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A Comparative Study of the Financial Assistance for the Subscription of Shares in terms of the 1973 and 2008 Companies Acts

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by

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CHAPTER 1

Introduction

The movement from the Companies Act 61 of 1973 (hereafter referred to as the 1973 Act) to the "new and improved" Companies Act 71 of 2008 (hereafter referred to as the 2008 Act) had loads of implications, considering that the 2008 Act had inputs from various institutions.

According to the Director-General of the time, of the Department of Trade and Industry (hereafter the DTI), Tshediso John Matona[1], the change in the company laws including the fact that the 2008 Act and its Regulations is now sovereign, "is the most fundamental reform of company law for over 30 (thirty) years"[2]. The 2008 Act was fashioned with the 2004 DTI Corporate Reform Policy as basis.

The question writer poses in this dissertation is whether the Companies Act 71 of 2008's financial assistance sections really is an "improvement" or a better form of the financial assistance provision in the 1973 Act.

According to Henochsberg on the Companies Act, 71 of 2008, sections 44 to 48 of the said 2008 Act may now be called the "corporate capital" regulations and is the conclusion of the movement from the "capital maintenance" rules[3].

What should be noted in this dissertation is that due to the fact that the 2008 Act only commenced on the 11th of May 2011, the most of the references to case law is before the commencement of the 2008 Act, and in so far as it also finds application to the said Act. Newer cases will be brought in when they are reported.

As concluded by Yeats and Jooste[4], the 2008 section 44 "represents a distinct change in the legislative approach regarding financial assistance and can now more

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[1] Director-General of the Department of Trade and Industry from 2006 – 2011 ("Public Sector Manager – Directory of Public Service Managers" http://www.gcis.gov.za/sms/public-enterprises.html as viewed on the 26th of October 2014).
[2] Grant Thornton Attorney's "Guide to the Companies Act" http://www.gt.co.za/publications/companies-act/2011/05/guide-to-the-companies-act/ (26th of October 2014).
[3] Henochsberg on the Companies Act, 71 of 2008, Volume 1 Issue 2, p 184.
[4] Yeats J and Jooste R "Financial Assistance – A New Approach" *South African Law Journal* (2009) 566, p 566.

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correctly be described as the regulation (rather than prohibition) of financial assistance by a company for the subscription or purchase of its securities"[5].

[5] Yeats J and Jooste R "Financial Assistance – A New Approach" *South African Law Journal* (2009) Vol 126 [3] 566, p 589.

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CHAPTER 2

Terminology

For this dissertation, it would logically make sense to start with a few basic concept definitions that will find application in the subsequent chapters, and will assist in the reading of this research:

2.1. 'Financial Assistance':

Is not defined in a section of the 2008 Act, nor is the full concept defined in the Oxford Dictionary. Splitting the two words and defining each could assist as follows: the word 'financial' is defined in the Oxford Dictionary as "connected with money and finance or in relation thereto" and 'assistance' is defined as "the action of helping someone" or "the provision of money, resources or information to help someone".

Courts have been faced with the question of whether 'financial assistance' was indeed granted or not, and have multiple tests that they use in this instance, also as indication of what would entail 'financial assistance' in the Court's view, as will be discussed in the subsequent chapters.

2.2. 'Related or inter-related':

This is not defined in the 2008 Act with reference to companies, but with regards to individuals:

- "Related" in terms of section 1 of the 2008 Act is defined with reference to persons and "means persons who are connected to one another in any manner contemplated in section 2(1)(a) to (c)."
- "Inter-related" in terms of section 1 of the 2008 Act is used in respect to three (3) or more persons and defined as meaning "persons who are related to one another in a linked series of relationships, such that two of the persons are related in a manner contemplated in section 2(1), and one of them is related to the third in any such manner, and so forth in an unbroken series".

This is however applicable *mutatis mutandis* to a company or group of companies.

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Section 2(1) of the 2008 Act (Related and inter-related persons, and control) further stipulates that for "all purposes of this Act-

(a) an individual is related to another individual if they-
    (i) are married, or live together in a relationship similar to marriage; or
    (ii) are separated by no more than two degrees of natural or adopted consanguinity or affinity;
(b) an individual is related to a juristic person if the individual directly or indirectly controls the juristic person, as determined in accordance with subsection (2); and
(c) a juristic person is related to another juristic person if-
    (i) either of them directly or indirectly controls the other, or the business of the other, as determined in accordance with subsection (2);
    (ii) either is a subsidiary of the other; or
    (iii) a person directly or indirectly controls each of them, or the business of each of them, as determined in accordance with subsection (2)."

