Short notes on:

SHARE BUY-BACKS AND WAIVER

Introduction

Investing in a private company is a personal decision contingent on sometimes, many personal factors. That being on the one side and on the other, the Company's right to buy back shares. Companies are in terms of the Companies Act 71 of 2008, as amended (hereinafter referred to as "the Act") – allowed to buy-back its shares from their own shareholders. The effect of a share buy-back is that the shares bought back are cancelled and do not form part of the issued shares of an entity. In turn, it could then lead to an increase in the value of one or more of the shareholders' shares of the company. This could have an effect on mandatory offer rules. If so, how should this be handled?

Background

In *Trevor v Whitworth*[1] (hereinafter referred to as "the Trevor case") the approach followed by our courts was outlined and which has since been strengthened by now promulgated statutory provisions. The point of departure as highlighted in the Trevor case, is that the contributed capital of a company constitutes the fund to which creditors of the company must look for the satisfaction of their claims, and this fund should be maintained. According to Akinyi Were,[2] the capital maintenance doctrine did not develop as an independent rule, but rather as an extension of the *ultra vires* rule.[3] This means that the evolution of the now Section 48 empowers the company not through its memorandum of incorporation but by operation of law to acquire its own shares, subject to the provisions of Section 46.

What is more, it cannot be assumed all repurchases of company shares have a sinister reason behind them. However, if the price of the shares is too low, the remaining shareholders will benefit at the expense of the selling shareholder. On the other hand, if the price is too high, the remaining shareholders will be disadvantaged in that their shareholding will be diluted.

[1] (1887) LR 12 App Case 409 (HL)
[2] November 2011: SECTION 48 OF THE COMPANIES ACT 71 OF 2008 – Nerima Akinyi Were
[3] Cilliers et al 322

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Mandatory Offers

As such, a shift in control in share repurchase is very real and it is necessary to guard against. There are two possibilities whereby persons in an acquisition in terms of Section 48 are obliged to either make a mandatory offer or a comparable offer. With regard to mandatory offers, any persons are able to exercise more than 35% of all the voting rights. The mandatory offer and share buy-back is dealt with under Sections 48 and 123(2) of the Act. According to Mashabane:
"*the Section applies to a regulated company that either re-acquires its own voting securities in terms of s 48 or where a person, either acting alone or in concert, who has acquired a beneficial interest in voting securities of a regulated company, and able to exercise less than 35% of all the voting securities and acquires further voting securities, and as a result thereof is able to exercise control of 35% or more of the voting securities of the company.*"[4]

Thus, a person that has acquired 35% or more of a company's securities that they did not own before, will be required to make a mandatory offer. The same applies to a situation where a company undertakes a share buy-back and as a result thereof, a shareholder ends up with 35% or more of the company's shares, either acting alone or in concert, such a shareholder will also be required to extend an offer.

Waivers

Regulation 86(4) of the Regulations to the Act provides that:
'***<u>A transaction is exempt from the obligation to make a mandatory offer following publication by a regulated company of a transaction requiring the issue of securities as consideration for an acquisition, a cash subscription or a rights offer</u>***, *if the independent holders of more than 50% of the general voting rights of all issued securities of the regulated company have agreed to waive the benefit of such a mandatory offer.'*

The purpose of the provision is to provide for a resolution to be passed and for the panel to grant a waiver from the obligation to extend an offer once support is obtained from 50% of the independent shareholders.
This is however, strictly limited to only those three circumstances highlighted above.

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[4] Accessed on 17 Sep 2018: http://www.derebus.org.za/share-buy-backs-and-waiver-of-mandatory-offers-in-terms-of-the-companies-act/

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According to Mashabane, "*Section 119(6) of the Act could provide some relief in that it provides the TRP with powers to wholly or partially, exempt parties to an affected transaction (as defined under s 117(1)) from the application of any provision on takeovers and mergers if it can be shown that it will not be prejudicial to the shareholders, it is less costly or that it is both reasonable and justifiable to do so.*"

The main rationale for a company in embarking on a share buy-back is mainly to protect the value of its shares. Iif same are under-valued while, providing an opportunity for the company to distribute its excess cash to its shareholders.

Conclusion

The main rationale of a mandatory offer is to ensure that shareholders are able to exercise 'freedom of association' by exiting a company that has a new controlling shareholder and to also benefit from the control premium paid by the new controller.

A mandatory offer is however required if the company's shareholder(s) crosses the 35% threshold, even if this is through a company buying back its own shares with very limited possibilities of the offer being waived.

It is therefore important for role-players to observe these requirements or to contact an expert at SchoemanLaw for expert advice and assistance so that transactions are structured correctly from the outset.

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