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Cancellations and postponements of dividends

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The COVID-19 outbreak, the subsequent lockdown and other resultant measures taken by the government to curb the spread of the virus has caused substantial unforeseen disruptions to businesses and their cash flows.

Many companies, especially companies listed on the Johannesburg Stock Exchange ("**JSE**"), have been cancelling or postponing the payment of dividends that have already been declared in order to preserve cash resources and viability of businesses or even just as a precautionary measure to ensure financial flexibility or bolster liquidity during these uncertain times.

Although the reason behind the cancellations or postponements of dividends are understandable in the face of the pandemic, companies must ensure that any actions taken are at all times lawful in order not to expose themselves to possible legal claims by shareholders, other investors or, if listed, even punitive measures by the JSE.

Guidance issued by the JSE

The JSE issued a letter on 30 March 2020 dealing with the cancellation and variation of dividends by issuers.

With respect to the cancellation of dividends, the guidance stipulates that

- an issuer can only cancel a dividend and the resultant payment before the finalisation date ("**FD**"). When an issuer declares a dividend, it must make a declaration announcement which specifies certain required information and incorporates the JSE's corporate action timetable. In terms of that timetable, the FD in respect of a dividend falls eight days before the record date ("**RD**"), being the date on which a shareholder must be in the register of the issuer to be paid the dividend in question. The RD, in turn, falls on the day prior to the date of payment of the dividend. Since the JSE settles on a T+3 basis, the last day to trade ("**LDT**") for the purchaser to be reflected as a shareholder on the RD (and to participate in the dividend) precedes the RD by three days. For convenience, the JSE corporate action timetable is set out in tabular format at the foot of this article;
- only the Listings Department of the JSE may sanction the cancellation of a dividend after the FD, and then only if such cancellation precedes the LDT.

With respect to other variations made to the pertinent details of a dividend (i.e. excluding the cancellation of a dividend), these must be made before the LDT and will result in a cancellation of the corporate action timetable stipulated in the initial declaration announcement. The issuer will be compelled to start afresh with a new timetable. As a result of the fact that shareholders and other investors rely on, and make important investment decisions based on, the information contained in declaration announcements, the JSE requires appropriate announcements to accompany cancellations and variations of dividends.

Continued compliance with the Companies Act 71 of 2008 ("the Act")

Whether listed or not, all companies must comply with the Act when deciding to cancel or postpone the payment of dividends already declared. The JSE has gone so far as to alert issuers to the fact that they must comply with Act in addition to the JSE's requirements.

The provisions of the Act are dealt with below.

There is no obligation on a company to declare dividends to its shareholders. However, once the board has declared a dividend the company may have little choice but to proceed to pay that dividend. In order to declare a dividend, the board of the company must resolve, in terms of section 46(1)(c) of the Act, that the company has applied the solvency and liquidity test and has reasonably concluded that it will satisfy the solvency and liquidity test immediately after paying the dividend.

The Act goes on to state, in Section 46(2), that a dividend must be fully carried out once the board of a company has adopted a resolution contemplated in section 46(1)(c), subject only to section 46(3) of the Act. This provision is peremptory in nature and therefore, on the face of things after a dividend has been declared, a company must fully carry out the dividend (i.e. pay the dividend). There is, however, a caveat which is contained in section 46(3) of the Act.

Section 46(3) of the Act deals with the reassessment of the solvency and liquidity test and the adoption of a further resolution after a period of 120 days. In short, if a declared dividend has not been paid within 120 business days after passing a resolution to declare such a dividend, the board cannot pay the dividend until such time that the solvency and liquidity test has been reapplied (i.e. the test **must** be applied again and a fresh board resolution adopted). If, after the reapplication of the solvency and liquidity test, the board cannot reasonably conclude that the issuer will satisfy the solvency and liquidity test after payment of the declared dividend, then the company would be prohibited from paying that dividend. In this regard section 46(1)(b) of the Act is clear, a company is prohibited from paying a dividend if it would not be solvent and liquid thereafter.

The Act does leave open the following issue: What is the position that prevails in the 120 day period before the solvency and liquidity test must be reapplied (i.e. what happens if the financial position of a company changes after the declaration of a dividend but prior to the payment thereof and the 120 days have not yet passed). We submit that there is nothing in the Act that precludes a company from conducting a further solvency and liquidity test before the 120 day period has lapsed if there is any doubt as to whether the solvency and liquidity test will be satisfied pursuant to change in, or unforeseen, circumstances. Again, this is due to the requirement in section 46(1)(b) of the Act that a company is prohibited from paying a dividend where the company would not be able to satisfy the solvency and liquidity test immediately after the payment of such dividend. If the board cannot, after the reassessment of the solvency and liquidity test, reasonably conclude that the company will satisfy the solvency and liquidity test after payment of the declared dividend due to these unforeseen circumstances arising between the time of the resolution and the date the dividend becomes due and payable, it can be argued that the board, in exercising its fiduciary duty, is required to reapply the solvency and liquidity test at that juncture. If the test is not satisfied the board, self-evidently, should not proceed to pay the dividend.

There is a further reason for adopting the position stated above. Irrespective of whether the provisions of section 46 have been complied with, the actions of the board of directors are always subject to the fiduciary duties of directors.[1] Therefore, if there is information that has come to the attention of a board, arguably such as the financial implications accompanying the COVID-19 outbreak and the measures taken as a result thereof, the board has a duty to act in good faith, in the best interests of the company for a proper purpose (section 76 of the Act). Therefore, cancelling or postponing the payment of a dividend pursuant to the reassessment of the solvency and liquidity test which has resulted in the inability of the company to satisfy the same, would arguably be in the best interests of the company. It is conceded that a tension exists between the wording of section 46(2) of the Act and the practical position put forward, however, not following such logic may have a detrimental effect on the long term sustainability of a business. This would not be in the best interests of the company nor its shareholders, nor give effect to the very purpose of the solvency and liquidity test.

Deciding whether to cancel or postpone a dividend must be dealt with on a case-by-case basis. If the company clearly will not satisfy the solvency and liquidity test after the payment of the declared dividend, it should be cancelled or postponed (as the case may permit). It is submitted that a company may not simply decide to cancel or postpone dividends to preserve cash, it must be based on the fact that the company has failed to comply with the solvency and liquidity requirements to make such distribution. Accordingly, if it appears, after the reapplication of the solvency and liquidity test, that the company will still satisfy the solvency and liquidity test, there would be no legal basis under the Act for the reversal of the declared dividend and same must be paid.

Conclusion

The cancellation and postponements of dividends, as mentioned above, should be dealt with on a case by case basis. If a company is still able to pay a dividend that has been declared without facing any risk of foreseeable future depletion of its

financial resources that would result in its inability to meet the solvency and liquidity test after the payment of the dividend within the following 12 month period after such distribution, there is nothing in the Act which would relieve the company from complying with its obligation to pay such dividend. However, if the company would no longer satisfy the solvency and liquidity test after the dividend is paid, we submit the company may seek to postpone/cancel such dividend based on the reasons stated above.

Day	Event
D – 13 Declaration date	Publication of declaration date
D – 8 Finalisation date	Publication of finalisation information
D – 3 Last day to trade	Last day to trade
D – 2 List date	Securities start trading ex dividend /interest
"Friday" D + 0 Record date	Record date to determine who receives the dividend/interest
D + 1 Pay date	Electronic transfer of funds or cheques posted / CSDPs and brokers credited

[1] Delport; *Henochsberg on the Companies Act 71 of 2008* (2011) Butterworths, 198(2)



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