2.3. 'Solvency and Liquidity test':

This test is set out in section 4(1) of the 2008 Act, and purports that for the function of this Act.

Section 4(1) of the act therefore states:

"4(1) For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all the reasonably foreseeable financial circumstances of the company at that time –

(a) the assets of the company or, if the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, the aggregate liabilities of the company, as fairly valued; and
(b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of –
    (i) 12 months after the date on which the test is considered; or
    (ii) In the case of a distribution contemplated in paragraph (a) of the definition of 'distribution' in section 1, 12 months following that distribution."

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Writer agrees with Van der Linde[6] that there are two elements present in this section, although personally added a third element worth being specifically noted, namely element (c) below:

a. The solvency element in that the assets are more than the liabilities;
b. The liquidity element whereby a company will be able to pay its debts and remain liquid;
c. A specific time frame of twelve (12) months or a year after the test was considered.

This is a new regime which will not "qualify as a capital maintenance regime" but rather a completely different management or regime[7]. The first move towards this regime started with the Companies Amendment Act 37 of 1999. In *Capitec Bank Ltd v Qorus Holdings Ltd*[8] the court found that the amendments dramatically changed the rule of 'capital maintenance' and *inter alia* the supposed protection it afforded to said creditors of the company[9].

The legislator further introduced the solvency and liquidity requirement with regards to 'financial assistance' as will be discussed in Chapter 3, specifically with reference to Sub-chapter 3.3, the chapter on section 38(2A).

2.4. 'Securities':

In terms of section 1 of the 2008 Act, 'securities' used to have the meaning as set out in section 1 of the Securities Services Act[10], but was amended in terms of section 1 of the Companies Amendment Act[11] and provides that 'securities' "means any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company".

[6] Van der Linde K "The Solvency and Liquidity approach in the Companies Act 2008" *TSAR (*2009) 224.
[7] .Fn 6, p 225.
[8] 2003 (3) SA 302 (W).
[9] *Capitec Bank Ltd v Qorus Holdings Ltd*, Fn 8, at p 306.
[10] Act 36 of 2004.
[11] Act 3 of 2011.

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2.5. 'Prescribed officer':

In terms of section 1 of the 2008 Act, a 'prescribed officer' can be defined as meaning a "person who, within a company, performs any function that has been designated by the Minister in terms of section 66(10)".

The importance for writer to briefly expand on the definition and the reason for placing it in this research is because of the directors' liabilities in terms of section 77(3) of the 2008 Act, which can arise when section 44 is contravened. In section 77, the word "director" specifically includes a prescribed officer[12].

Further to the definition, the Companies Regulations of 2011, Regulation 38 defines a 'prescribed officer' as follows:

> "Despite not being a director of a particular company, a person is a 'prescribed officer' of the company for all purposes of the Act if that person –
>
> - exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or
> - regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company."

Kleitman[13] wrote an article[14] on the 'prescribed officer' and intoned that a wide selection of people could possibly be deemed 'prescribed officers', and that said 'prescribed officer' definition is very similar to the 1973 Act's 'manager'. Kleitman then further just states that reasonably all the stringent duties and liabilities placed on such a person would indicate that it would have to be "significantly influential or powerful" people who could be deemed as such.

[12] Section 77(1)(a) of the Companies Act 71 of 2008.

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CHAPTER 3

Section 38 of the Companies Act 61 of 1973: No financial assistance to purchase shares of company or holding company

3.1. General

Section 38 of the 1973 Act starts out as a prohibition, whereas section 44 of the 2008 Act, as discussed in Chapter 4, is an open indication of where the financial assistance will be admissible.

The background to section 38 is that it was implemented statutorily as an extension of the common law rule that companies were not allowed to buy back their own shares. The financial assistance granted for the purchase of or the subscription of shares was seen as a method of indirectly acquiring its own shares.

The ideology behind this provision was also to extend to such an extent as to ascertain that a person with insufficient funds could not gain control of a company[15].

