns, where the individuals concerned, much as they would welcome an injection of capital, are reluctant to raise it through an issue of shares for fear of loosing control of the business to an outsider. Outsiders, for their part, are reluctant to contribute their capital to an enterprise whose shares are not easily marketable and where they risk being locked in. it thus became clear that some reform was necessary.

Other related shortcomings in regard to capital were, the absence of minimum paid up capital requirements; and the possibility of dilution where shares are issued in return for assets rather than cash. But of course the fact that no minimum capital required is unrelated to the capital maintenance rule, which rule was based on the theory that capital funds put into the company must not be returned to the shareholders to the prejudice of the company's creditors who had relied upon those funds when extending credit to the company. And the possibility of illegal watering of shares by issuing them for over-valued assets, suggests a tightening up of relevant rules. In any event, in those jurisdictions including our own where the capital maintenance rule has been abolished, the rules against watering shares have been left in place.

The minimum capital requirement is not a means of protecting creditors, because it is so readily avoided. This matter might be better left for the market to regulate it. Further the capital maintenance doctrine is an antiquated and unnecessarily restrictive means restrictive means of preserving creditors' priority to shareholders, and in the light of the improvements in accounting standards, the enhancement of directors' accountability and the greater availability of 'claw back' remedies, the rationale for the protection has largely disappeared. Its replacement with the 'solvency test' which transfers to shareholders out of capital would have to satisfy. [48]

[47] http://www.accaglobal.com/publications/studentaccountant/26856?view=Printable=version Capital maintenance doctrine in South African Corporate law by J.T. Pretorius (2000)

The law relating to financial assistance at some length, its ambit is broader than is necessary to implement the capital maintenance principle. The three possible rationales for the rules should be rejected:

(i) The prevention of market manipulation;
(ii) The prevention of 'share support' schemes in relation to takeovers;
(iii) The protection of creditors.

In the light of other more clearly targeted regulatory measures and creditors' grater sophistication, the extensive financial assistance rules are in my opinion no longer required. Creditors could be adequately protected through the introduction of 'solvency' requirement, as for the capital maintenance rules.

Armour[49], questioned whether the body of rules known as 'capital maintenance' are likely to be an appropriate means of promoting efficiency as central to the aims of the Company law reviews strategic framework Document. Whilst the current rules are unlikely, on the whole, to be justified in terms of efficiency, a case may be made for a framework within which companies may 'opt in' to customized restrictions on dealing in their share capital. The 'presumption against prescription as set in the document implies that a case for legal intervention on the grounds of enhancing efficiency must be made out on the grounds that a market subject to a given rule will function in a more efficient manner than one without such a rule.

The rules regulating the raising of capital (the par value rule and the expert valuation rules for public companies) might be understood as responding to information asymmetries in markets for corporate credit, by making it more likely that capital figures stated in firms, public documents will actually have been represented by assets paid into the company by shareholders. In practice, however, this information is unlikely to be of

[48] Beuthin R.C. South African Law Journals *(The new statutory provisions on company share repurchases: a critical analysis)* (1999) Juta & Co. Ltd: Kenwyn

[49] Armour J (2000) Share capital and creditor protection: efficient rules for modern company law. Modern Law Review.

relevance to creditors, and the costs of compliance with the rues therefore almost certainly outweigh any benefits they confer.

The rules mandating public companies to be formed with minimum capital, when viewed in conjunction with the expert valuation rules, might be understood as a primitive means of protecting involuntary creditors from the use of limited liability companies as an easy judgment-proofing strategy for those conducting hazardous activities. However, this is at once likely to be both under and over-inclusive. The more useful the measure as a means of preventing judgment-proofing (i.e. the higher it is set) the more restrictive it will be on firms' ability to make use of limited liability. If this were the only technique available for internalizing the costs which judgment proofing may impose on involuntary creditors, then would have caused for a detailed enquiry into costs and benefits. However, there are a variety of more finely-tuned regulatory techniques which might be adopted instead- such as unlimited shareholder liability, super priority for involuntary creditors, and mandatory insurance regimes.

Amour[50] argues that the capital maintenance rules can be understood as supplying 'terms' into bargains between creditors and shareholders. Empirical studies show that creditors and firms do in fact spend resources drafting loan covenants which restrict companies' distributions to shareholders. In the US, where distributions rules no longer have any teeth, some studies suggest that such covenants take a form which bears a striking resemblance to the restriction found in the Companies Act of 1985. Thus the case for legal protection of creditors should not be dismissed out of hand. However, the capital maintenance rules also generate costs, particularly in small firms, where shareholders are unable to withdraw capital from the firm when it has no good projects to pursue. There is some evidence that this may actually encourage undercapitalization in small firms. Even so, if the current rules were the only possible regulatory solution, we would have cause for more detailed investigation of the costs and benefits.

[50] Armour J (2000) Share capital and creditor protection: efficient rules for modern company law. Modern Law Review.

He however, suggests that a superior alternative exists in the form of default rules restricting distributions. Because one term is unlikely to suit all parties' needs, these could be offered in the form of a 'menu' into which firms could opt in on incorporation, and could perhaps subsequently switch through a collective creditor decision-making mechanism.

Financial assistance can be seen as combating the unusually severe conflicts of interest which arise in the case of leveraged buy-outs (LBOs). Where a firm is purchased by a heavily-indebted buyer, and the formers' assets are used to underwrite the latter's loan, the 'old' creditors of the firm will experience a sudden and dramatic increase in the riskiness of their debt. The American experience proves instructive once more, where there are no financial assistance laws, but there have been calls for mandatory rules designed to protect creditors from precisely this sort of risk. Armour again suggests, however, that the case for mandatory rules is probably not made out. Whilst they might (perhaps) be better than no rules, default rules (in the form of an opt in menu) would clearly be superior to both. He concluded with a call for serious consideration to be given to his proposal for a 'menu' of creditor terms to be made available by the law to firms and their creditors.

