

Bill empowers poorer partners

THE Corporate Laws Amendment Bill will revolutionise the way that corporate lawyers, investment bankers and many others structure Black Economic Empowerment (BEE) transactions, and is likely to usher in a new era of empowerment funding structures.

This is because the bill, when passed into law, will amend section 38 of the Companies Act 61 of 1973.

Section 38 presently prohibits a company from giving financial assistance for the purchase of its own shares or the shares in its holding company, except and only as provided in limited circumstances. The consequences of non-compliance are harsh. A transaction entered into in contravention of the provision is considered void and in addition each of the directors of the company that gives the financial assistance will be guilty of a criminal offence.

The main challenge in most BEE transactions is that the majority of empowerment partners have no or limited access to funding. Therefore it is typical of most BEE transactions that empowerment partners source

funding from external financiers. This invariably increases the costs of BEE transactions for vendors and empowerment partners alike. The amendment to section 38 is likely to alleviate some of these difficulties.

The explanatory memorandum to the bill says that the amendment to section 38 is meant to facilitate shareholder diversification and broad-based BEE.

The amendments achieve this by introducing much needed flexibility to enable a company to provide financial assistance for the purchase of its own shares where certain conditions are met.

The bill has introduced section 38(2A) which must be read together with the provisions of section 38(1). In terms of section 38(2A), a company will be permitted to give financial assistance for the purchase of its own shares if the company's directors are satisfied that:

- Subsequent to the transaction, the consolidated assets of the company fairly valued will be more than its consolidated liabilities; and
- Subsequent to providing the assistance, and for the duration of the

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transaction, the company will be able to pay its debts as they become due in the ordinary course of business; and

- The terms upon which the assistance is to be given is sanctioned by a special resolution of the shareholders of the company.

In making their determination on the solvency and liquidity of the company, its directors must account for any contingent liabilities that may arise, including any contingent liability which may result from the provision of the financial assistance.

The solvency and liquidity conditions introduced here are not new to the Companies Act and are similar to those in section 85, which allow a company to buy back its shares where there are reasonable grounds for believing that the organisation is, and after the transaction, would be in a position to pay its debts as they fall due in the ordinary course of business.

Section 38 of the Companies Act, being a sub-set of the capital maintenance rule, had as its initial purpose the protection of shareholders' and creditors' value in the company.

But more recently, the function of the capital maintenance rule has found fewer supporters with many commentators, international and local, recognising no need to prevent a company from financing the acquisition of its own shares where it is shown to be solvent and liquid.

Once the bill comes into force, section 38 of the Companies Act will be in line with corporate law reform policies implemented in other international jurisdictions. For example, the Australian Companies Act permits a company to give financial assistance where the transaction does not prejudice that company's or its shareholders interests or its ability to pay its creditors. This also applies where a shareholders' resolution approves giving financial assistance.

The amendment to section 38 is likely to result in the reduction of the costs of concluding BEE transactions, mainly because empowerment partners would no longer be solely dependent on third party or external financing.

Lena Chirwa

Edward Nathan Sonnenbergs