Section 38 was enacted after issues of protection of minority shareholders and creditors arose in the English case *Trevor v Whitworth*[16]. The rule was developed after the said case that companies were not allowed to squander company funds subscribed for shares, and encapsulated this in the Section 38 prohibition.

The section was then amended in terms of the Companies Amendment Act 37 of 1999. The last mentioned Act allowed for financial assistance in a handful of circumstances. This was however not a significant amendment to the Act, but rather a further exception that was added to the prohibition of financial assistance, in effect allowing buy-backs of shares within a group of companies[17].

---

[13] Yaniv Kleitman, a senior associate at the Corporate and Commercial Department, Cliffe Dekker Hofmeyer at the time of publication.
[14] Kleitman Y "Prescribed officers" *Without Prejudice* (November 2011) [Vol 11] 18.
[15] Cilliers, Benade, Henning, Du Plessis, Delport, De Koker, Pretorius *Cilliers & Benade Corporate Law* (2000) Third Edition LexisNexis Butterworths at p 328.
[16] *Trevor v Whitworth* (1887) 12 App Cas 409 (HL) 416.
[17] Yeats JL and Jooste R "Financial Assistance – A New Approach" *SALJ* (2009) 566 at p 568.

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3.2. Section 38(1)

Subsection (1) of section 38 reads as follows:

> "No company shall give, 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 person of or for any shares of the company, or where the company is a subsidiary company, of its holding company."

It is therefore clear that the 1973 Act did not intend for financial assistance to be available for the purpose of acquiring shares. Under the 'English' rule[18] a company was not allowed to purchase its own shares, the so-called share buy-backs. This was where Companies therefore indirectly acquired shares and subsequently contravened the 'capital maintenance rule'.

The capital maintenance rule was described by FHI and R Cassim[19] as the share capital issued by a company that is seen as a permanent or guarantee fund only intended for the use of payment of creditor claims, therefore resulting in the non-reduction of the share capital of said company. It may also not be returned to shareholders except where the Common Law or Companies Act authorised it. The 'capital maintenance rule' can best be described by the basic accounting equation: assets = equity + liabilities[20]. Where a company bought back the share capital (equity), they used their cash (an asset), which means that less capital is available to pay the creditors (a liability). Section 38 therefore is used as an 'abuse of control' measure and is a "statutory extension of the capital maintenance rule[21].

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[18] As discussed in Pretorius JT, Delport PA, Havenga M, Vermaas M *Hahlo's South African Company Law through the cases* (1999) Juta & Co Ltd Sixth Edition.

[19] Cassim FHI & Cassim R "The Capital Maintenance Concept and Share Repurchases in South African Law" http://www.bowman.co.za/News-Blog/Blog/The-Capital-Maintenance-Concept-and-Share-Repurchases-in-South-African-Law-By-F-H-I-Cassim-and-Rehana-Cassim (11 October 2014).

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3.2.1. Cases with reference to section 38(1) and its predecessor

Section 38 follows section 86*bis*(2) of the Companies Act 46 of 1926 (hereafter referred to as the 1926 Act). Cases decided before 1973 were decided in terms of the 1926 Act, however, the provision remained the same.

In *Gradwell (Pty) Ltd v Rostra Printers Printers Ltd*[22] it was decided that the method for giving the financial assistance can hardly determine what the giving of financial assistance would be in terms of section 38(1). The payer (Gradwell) would not have a change in the balance, even though its assets and liabilities will be put in another form.

In the 1976 case *Jacobson v Liquidator of M Bulkin & Co Ltd*[23] it was contended that in a series of court decisions, the deciding factor should be the "impoverishment test". This means that the assistance granted should have put the company at a worse financial position than before the assistance. The legal representative intended for the operation of the prohibition to be dependent upon the financial position of the borrower, which cannot be a fair qualification, and was not accepted by the judge *in casu*.

3.2.2. The *Lipschitz*-case[24] and specific reference to "the purpose of or in connection with"

The words "for the purpose of or in connection with" play a deciding roll in many of the cases with regards to section 38[25] financial assistance, and are of great importance. These words need to be complied with for a certain action to be construed as financial assistance.