2.5. Abolition of the capital maintenance rule

The capital maintenance rule which applied in both South African and Namibian Company law since its inception was to a large extent abolished by the Companies Amendment Act in favor of the "American" rule. The philosophy of the Amendment Acts is encapsulated in the principles as set out in section 90 of the Companies Act substituted by s14 of the Amendment Act, in terms of s90 of the Companies Act a company may make payments to its shareholders, if authorized by its articles and if there is a reasonable belief that after the payment the company will be abler to pay its debts as they become due in the ordinary course of business (liquidity test) and that the consolidated assets of the company would after the payment exceed its consolidated

liabilities (solvency test).[51] The term payment includes any direct or indirect payment of money or transfer of property to a shareholder by virtue of the shareholder's shareholding in the company. A payment made to a shareholder in another capacity for example, as a creditor of the company is excluded from the provisions of Section 90. Perhaps this conflict in the underlying philosophy and policy of the South African Companies Act is a direct result of the patchwork and piecemeal reform that has taken place in the South African corporate law during the existence of the Companies Act of 1973. By a way of contrast, ss135-141 of the UK Companies Act of 1985 have observed the statutory procedures and regulations relating to reductions of share capital.[52]

Chapter 3
An analysis of Section 38[53]

3.1. Introduction

Cilliers[54] states that flagrant circumventions of the common law prohibition on a company buying in its shares in practice drew the attention of the Greene Committee in

[51] Section 90(1)-(2)
[52] The capital maintenance concept and share repurchases in South African law. By F.H.I Cassim and Rehana Cassim
[53] A company is prohibited from giving, 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 the purchaser or subscription made or to be made by any person of or for any shares of the company.
[54] Cilliers (2000:323)

England, which therefore recommended the introduction of a prohibition against financial assistance by a company for the purchase of its own shares.

The Jenkins Committee[55] said that the mischief at which the section was aimed was the abuses which become possible when persons, with insufficient funds or credit facilities of their own, gain control of a company on the basis that they will use its funds to pay for their shares. If the speculation fails, the company will suffer loss, for it will not have received an adequate *quid pro quo* when parting with its funds. In such a case the interests of creditors and minority shareholders of the company would, at best have been subjected to an improper risk, while at worst, such creditors and shareholders may only be left with a claim for damages against the director's of the company if it should fail.

In England the Greene Committee[56] also examined these abuses. It thought that such an arrangement offended against the spirit, if not the letter, of the law which prohibited a company from trafficking in its own shares. The Committee's recommendations were given statutory recognition which was contained in s54 of the 1948 English Companies Act. Substantially the same provision was enacted into South African Company Law by s86 (*bis*) (2) of the 1926 Companies Act. It was re-enacted, with minor amendments, in s 38 of the 1973 Act.

Blackman[57] states hat although the section was enacted to prevent the above stated abuses, as Cilliers and Benade[58] point out: 'the scope of this provision goes much further than being an extension of the rule that accompany cannot purchase its own share, thereby reducing its capital unlawfully. The mere provision of financial assistance by a company to a person for the purchasing of its own shares does not of itself amount to a reduction of its capital. The company providing the assistance is merely changing the form of its assets or encumbering its assets and if the borrower is able to meet his obligation in regard to the purchase of the shares, the company's capital remains intact'.

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[55] Report of the Company Law Committee (the Jenkins's Committee)
[56] English Company Law Reform Committee (1926)
[57] Black man (2005:4-57)
[58] Cilliers (2000:330)

Section 38 is drawn in very wide and general terms. But as Miller said in **Lipschitz NO v UDC Bank Ltd**[59], 'there has been a tendency, in the light of the extremely wide terms of the prohibition considered in conjunction with the circumstances that contravention of the section constitutes a criminal offence, to give close attention to the underlying purpose of the prohibition and the real mischief at which it was aimed and, with that in mind to adopt what R C Beuthin has described as a "much narrower approach to the section".'

Nevertheless the Appellate Division[60] has stressed that 'there is no latitude for curtailment by the Courts of its scope in respect of conduct which was has been clearly prohibited'. In **Zentland Holdings (Pty) Ltd v Saambou Nasionale Bouverenging**[61], the court held that the onus of proving that s 38 has been contravened is on the person making the allegation.

It was widely expected that s 38 would be reformed or even repealed in its entirety simultaneously with the introduction in 1999 of the right conferred on a company to purchase its own shares. The basis of such an approach would have been that for many years, both in English as well as South African/ Namibian law; s38 was regarded essentially as a statutory extension of the common law prohibition laid down in **Trevor v Whitworth**[62] against the purchase by a company of its own shares. On this basis, once a company is permitted to purchase its own shares, it is only logical that it be permitted to also give financial assistance for the purchase of its shares, subject to adequate safeguards for creditors and minority shareholders.

But in the course of time, it became evident that s 38 may have had objects other than the maintenance of the company's share capital. For instance, s38 remains an effective and useful deterrent against an asset stripper or a 'white knight' share purchaser, and of course it does prevent a company from exposing its funds to unnecessary risks. Thus a number of common law jurisdictions have preserved in a modified form the prohibition against a company giving financial assistance for the purchase of subscription of its

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[59] 1979 (1) SA 789 (A) 797-798
[60]Lipschitz NO v UDC Bank Ltd 1979 (1) SA 789 (A) 798
[61] 1979 (4) SA 574 579 (C)
[62] 1987 12 App Cas 409 (HL)

shares. What is clear from these experiences, including our own, is that the old common law capital maintenance concept no longer forms the basis of the prohibition against a company giving financial assistance for the purchase or subscription of its shares. [63]

He further states that "It is therefore rather surprising, at first sight, to find Mpati AJA in **Peters & Others NNO v Schoeman & Others**[64]**,** relying on the statement from the judgment in **Lewis v Oneanate (Pty) Ltd**[65] that the object of s38 was to protect 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'. Fortunately Mpati AJA, quoting further from **Lewis v Oneanate**, correctly indicated that the purpose of s38 is to avoid the 'employment and depletion of that fund or exposing it to possible risk in consequence of transactions concluded for the purpose of or in connection with the purchase of its shares."