[20] Pretorius D, Venter E, Von Well R, Wingard C *GAAP Handbook, Financial Accounting and Reporting Practice* (2010) Lexis Nexis, p 8-9 [if it is outdated, it is writer's handbook from BCom studies, only used in the indication of the accounting principle that has remained unchanged].
[21] Hahlo fn 18, p 125.
[22] 1959 (4) SA 419 (A).
[23] 1976 (3) SA 781 (T).
[24] *Lipschitz v UDC Bank Ltd* 1979 (1) SA 789 (A).
[25] Of the 1973 Act.

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A case with regards to financial assistance therefore is *Lipschitz v UDC Bank Ltd*[26]. The court referred to the interpretation of the section (decided in terms of the 1926 Act, although the same principles apply in terms of the 1973 Act), being the purpose or nexus, as well as the aforementioned "impoverishment test".

The prohibition is laid out in extremely wide terms, and the court specifically accentuated the fact that 'any' financial assistance is prohibited, irrespective of the fact if it was 'directly or indirectly'. It then further needs to be either for the purpose of granting financial assistance, or there should be a link or connection to such a purchase or acquisition of shares.

As mentioned, the interpretation of the section was the question in the *Lipschitz*-case[27], as 'financial assistance' was never specifically defined. The courts therefore formulated tests to assist in the with regards to whether 'financial assistance' have indeed been granted. Judge Miller JA is quoted in the *Lipschitz*-case with reference to the *Gradwell*-case[28]: "...it seems to have been gradually accepted that, in deciding whether financial assistance has been given, the inquiry should be directed towards ascertaining whether the company has been made poorer...", therefore a clear reference to the 'impoverishment test'.

According to Miller JA in *Lipschitz NO v UDC Bank*[29]*,* section 38 is a qualified prohibition with two discernible elements: the granting of financial assistance and the purpose for the granting of said financial assistance. The two elements form one linked prohibition although they are vastly different in concept.

This prohibition will find application on every single company with share capital, albeit private or public companies, and regardless of the ratio of the capital constituted by the share(s) concerned[30]. This prohibition does not discriminate against whom the financial assistance is given, and will find application as long as

---

[26] Fn 24.
[27] Fn 24.
[28] Fn 22.
[29] Fn 24 at p 799.
[30] *Karroo Auctions (Pty) Ltd v Hersman* 1951 (2) SA 33 (E) at p 37.

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the financial assistance is given for the purpose or goal of the purchase or subscription of securities[31].

Miller JA went further and indicated that the impoverishment test could be a helpful guide and can indicate in certain instances that there was financial assistance, but that in other cases the impoverishment test is irrelevant. Therefore the court firstly wants to ascertain whether it is for the purpose of or in connection with.

Furthermore in the *Lipschitz*[32]-case, 'in connection with' was discussed. The court favours the interpretation that shows a close enough link and found that the legislator probably just wanted to cover loopholes, where the financial assistance's purpose was not necessarily established, but still affected the company in the same relationship. If the ordinary meaning were to be given to 'in connection with' it would have been vastly wider than the prohibition already is[33].

3.2.3. Additional case law with regards to section 38

In *Fidelity Bank Ltd v Three Women (Pty) Ltd*[34] the court found that the further liability was an instance where the impoverishment test was not an applicable way of deciding whether there was financial assistance. Cloete J stated that a second acknowledgement of debt had the company contravening section 38, and was quoted as stating that –

> "... where the position is that performance of a contract, or of an inseverable part of a contract, or of a contract which is an inseverable part of a larger transaction (all of which amount to the same thing) would be in contravention of section 38, it is unnecessary for the person resisting performance to prove that the person seeking enforcement had subjectively guilty knowledge that the performance was prohibited"[35].

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[31] Discussed in Henochsberg on the Companies Act, 71 of 2008 [Issue 4] Vol 1 LexisNexis with reference to inter alia *Jacobson v Liquidator M Bulkin & Co Ltd* 1976 (3) SA 781 (T) p 787 – 788.
[32] Fn 24.
[33] Also discussed in Cilliers and Benade, fn 15, p 333.
[34] 1996 (4) All SA 368 (W).
[35] *Fidelity Bank Ltd*-case, fn 34, para 382 – 383.