There have been a number of judicial attempts to prune down the wide ambit of s 38. Schreiner J in **Gradwell (Pty) Ltd v Rostra Printers Ltd**[66]laid down the 'impoverishment test' and suggested further a distinction between the direct object and the ultimate object of the transaction, a distinction which Miller JA endorsed in **Lipschitz v UDC Bank**[67]. According to this test, if the direct object of the transaction is legitimate its ultimate object of, even if it is to facilitate the purchase of the company's shares, becomes irrelevant. Furthermore, once the direct object of the company in performing the act complained of is established and there is something other than the purchase of the company's shares, 'there would in general (though there may be exceptions) be little room or no room for finding that…the act was nevertheless performed in connection with the purchase of its shares.

[63] F H I Cassim (*The new statutory provisions on company share repurchases: a critical analysis*) (1999) 119 SALJ, 90
[64] 2000 (1) SA 872 (SCA)
[65] 1992(40 SA 811 (A) at 818D
[66] 1959 (4) SA 419 (A)
[67] 1979 (1) SA 789 (A)

This test clearly has the effect of cutting down the wide ambit of s 38 so that it only hits only those transactions in which the direct object of the company in entering into the transaction is to give the prohibited financial assistance for the purchase or subscription of its shares, even if it facilitates the purchase of the company's shares, becomes irrelevant. The fact that the financial assistance may have been given in connection with the purchase or subscription of its shares, or that this may have been the ultimate object of the transaction, or that it facilitates the purchase or subscription of the company's shares would not necessarily result in the transaction being struck down.[68]

3.2. Exceptions to the prohibition[69]

The section provides exemptions to the operation against financial assistance in the following cases:

a) The lending of money in the ordinary course of the business by a company whose main business is the lending of money.[70]
b) The provision of money by a company- under a scheme in force for the time being- for the subscription or purchase by trustees of shares in the company (or in its holding company) to be held by or on behalf of its employees (including any director holding a salaried office in the company.
c) The making of loans by a company to its bona fide employees other than directors to enable them to purchase, or subscribe to shares in the company (or in its holding company) on their own behalf.
d) The provision of financial assistance for the acquisition of shares in the company by the company or by its subsidiary in terms of section 85.

3.3. Content of prohibition

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[68] Pretorius J.T. et al. *Hahlo's South African Company Law through the cases 6th Edition*. (1999) Juta & Co Ltd: Kenwyn 124
[69] Cilliers et al. Corporate Law 3rd Edition. (2000). Butterworths: Durban, 330
[70] Steen v Law (1963) 3 All ER 770 (PC)

The cardinal consideration in this formidable problem area is the precise content of the concept of the provision of financial assistance for the purchase or subscription of shares. As the section is drawn in the widest and most general terms, there is a great difference of opinion as to its application, particularly in complicated commercial transactions, and it consequently generates more than its fair share of commercial uncertainty[71].

In analyzing the prohibition against the provision of financial assistance, the appellate Division pointed out in **Lipschitz v UDC Bank**[72] that it comprised two elements which are linked to form a single prohibition, but although so linked they are vitally different in concept, namely:

a) The giving of financial assistance; and
b) The purpose for which it is given.

3.4. Giving of financial assistance[73]

In **Gradwell (Pty) Ltd v Rostra Printers Ltd & another**[74], Schreiner J held that, it is clear from s38 (1) that giving 'financial assistance' includes a loan, a guarantee and the provision of security. The section does not elaborate on the meaning of the words 'or otherwise' and it is clear that these words are not construed *eiusdem generic* with 'loan, guarantee, the provision of security. Nothing further is stated in s 38 as to what constitutes 'financial assistance' within the meaning of the section.

In **Charterhouse Investments Trust Ltd v Tempest Diesel Ltd**[75]**,** Hoffman J said: 'There is not a definition of giving of financial assistance in the section, although some examples are given. The words have no technical meaning and their frame of reference is in my judgment the language of ordinary commerce. One must examine the commercial realities of the transaction and decide whether it can properly be described as giving

[71] Cilliers (2000:330)
[72] 1979 (1) SA 789 (A)
[73] Cilliers et al. (2000:331).
[74] 1959 (4) SA 419 (A) 425
[75] (1986) 1 BCLC 10

financial assistance by the company, bearing in mind that the section is a penal one and should not be strained to cover transactions which are not fairly within it'.

One of the tests formulated by the courts in the determination as to whether financial assistance had been rendered or not is the so called "impoverishment test. This test involved the question whether the company had become poorer in consequence or in connection with the purchase or subscription of its shares. If the company's financial position had been adversely affected by the transaction, it had been impoverished and had therefore given financial assistance.[76] This test was originally formulated in **Gradwell v Rostra Printers Ltd**[77] and was often used by the courts to determine whether financial assistance had been given.

The impoverishment test came in for a great deal of criticism and was much debated. In the **Lipschitz** case, Miller JA referred to the criticism that has been leveled against the section and held that, valid as it may be, there is no latitude for curtailment by the courts of the scope of the section, he said that he was not convinced of the generality of the acceptance of the impoverishment test and said that the judgment of Schreiner JA in **Gradwell's** case does not justify such acceptance. Such an interpretation, he said, unduly narrows and restricts the terms of the section which 'expressly and unequivocally includes within the meaning of "financial assistance" acts not necessarily nor even probably involving impoverishment of the company or the employment of its "pecuniary resources", for example the giving of guarantee or the provision of security by a company for the purchase of its own shares. This specific inclusion "financial assistance" of the giving of guarantees and the provision of security was to guard against a company merely exposing its fund to probable risk as distinct from actually employing its funds for the purpose of or in connection with the purchase of shares.