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Cloete J therefore found that the second acknowledgement was interrelated to the first action of financial assistance as it was an inseverable part of a transaction which contravened section 38, and is therefore unenforceable.

Furthermore, after multiple decisions by the court[36] it can be said that the section 38 prohibition is 'not confined to financial assistance to the purchaser'[37]. Cassim et al[38] further states that it is directed at any financial assistance granted to "any person, provided that it is for the purpose of a purchase of shares or in connection with a purchase of shares"[39].

3.3. Section 38(2)

This subsection gives the exceptions to the prohibition of giving financial assistance, and reads as follows:

> "The provisions of subsection (1) shall not be construed as prohibiting –
>
> (a) the lending of money in the ordinary course of its business by a company whose main business is the lending of money; or
> (b) the provision by a company, in accordance with any scheme for the time being in force, of money for the subscription for or purchase of shares of the company or its holding company by trustees to be held by or for the benefit of employees of the company, including any director holding a salaried employment or office in the company; or
> (c) the making by a company of loans to persons, other than directors, *bona fide* in the employment of the company with a view to enabling those persons to purchase or subscribe for shares of the company or its holding company to be held by themselves as owners; or
> (d) the provision of financial assistance for the acquisition of shares in a company by the company or its subsidiary in accordance with the provisions of section 85 for the acquisition of such shares."

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[36] One for instance the *Jacobson*-case, fn 23.
[37] Cassim FHI, Cassim MF, Cassim R, Jooste R, Shey J & Yeats J *Contemporary Company Law* (2012) Second Edition Juta, p 323, last paragraph before par 8.4.4.
[38] Cassim et al, fn 37.
[39] Cassim et al, fn 37.

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Note that section 38 keeps referring to the purchase of or subscription for shares, whereas in the 2008 Act it specifically mentions 'securities', which includes shares, but is a lot wider.

3.4. Section 38(2A)

Black Economic Empowerment (hereafter referred to as 'BEE') was also factored into the application of section 38 and was inserted with the Corporate Laws Amendment Act 24 of 2006[40] as a further exception in terms of subsections (2A) and (2B). Subsection (2A) is quoted as follows:

> "38(2)(2A) Subsection (1) does not prohibit a company from giving financial assistance for the purchase of or subscription for shares of that company or its holding company, if –
>
> (a) the company's board is satisfied that-
>   (i) subsequent to the transaction, the consolidated assets of the company fairly valued will be more than its consolidated liabilities; and
>   (ii) subsequent to providing the assistance, and for the duration of the transaction, the company will be able to pay its debts as they become due in the ordinary course of business, and
>
> (b) the terms upon which the assistance is to be given is sanctioned by a special resolution of its members."

Yeats[41] stated that before the introduction of this subsection, section 38 was deemed an impediment to BEE in that it prevented companies that were considered financially strong from offering and granting financial assistance for the acquisition of shares to potential BEE partners who could not independently acquire shares. Yeats[42] further indicated that this amendment's initiative is to assist in the diversification of shareholders and broad-based black economic empowerment.

[40] Section 9 of the Corporate Laws Amendment Act 24 of 2006.
[41] Yeats JL "The Drafters Dilemma: Some comments on Corporate Laws Amendment Bill 2006" *SALJ* (2006) [Volume 123] p 607.
[42] Yeats, fn 41, p 607.

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Van Wyk[43] also discussed the amendment in favour of assisting previously disadvantaged person financially in acquiring or subscribing to shares. In his article[44], Van Wyk stated that the question by the board will now have to be the solvency of the company, and not the reluctance to contravene the provisions of section 38.

3.5. Section 38(2B)

As stated above, a further exception was inserted with the Amendment Act[45] and states that –

> "38(2)(2B) For the purposes of paragraph (2A)(a), the directors must account for any contingent liabilities which may arise to the company, including any contingent liability which may result from giving the assistance."

3.6. Section 38(3)

The effects of a contravention of section 38 are specifically spelt out, and the specific section reads as follows:

> "(3) (a) Any company which contravenes the provisions of this section, and every director or officer of such company, shall be guilty of an offence.
> (b) For the purpose of this subsection **'director'**, in relation to a company, includes any person who at the time of the alleged contravention was a director of the company.
> (c) It shall be a defence in any proceedings under this section against any director or officer of a company if it is proved that the accused was not a party to the contravention."