Miller JA then proceeded to put the impoverishment test in its proper perspective. In certain cases, depending largely on the form which the alleged financial assistance is said to have taken, the impoverishment test might be a very helpful guide and might often

[76] Cilliers & Benade (2000:334)
[77] 1959 (4) SA 419 (A)

yield a decisive answer to the financial assistance question. In many other cases, however, the impoverishment test might be entirely irrelevant in determining whether financial assistance had been given, though the company's financial position and those of other person involved in the transaction as well as other circumstances, could all be relevant to the answer to the second element of prohibition, namely whether the assistance was given of or in connection with the purchase of shares of the company.[78]

The impoverishment test was applied and operated in numerous cases to mention a few:

- **Lewis v Oneanate (Pty) Ltd** [79], where a company had given security for repayment of its previously unsecured loan indebtness to persons who are parting with control of that company by selling the shares they hold in it, the provision of that security does not constitute financial assistance in connection with that sale of shares.
- **Straiton v Cleanwell Dry Cleaners (Pty) Ltd**[80], where a company had passed a bond over its assets to raise money for the purchaser to pay for its shares or to secure the purchase price, financial assistance is present.
- **Fidelity Bank Ltd v Three Women (Pty) Ltd**[81] , where a company had a loan with a bank and a shareholder sold his shares to the remaining shareholders a second loan was made, and the proceeds used to repay amounts by the seller to the bank and to pay an amount to him, where after he transferred his shares to the buyer, it was found to be financial assistance.

The **Strerileair (Pty) Ltd v Papallo**[82] **case** held that the issue is whether 'in practical business sense' financial assistance was given for the purpose of or in connection with the acquisition of the shares. The prohibition in s 38 is not confined to financial assistance to the purchaser.[83] It is directed at financial assistance to whomsoever given,

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[78] Charterhouse v Tempest (1986) BCLC 1 (ChD)
[79] 1992(4) SA 811 (A). See also Karnovsky v Hyans 1961(2) SA 368 (W); Bay Loan Investment v Bay View 1972 (2) SA 313 (C) 317
[80]1960 (1) SA 355 (SR) 359. See also Karroo Auctions v Hersman 1951 (2) SA 33 (E)
[81] (1996) 4 All SA 368 (W)
[82] (1998) 29 ACSR 461 468
[83] Jacobson & another v Liquidator of Bulkin & Co Ltd 1976 (#) SA 781 (T) 787-8

provided that it be for the purpose of a purchase of shares or connection with a purchase of shares.[84]

3.5. The purpose for which financial assistance was given

The impoverishment test, although not the sole test in regard to the determination of what is meant by 'financial assistance', may be relevant and helpful in deciding whether such assistance was given for the purpose of or in connection with' the purchase of the company's shares. The financial position of the company and of others involved may be useful in this regard.

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 though there may be exceptions be little or no room for finding that, for purposes of s38 the act was nevertheless performed in connection with the purchase of the shares. This test clearly has the effect of cutting down the wide ambit of s38 so that it only hits only those transaction in which the direct object of the company in entering into the transaction is to give the prohibited financial for the purchases of subscription of its shares, even if it facilitates the purchase of the company's shares becomes irrelevant. The fact that the financial assistance may have been given in connection with the purchase or subscription of its shares, or this may have been the ultimate object of the transaction, or that it facilitates the purchase or subscription of the company's shares would not necessarily result in the transaction being struck down.[85]The House of Lords in **Brady v Brady**[86]**,** held that a distinction must be drawn between a 'purpose' and the 'reason' why a purpose if formed. Motive is not the same as purpose.

The question arose whether in interpreting the prohibition, the words "in connection with" should be given their literal meaning or not, so that financial assistance only

[84] E H Dey (Pty) Dey 1966 VR 464 470
[85] Pretorius JT et al. Hahlo's South African Company Law through cases, 6th Edition. (1999) Juta & Co Ltd : Kenwyn 124
[86] (1988) 2 All ER 617 (HL) 633

remotely connected with a purchase or subscription of shares should be said to be financial assistance in connection with such a purchase or subscription. In the **Lipschitz** case it was held that "in connection with" is an alternative to "for the purpose of" and in the context of the section its connotation was greatly affected by the concept to which it is an alternative. The word appeared to have been inserted in order to cover a situation where, although the actual purpose of the company in giving financial assistance might not have been established, the conduct of the company nevertheless stood in such a close relationship to the purchase of its shares that substantially, if not precisely, it conduct was similar to that of a company which was giving the forbidden assistance with the purpose described in the section.[87]

In the words of Miller JA[88]: '…the alternative was inserted merely to close possible loopholes; it was not intended by such insertion create a different type of offence, or a lesser offence, or to prohibit conduct which was not substantially similar to the conduct prohibited by the main provision characterized by the words 'for the purpose of'.' Obviously, it is not possible to define the exact extent of the enlargement of the scope of the prohibition by the addition of the words in question; the facts of each case will determine whether the established connection with the purchase of shares constitutes conduct which the Legislature was concerned to prohibit.

3.6. Consequences of a contravention of the prohibition

Both civil and criminal consequences flow from a contravention of the prohibition in section 38. As criminal proceedings rarely follow, it is necessary to consider the serious civil consequences attached to a transaction illegally proceeding financial assistance. In **Geyer v Geyer's Transport Services**[89], the court held that such a transaction is void in its entirety, meaning that any accessory obligation relating to the transaction, such as the provision of security, which is not severable from that transaction, will also be void.[90]

[87] Blackman (2005:4-64)
[88] At 804-805
[89] 1973 (1) SA 105 (T)
[90] Fidelity Bank Ltd v Three Women (Pty) Ltd (1996) 4 All SA 368 (W)

Moreover, the directors of the company providing financial assistance could be held liable for damages to that company for breach of their fiduciary duties towards it by entering into an illegal contract on its behalf.[91] In addition, the company or its liquidator could also have a remedy both against the person to whom financial assistance had been wrongfully given and against the original lender (whose loan had been repaid by means of assistance given) if those persons acted with knowledge of the facts.