This section explicitly makes provision for an offence, and a contravention will therefore be a criminal matter. This is decidedly different in the 2008 Act, as will be discussed in Chapter 4 below.

[43] Van Wyk J "Will the amended s38 accelerate BEE ownership?" *Without Prejudice* (March 2008) [Volume 8] 28.
[44] Van Wyk, fn 43.
[45] Section 9 of the Corporate Laws Amendment Act 24 of 2006.

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Courts have treated the breach of this provision as voiding the said action, although it was not clearly stated, which makes for a relatively welcome change[46] to come in the 2008 Act's section 44.

3.7. Further comments on the application of Section 38

According to Cilliers and Benade[47], section 38 was one of the most problematic areas in the Act[48], due to the fact that the concept 'financial assistance' was not specifically defined[49]. The varying opinions due to the extremely wide and very general terms were the cause for many a commercial uncertainty[50].

[46] Section 218(1) of Act 71 of 2008 does somewhat confuse the matter.
[47] Cilliers and Benade, fn 15, p 329.
[48] Cilliers and Benade, fn 15, p 329.
[49] Cilliers and Benade, fn 15, p 330.
[50] Cilliers and Benade, fn 15, p 330.

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CHAPTER 4

Section 44 of the Companies Act 71 of 2008: Financial Assistance for the Subscription of Securities

4.1. Introduction to Section 44

Section 44 of the 2008 Act replaced the 1973 Act's section 38 in full. The comments with regard to the change are plentiful and will follow in the subchapters.

Section 44 is a clear indication of the move from the old and transformation into the new. In the *Lipschitz*-case[51], with reference to the English Company Law equivalent of section 38 and regularly used as critique with regards to last mentioned provision, it was said that the financial assistance prohibition was described as an "occasional embarrassment to the honest, without being a serious inconvenience to the unscrupulous"[52]. The 2008 Act therefore seeks to change this position so that innocent transactions would not be troubled by the prohibition. In brief, the Companies Act had a metamorphosis.

It could however be said that section 44 is the "death of the capital maintenance rule as a principle underlying company law in South Africa"[53]. What should however be commended is that the allowance of financial assistance is not a disregarding of the third party interests and minority shareholders, as was the issue in the *Trevor v Whitworth*-case, but has allowed the assistance subject to specific requirements[54]. These include the usage of the solvency and liquidity test, which means that a company will still have the means to attend to company debts, and shareholder rights of the minority will be protected against the capital being depleted.

In section 7 of the 2008 Act, the purpose of the 2008 Act is to promote the development of the South African economy by "creating flexibility and simplicity in the formation and maintenance of companies"[55]. It would therefore suffice to state

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[51] *Lipschitz NO v UDC Bank* 1979 (1) SA 789 (A).
[52] Report of the Company Law Committee (Jenkins Report) Cmnd 1749 (1962).
[53] Wainer HE "The Companies Act Changes – Problems and Doubts" *SALJ* (2001) 133 at p133.
[54] The requirements contained in subsections (3) and (4) to be discussed in subsequent chapters.
[55] Section 7(b)(ii) of the 2008 Act.

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that the prohibition in terms of section 38 of the 1973 Act being lifted is in accordance with the said purpose of the Act.

In South African Company Law for the 21st Century – Guidelines for Corporate Law Reform[56], the aim of the proposed ideology were formed. The fact was that the aim was to have a comprehensive but not burdensome regime. Researcher quotes as follows:

> "Although company law will inevitably impose restraints on the activities of companies and on those who control and mange them, its primary aim should be to make it possible for companies to structure themselves and carry on business in the way they consider most appropriate for the conduct of their business and the administration of their affairs"[57].

This could be an indication of the change in the financial assistance changes, as the legislator did away with the prohibition and made it possible in certain circumstances to grant financial assistance, which means it could be better for "the administration of a company's affairs". This means transactions previously prohibited will now be legitimate and can now assist in wider ownership of shares and venture capital investment assistance.

4.2. Section 44(1)

Section 44(1) specifically states what the section is applicable to, and is quoted as follows:

> "In this section, 'financial assistance' does not include lending money in the ordinary course of business by a company whose primary business is the lending of money."