3.7. Severability of transactions

A very important consideration in determining the validity of a transaction under scrutiny for contravention of the prohibition against financial assistance is whether the valid and invalid components of the transaction are severable, that is to say, whether the transactions have separate existence each independent of the other.[92] Where the transactions are severable, only that transaction which offends against the prohibition will be void. If the principle obligation is void, the accessory obligation will also be void.[93] This test for severability was laid down in **Cameron v Bray Gibb & Co (Pty) Ltd**.[94]

[91] Steen v Law (1964) AC 287 (PC); Jacobson v Liquidator M Bulkin & Co Ltd 1976 (3) SA 781 (T)
[92] Fidelity Bank Ltd v Three Women (Pty) Ltd (1996) 4 All SA 368 (W)

[93] If the sale of shares is void because financial assistance is provided, any security for the performance of obligations under that sale will also be void.
[94] 1966 (3) SA 675 (R)

Chapter 4:
Companies Act Amendment- Share repurchases

4.1. Introduction

Prior to the insertion of the present ss 85-88 by ss 9-12 of act 37 of 1999, a company could not purchase its own shares, even though expressly empowered to do so by its memorandum or articles of association.[95] In **Re Castiglione's Will Trust**[96] it was held that, although a company could not purchase its own shares or be a member of itself, there was no reason why shares acquired otherwise than by purchase (e.g. under a will) could not be held by a trustee for the benefit of the company. That was established in 1887 by the House of Lords in **Trevor v Whitworth**.[97] Commonwealth jurisdictions followed this rule; and until the coming into for force of ss 85-88, this prohibition

[95] Wolfe v Liquidators Smyth and Crawford 1914 CPD 187
[96] (1958) 1 All ER 480
[97] (1887) 12 App Cas 409 (HL)

constituted a fundamental rule of our company law. The illegality and voidness of such a purchase was held to follow from the Companies Act itself.[98]

The prohibition had a twofold purpose. First, and this was its primary purpose, it protected the company's creditors by preventing what would have amounted to an unlawful reduction of the capital of a limited company's capital: 'the stringent precautions to prevent the reduction of the capital of a limited company, without due notice and judicial sanction, would idle if the company might purchase its own shares wholesale, and so effect the desired result'. Secondly, it protected the company's shareholders by preventing the company from trafficking in its won shares.[99]

The rule against purchases of its own shares by a company was however rejected in most jurisdictions in the United States of America. And influenced by practice in the United Sates, Canadian legislation relaxed the rule in the 1970s. In the United Kingdom, in 1962, the Jenkins Committee found no appreciable support for modification of the rule. But in 1981 the rule was effectively abolished. Australia and New Zealand followed suit. In 1989, our Standing Advisory Committee on Company Law, in a press release, indicated that it was considering the introduction of a rule permitting a company to purchase its won shares. And in 1999 the present ss 85-88 were enacted which empower a company to acquire its own shares and regulate such acquisitions. In addition, s89 permits, subject to certain restrictions, a subsidiary to purchase the shares of its holding company.[100]

The new statutory provisions in South Africa finally relinquish, though not completely, the notion that the share capital of the company is a guarantee fund or a permanent fund intended for the payment of the claims of creditor of the company.[101] Instead, the amendment substitutes the more modern tests of 'liquidity' and 'solvency' as safeguard for creditors.[102]

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[98] Unisec Group Ltd v Sage Holdings Ltd 1986 (3) SA 259 (T) 264

[99] Sage Holdings Ltd v Unisec Group Ltd 1982 (1) SA 337 (W) 348-349

[100] Blackman et al (2005:5-42)

[101] Annual Survey of the Law of South Africa *Vol. 4 Part 1*- Companies Share repurchases (2001) Butterworths: Durban 402

[102] Harvey E. Wainer

4.2. Nature of repurchases

A repurchase or buy back, is a transaction entered into between a company and one or more of its shareholders in terms of which it is agreed that the company will take back their shares in return for an agreed consideration, to be paid by the company to the shareholders concerned.

Of course, strictly speaking, McCabe[103] holds, the company does not purchase of buy its shares. A company cannot acquire rights in itself. Its acquisition of the shares puts an end to those rights.[104] Although the transaction is not gratuitous from the point of view of the company (rights against the company are extinguished), the company does not purchase anything. Therefore, strictly speaking, the contract of purchase and sale.

Essentially a repurchase is a distribution of assets coupled with reorganization, in the form of a reduction, of the company's share capital, accomplished by means of a transfer of shares. But, although a distribution, repurchase is not a device for putting income pro rata into the hands of shareholders on a continuing basis. Consequently, unlike dividends, it does not convey signals with respect to future earnings. Unless coupled with refinancing, its effect is to contract the size of the company. In these sense it is a form of partial liquidation.

4.3. Repurchase and capital maintenance

Although the introduction of provisions permitting a company to purchase its shares has frequently been coupled with an abolition of the capital maintenance rule, there is no necessary connection between permission to repurchase and the abolition of the capital maintenance rule.

[103] Bernard McCabe 'The Desirability of a Share Buy-Back Power' (1991) 3 Bond LR 115 120-121

[104] A share is a bundle of rights. Where a company buy 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 acquires 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.

This necessary connection was emphasized in **Capitex Bank Ltd v Qorus Holdings**[105] the first case dealing with the statutory provisions relating to share repurchases, where Malan J respectively held that s 85(1) 'effectively repeals one of the three sub rules of the common law rule that a company maintain its capital … viz that a company may not purchase its own shares. This general power given to all companies inconsistent with the unexpressed rule of the common law that a company may not purchase its own shares. While it is true that the capital maintenance principle may still have residual application, the rule against a company purchasing its shares has effectively been done away with'. On this basis the Court held that 'the mere purchase or the mere conclusion of an agreement of purchase and sale or other transaction relating to the "acquisition" by a company in respect of its own shares' was not *prima facie* illegal. Only payment made in contravention of s 85(4) would result in an illegality. [106]

The tendency to identify rules against repurchase with the capital maintenance rule would seem to stem from **Trevor v Whitworth**, where the rules were for the most part treated as indistinguishable, it being held that a company cannot purchase its own shares, because it would inter alia result in a reduction of the company's capital funds. But as Eilis Magner[107] puts it, 'the question of whether companies should be allowed to purchase their own shares and the question whether companies should be allowed to reduce their capital… are distinct and involve different policy considerations.