This obviously indicates that the ordinary course of business of a specific company should first be established before the exemption might find application. This will be discussed in the subchapter to follow.

The legislator erred in not having this section defining 'financial assistance', but only having the negative provision as to what should not be deemed 'financial

[56] Government Gazette 26493, General Notice 1183 of 2004 published on the 23 June 2004.

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assistance'. In the *Lipschitz*-case[58] applicable to section 38 of the 1973 Act, but which also finds application to the 2008 Act, the absence of a clear definition was discussed, and was said to lead to legal uncertainty with reference to when a company offered or granted this assistance.

4.2.1. The "Primary Business" Question

The "primary business" is a factual question to be answered with the actual business and the Memorandum of Incorporation provisions taken into account[59]. Nienaber JA in the majority judgment referred to a dictum in *South African Flour Millers' Mutual Association v Rutowitz Flour Mills Ltd*[60] where Davies J distinguished between "the ultimate object"[61] and the "purely fortuitous and subsidiary object" of the said company[62].

For the 'ultimate object' Nienaber JA is quoted in the *Mitchell's Plain Town Centre Merchants Association v McCleod*-case[63], stating that Davies' dictum in the *South African Flour Millers*-case[64]:

> "appears to suggest that there can be but one main object. The word 'its' in the expression 'that has for its object the acquisition of gain' does lend some support to that approach. But I (*Davies*[65]) am by no means convinced that the word 'its' is sufficiently weighty (a) to be indicative of a single dominant purpose with the implication that any other purpose is relegated to the status of a subordinate purpose which must then be disregarded, and *(b)* to exclude the feasibility of a duality or even a multiplicity of purposes, provided that they are congruent and not contradictory."

What Nienaber JA further stated was that according to him the *dictum* seeks to emphasise that insignificant objects, to the extent of being considered trivial in

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[57] Fn 56, p30.
[58] Fn 51.
[59] *Mitchell's Plain Town Centre Merchants Association v McCleod* 1996 (4) SA 159 (A) 168.
[60] 1938 CPD 199.
[61] 1938 CPD 199 at 207.
[62] 1938 CPD 199 at 206.
[63] Fn 59.
[64] Fn 60.
[65] Writer's insert.

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context, should not be allowed to distort the image of the primary business and its object. The rightful function of an association remains a matter of degree.

4.3. Section 44(2)

This section indicates exactly who may authorise the financial assistance and what it could possibly encompass:

> "Except to the extent that the Memorandum of Incorporation provides otherwise, the board may authorise the company to provide financial assistance by way of a loan, guarantee, the provision of security or otherwise to any person for the purpose of, or in connection with, the subscription of any option, or any securities, issued or to be issued by the company or a related or inter-related company, or for the purchase of any securities of the company or a related or inter-related company, subject to subsections (3) and (4)."

In this subsection the legislator in fact chose to give a list of possible activities which could encompass financial assistance, but with the insertion of the words 'or otherwise' made the list a non-exhaustive list, and it was said that the words should not be construed *eiusdem generis* with 'loan, guarantee, the provision of security'[66]. The scope is therefore wide with relation to what will be deemed as financial assistance, seeing as the term is incapable of precise legal definition and Cassim et al[67] referred to the fact that it is "clearly unwise for the legislature to to lay down a precise definition of the term"[68]. The purpose of the subscription will be discussed in the subsequent subchapter as indication of what the courts found financial assistance to be.

Furthermore, the implications of related or inter-related parties will now also apply, and the question will also now arise when there are enough degrees between the assisting company and the intended purchaser to not be deemed financial assistance.

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[66] Cassim FHI, Cassim MF, Cassim R, Jooste R, Shey J & Yeats J *Contemporary Company Law* (2012) Second Edition Juta, p 316, par 8.4.3.
[67] Cassim et al, fn 66, p 316, par 8.4.3.

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4.3.1. "For the purpose of" or "in connection with"

The insertion of the words 'in connection with' may lead to the question of whether the words should be given their literal meaning or not. The jurisprudence with regards to 'in connection with' for the 1973 Act will apply *mutatis mutandis* to the 2008 Act until the courts change their findings.