4.4. Share repurchase

In terms of the new statutory provisions on share buybacks, a company proposing to 'acquire' shares issued must be authorized to do so in its article of association, and the share repurchase must be approved by a special resolution passed by members of the company. Read literally, Blackman states,[108] this provision does not empower a company

[105] 2003 (3) SA 302 (W)
[106]FHI Cassim(1999:774))
[107] Eilis Magner 'The Power of a Company to Purchase its Own Shares: A Comparative Approach. (1984) 2 C & SLJ 79 105
[108] Blackman et al (2005:5-61)

to purchase its own shares- it merely empowers the members to approve acquisition of the company's issued shares. What is meant is that the members can approve the acquisition by the company of shares issued by it.

Further the section requires that the company be 'authorized' by its articles to repurchase shares issued by it. Thus the company's power to repurchase its shares is conferred on it, not in its memorandum, but in its articles. In the absence of such authorization, the company has no such power, and it would seem, a repurchase of its shares will be beyond its powers and hence void. Since the effect of such authorization is to empower the company neither the rule in **Royal British Bank v Turquand**[109] nor the doctrine of estoppel will afford the shareholders who sell any protection where the company is not authorized for the repurchase is not merely beyond the authority of the directors, but is also beyond the powers of the company.

Such approval may either be a general approval which is valid until the next general meeting unless varied or revoked earlier,[110] or it could be s specific approval for a particular acquisition. The shares so acquired must be cancelled and restored to the status of issued shares. The important principle here is that the share capital of the company will be reduced by the shares so acquired.[111]

Prejudice to the creditors in the acquisition of shares is excluded by the very important requirement that a company may only acquire its shares if there is a reasonable belief that:

- The company is, or would after the acquisition, be able to pay its debts as they fall due in the ordinary course of business (**liquidity test**)[112]; or

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[109] (1855) 5 E & B 248

[110] Section 85(2)-(3)

[111] In the case of par value shares, the issued capital will be reduced by the par value of shares if so required and in the case of non-par value shares, a "value" per share must be computed and the stated share capital will be reduced by multiplying the "value" with the number of shares acquired.

[112] As far as the liquidity test is concerned, no limit is placed upon the time in which the company must be able to pay its debts in the ordinary course of business.

- That the consolidated assets of the company would, after the acquisition, exceed its consolidated liabilities (**solvency test/balance sheet**).[113]

Clearly both the liquidity and solvency test must be satisfied. F H I Cassim[114] says that, 'the wording of s85 (4) (a) and (b) suggest very strongly that the company should be liquid and solvent both at the time when the contract was entered into and at the time of payment for the acquisition of its shares', i.e. the twin test laid down in s85 (4) must be applied both at the time of the contract and at the time of the performance of the contract. Blackman[115] argues that however since, the assumption of an obligation to pay is not usually considered to constitute a payment, and since the claims of the shareholders against the company are subordinated to this claims of the company's other creditors[116], it would seem that the tests apply only at the time of the actual payment. It is clear from the wording of the section that the twin tests are both objective, and that both tests must be satisfied for a valid share repurchase

In **Fisheries Development Corporation of SA Ltd v Jorgensen**[117] the court held that the section does not require the directors to prove that the company's assets exceed its liabilities or that it is able to pay its debts as they become due in the ordinary course of business; all they have to prove is that they have 'reasonable grounds' for believing. Consequently, provided that they have consulted the accountant or auditors and other financial expert of the company and that they do not act blindly on the basis of such advice, they would probably be safe in causing the company to effect a share repurchase.

Further in the **Capitex Bank Ltd** case, the court held that in view of s.85 (1) of the Companies Act, an agreement relating to the acquisition by a company of its own shares is no longer, in itself illegal or unlawful but that a payment made in contravention of the liquidity and solvency tests as embodied in s.85 (4) (a)-(b) would result in the illegality of

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113 Pretorius J.T. (1999:125)
114 FHI Cassim 'The new Statutory Provisions on Company Share Repurchases: A Critical Analysis' (1999) 116, SALJ 760 768
115 Blackman et al (2005:5-71)
116 s88(3)
117 1980 (4) SA 156 (W) at 166D

the share repurchase agreement. There are no restrictions on the source of the funds utilized to acquire the company's shares.[118]

4.5. Liability of directors and shareholders

(1) Liability of company

- First the company owes a duty to its shareholders to provide them with sufficient information to enable them to make an informed decision on whether or not to approve (specifically or generally) a repurchase or repurchases.
- Secondly, as to the repurchase it self, the company may incur liability to the vendor-shareholders if the purchase price was too low in the sense that if those shareholders had not been mislead, or had all the information which the company held, they would not have sold at a so low a price, or perhaps, would not have sold at all. Thus the company may incur liability to the vendor shareholders on the ground of either negligent or fraudulent misrepresentation. The vendor-shareholder's remedy will either be rescission of the contract or damages.[119]
- Thirdly, a company is under a duty not to discriminate unfairly between its shareholders. If the special resolution approving or authorizing the repurchase does discriminate, it will constitute a 'fraud on the minority. In **Kahn v United States Sugar Corporation**[120] it was found that, such discrimination is perhaps more likely to occur in the case of selective or targeted offers, e.g. if the repurchase involves either an 'overpayment' or an underpayment.

(2) Liability of directors

2.2 Duty of care owed to company

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[118]FHI Cassim 'The new Statutory Provisions on Company Share Repurchases: A Critical Analysis' (1999) 116, SALJ 760 769

[119] Blackman et al (2005:5-77)

[120] No 7313, Delaware Court of Chancery, 1985 WL 4449

- It is the responsibility of the directors to ensure that a share repurchase does not cause the company to become insolvent or illiquid. Directors may be liable to the company where the company has suffered harm as result of the repurchase and the directors acted in breach of their duty of care and skill. If it does the directors become jointly and severally liable to restore to the company the amount paid by the company and not otherwise recovered by the company, subject to any relief granted by the court in the exercise of its discretion under s.248 to excuse a director who has acted honestly and reasonably and who ought fairly to be excused. The company, however, commits no criminal offence as it does in Singapore. In Namibian and South African law, the directors owe no fiduciary duty to the creditors of the company.[121]

2.2. Fiduciary duty to company and to shareholders

- The Court in **Howard Smith Ltd v Ampol Petroleum Ltd**[122] Directors owe their company a fiduciary duty to act bona fide in the in the interests of the company. Negatively, this means that the directors may not act to promote interests other than those of the company.
- Further in **Hickman v Ahmanson**[123], a case involving greenmail, the court said:'…..So, too, directors will act in breach of this duty if their primary purpose is to benefit a particular shareholder, as when their purpose is to 'bail him out' or to give him a premium over the market price. Positively the directors' duty is to act in the interests of the company is a duty to promote the interest of the company. The interests of the company are the interests of the shareholders as a whole.[124] In **Stein v Blake**[125] Millet LJ held that the general rule is that directors act in breach of duty if they exercise their powers for the primary purpose, not of

[121] FHI Cassim (1999:770)
[122] (1974) AC 821
[123] 214 Cal Rptr 177
[124] Darvall v North Sydney Brick and Tile Co Ltd (1989) 15 ACLR 230 CA (NSW)
[125] (1998) 1 All ER 724 729-730

furthering the company's business, but affecting the rights and powers of shareholders.[126]

2.3 Duty of care owed to shareholders

- If the directors act fraudulently, they will incur liability to all persons upon whom they committed those frauds. But in the absence of fraud or breach of fiduciary duty, it would seem that the only possible action would be one based on a duty of care owed by the directors to non-selling shareholders.
- The directors held liable may obtain a court order to compel a shareholder to return the consideration that she/he received in contravention of s90[127] and s85 (4)[128]. An action against directors must be instituted within three years after date of completion of the acquisition and the directors who are liable would include the directors of a holding company.

4.6. Section 252 and winding up on just and equitable ground

Where the offer to repurchase is unfairly prejudicial, unjust or inequitable to a member or to some part of the members of the company, a member can make an application to court for relief under s252. A member may also bring an application for the winding up of the company on the just and equitable ground for winding-up in s344 (h).

4.7. Procedure of acquisition of certain shares by company

The procedure for share buy-back is of crucial importance in preventing abuse of the repurchase power and discrimination against the minority shareholders. Three types of procedure are provided for:

[126] Hogg v Cramphorn Ltd (1967) Ch 254
[127] Act 28 of 2004
[128] Act 37 of 1999

1. A general offer made to all shareholders or to all the holders of a class of shares, (Self tender offer);
2. An offer made to a certain shareholder or to certain individual shareholders
3. An offer to purchase on the open market, usually on a stock exchange.

It is clearly desirable that a company repurchases its share from all the shareholders on a pro rata basis so that all shareholders are given the right were reasonably practicable to participation on an equal basis. In accordance with this theme, s.87(1) requires in the case of unlisted shares that the company delivers or posts to each registered shareholder a copy of a prescribed offering circular stating the relevant details of the share repurchase. Shareholders could in response to this circular offer to sell shares to the company, and should they offer to dispose of a greater number of shares than that which the company offered to acquire, the company is required to acquire the additional shares on a pro rata basis. Cassim[129] points out that 'while the consequences of non-compliance with the provisions relating to share repurchases are mainly civil, in that directors become personally liable to the company, s287 read with s441 (b) imposes criminal sanctions for failure to comply with the provisions of s.87 (1).

This procedure, does not apply in two cases:

1. **First**, a repurchase by the company of shares listed on the stock exchange, the reason for this exclusion being that the JSE has prescribed its own and more effective safeguards and procedures for share repurchase;
2. **Secondly**, rather strangely, where the company has reacquired its shares in terms of a special resolution passed under s93 (3). In such cases, an offering circular is not appropriate and is dispensed with. If the object of this exemption it to accommodate employee share schemes or share re-purchase in order to settle or compromise a debt owed to the company, or to eliminate fractional shares or to repurchase shares from the estate of a deceased shareholder-as is commonly permitted in other jurisdictions in which our own legislation is based- then a further or second resolution or

[129] FHI Cassim (1999:773)

preferably an ordinary resolution, ought to have been required in terms of s93(3) in these obviously useful instances of share repurchase an ordinary resolution ought to suffice, since the dangers of abuse in these instances are not so pronounced and there is therefore sound reason for the repurchase. Manifestly, in these instances the offering circular to all company shareholders is quite inappropriate.[130]

4.8. Enforceability of contracts for acquisition by company of certain shares

The new s 88 expressly provides that a contract in terms of which a company undertakes to acquire its own shares, will be enforceable against the company except if the liquidity and solvency requirements cannot be satisfied at the time when the payment has to take place. The burden will be on the company to prove that there are reasonable grounds for believing that these requirements will not be met.

The origin of s 8891) is to be found in the decision of the New York Court of Appeals in **Topken, Loring, and Schwartz, Inc v Schwartz.**[131] There it was held that, where the only consideration for the shareholder's promise to sell shares to the corporation is the corporations promise to buy them, then, because 'the corporation could execute the contract by purchasing the stock out of surplus, but could not, without violating the law, purchase its stock when it had no surplus', the contract rested for the consideration on mutual promises, 'one which promises may or may not to perform'. Therefore, 'there is no consideration and the contract cannot be reinforced'.

The decision was criticized[132] and departed from, or at least narrowly construed[133]. Several jurisdiction nevertheless enacted provisions expressly providing that the contract was enforceable by the shareholder and the corporation, i.e. the possibility that the

[130] FHI Cassim 'The new statutory provisions on company share repurchases: A critical analysis' (1999) 116 SALJ 760 at 773-4
[131] 163 NE 735 736 (1928)
[132] Cross v Beguelin 169 NE 378 (1929)
[133] Re Farah 193 NE 2d 641 (1963)

corporation might not be able to perform the contract did not deny either the right to insist on specific performance if, at the time of performance, the corporation was legally able to perform.[134]

Magner[135] pints out that, since the subsection expressly provides that the contract 'is enforceable against the company', it could be argued that the maxim *expresso unius exclusion altertius* applies, and there the contract is not enforceable by the company.

The other contracting party (the shareholder or former shareholder) will remain entitled to payment until the company is lawfully able to make payment. If the company is wound up before the shares have been paid for, the shareholder or former shareholder has a preferent right to payment for the acquired shares in priority to the shareholders of the same class who have not sold their shares to the company. The claim for payment will, however, rank after the claims of creditors and of shareholders of classes of shares which enjoy preference above the class of the acquired class.[136]

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[134] Blackman (2005:5-95)

[135] Ellis Magner 'The Power of a Company to Purchase Its Own Share: A Comparative Approach; (1984) 2 C & SLJ 79 108

[136] Acquisition by a company of its own shares 8-9 Mercantile Law Journal. (2000) 12 SA Recent developments in Corporate law: Part 1

Chapter 5
Doubts and defects

The amendments to the Companies Act 1973 by the Companies Amendment Act of 1999[137], reflected a fundamental shift in philosophy, but new legislation leaves a host of question marks and apparent lacunae.[138] The promulgation of the new ss89-96[139] indicate the apparent death of the capital-maintenance concept as principle underlying company law in both South Africa and Namibia, and a shift to factual and commercial solvency measures as the protection for investors and creditors.

Despite the apparent abandonment of the capital maintenance concept, there are several relics of its existence still lurking in the Companies Act. Moreover, amendments promulgated simultaneously with the introduction of the new ss 89-96 appear curiously to reinforce certain elements of the capital maintenance philosophy. On the basis that

[137] Namibian Companies Act of 2004
[138] Harvey E.W. The South African Law Journal: *The Companies Act changes- problems and doubts*. At 137
[139] Act 28 of 2004 and 85-90 of Act 37 of 1999

investor and creditor protection is covered by solvency measures, the preclusion of financial assistance, which remains extant in s38, appears unnecessary. Having regard to the harsh consequences of a breach of s38 and the commercial realities, the continued existence of this section of the Act undermines the new philosophy and is restrictive of the encouragement of commercial activity.[140]

Further, Although the Companies Act now provides that a company may, if authorized in the articles, approve the acquisition of its issued shares by special resolution, s.38 was only amended to the extent that the provision of financial assistance by the company for the acquisition of share in the company or its subsidiaries in terms of s.85 would be exempted from the prohibition against the giving of financial assistance.[141] The amendment does not provide for an exemption to provide financial assistance to third parties where there is reasonable belief that the company will remain solvent and liquid notwithstanding the financial assistance. As a result the ambit of s.38 has remained substantially the same and a company is still prohibited from giving, 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 outside person of or for any shares in the company. This was clearly an oversight on the part of the legislature.

Likewise the restriction contained in ss 76 and 77 regarding the uses of share premium and stated capital, as well as the provisions of s98 regulating the manner of redemption of preference share which still require a transfer to a capital redemption reserve fund in respect of preference shares redeemed, are anachronistic in the context of the abandonment of the capital-maintenance concept.

Another disappointing omission in the new statutory provision relating to share repurchases is that there is no provision that companies repurchasing their own shares or intending to do so, does not acquire the status of an 'insider' and must therefore refrain

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[140] Beuthin R.C. South African Law Journals *(The new statutory provisions on company share repurchases:a critical analysis)* (1999) Juta & Co. Ltd: Kenwyn
[141] S.38(2)(d)

from repurchasing their shares from shareholders as a time when they are in possesion of confidential price-sensitive information relating to the affairs of the company. The Insider Trading Act applies only to natural persons, although an "individual" that encourages a company to deal, or discourages it from dealing, on the basis of material non-public information would, according to s2 (1)(b) of the Insider Trading Act, commit a criminal offence. Thus a director of a company who causes the company to deal in it securities would commit a criminal offence, but the company itself cannot be convicted of the offence.

In sharp contrast, in New Zealand, Australia and Canada, a company is treated as an "insider" of itself when it repurchases its own shares. The New Zealand Commission Report 10(10) went so far as to describe the company the repurchasing its own shares as an "ultimate insider". The policy ought to have been that companies ought not to be permitted to repurchase their own shares until such a time as any material non-public information that they may have relating to their own securities has been made public. The Insider Trading Act must be amended urgently to take into account the new statutory power of a company to repurchase its own shares so that all companies exercising this power are treated as insiders for the purpose of the Insider Trading Act.[142]

The provisions of the Companies Act relating to share repurchases are in some important respects defective and lacking in technical quality. Although we still have much work to do in developing our law relating to share repurchases, we have nevertheless made considerable progress in partially abandoning the outdated concept of capital maintenance.

The new Companies Act will benefit Namibia and its people and will be more competitive in the international market with such new incentives available, because our law is now in more or less harmony with the law in other common law jurisdictions,. It is however, imperative for the success of this new Act that the judicial environment of Namibia is in a position to implement, apply and enforce the new stipulations, and

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[142]Annual Survey of South African Law *(Share repurchases)* (2001: 406-407)

especially the penalties, for non-compliance as well the judicial interpretation and clarity on some of the ambiguous and uncertain provisions of the Companies Act.

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