In *Gradwell (Pty) Ltd v Rostra Printers Ltd*[69] the Court distinguished between the "ultimate goal" and the "direct object" of a transaction, and stipulated that only the "direct object" is relevant to deem if the financial assistance was for the purpose of subscription or purchase of securities. This was also found as the deciding factor in *ABSA Bank v Kernsig 17 (Pty) Ltd*[70]*.*

Some cases, for example *Lewis v Oneanate (Pty) Ltd*[71] utilised the "impoverishment test" to ascertain whether there was financial assistance. This "impoverishment test" is a test of whether a company will have become poorer due to the transaction. The application of this test can assist in ascertaining whether the two elements of the prohibition indeed are present, but it is not the indicative test.

The party asserting a case that financial assistance was given bears the onus of proof that it was financial assistance in terms of the meaning of section 44. Companies have tried to circumvent the application of this section, and contraventions that are a deliberate attempt to avoid the prohibitions should be safeguarded against.

Examples of such a contravention are where a certain company would mortgage its property with the sole purpose to fund the purchaser's acquisition of shares, or where a company would buy a property it does not require, enabling the seller of the property to acquire securities in the company.

In *Gardner v Margo*[72] Van Heerden JA referred to the *Lipschitz*[73]- and *Gradwell*[74]-cases, and writer respectfully agrees with the Cassims[75] that the respected judged

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[68] Discussed in Cassim et al, fn 66, with reference to the *Gradwell*-case.
[69] 1959 (4) SA 419 (A) at p424 – 426.
[70] 2011 (4) SA 492 (SCA) at 498.
[71] 1992 (4) SA 811 (A).
[72] *Gardner v Margo* 2006 (6) SA 33 (SCA).
[73] *Lipschitz*-case*,* fn 51.
[74] *Gradwell*-case, fn 69.

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misapplied the provisions of section 38. A guarantee was given to the seller of shares for the full payment thereof, and it should have accordingly been financial assistance, even though the assistance was to the seller. Never does section 38 specifically indicate that the assistance should be granted to the purchase, only that it needs to be 'for the purpose of or in connection with a purchase or subscription'. It therefore seems fair to state that this position will also apply in terms of section 44 of the 2008 Act.

4.3.2. The Memorandum of Incorporation

The even bigger qualification inserted in subsection 44(2) is that of the compliance with the Memorandum of Incorporation. This is an alterable provision in the 2008 Act in the sense that the Memorandum of Incorporation is not permitted to allow or disallow the procedure of financial assistance, but the procedure can be further encumbered with more stringent restrictions or conditions. The 2008 Act therefore clearly indicates that financial assistance my granted subject to section 44, and then *further subject*[76] to the Memorandum of Incorporation. The section is unalterable in the sense that it cannot be overturned by the Memorandum of Incorporation.

The 1973 Act was more focused on the shareholders as they were in control of a company, however, in terms of section 66(1) of the 2008 Act, there was a movement in terms whereof the board of directors are now in control of a company. The decision to grant financial assistance therefore should now be a board initiative. This once again boils down to directors' fiduciary duties and irrespective of whether the statutory provisions have been attended to, a director may still be liable if the transaction is not in good faith, in the best interest of a company for a proper purpose[77].

[75] Cassim R and Cassim MF "*Gardener v Margo:* A Misapplication of Section 38 of the Companies Act" *South African Law Journal* (2007) p 37.
[76] Own emphasis.
[77] Section 76(3) of Act 71 of 2008.

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4.3.3. For the subscription of 'securities' and 'options'

Before we touch on what 'securities' and 'options' would entail, a question of importance is whether the word 'subscription' includes an exchange of shares. In *Gold Fields Ltd v Harmony Gold Mining Co Ltd*[78] with regards to the offer of shares to the public, the Supreme Court of Appeal found that 'subscription' includes an exchange of shares[79].

4.3.3.1. 'Securities'

The change from the 1973 dispensation can further be indicated with the change in what the subscription is for. The 1973 Act prohibited the financial assistance for the acquisition of 'shares'. The 2008 Act limits the financial assistance for the subscription of 'securities'.

In section 1 of the 2008 Act, a 'share' is defined as meaning "one of the units into which the proprietary interest in a profit company is divided". In subchapter 2.4 the definition of securities was given. In brief, a security includes a share, but is a lot wider. This was confirmed by Yeats and Jooste[80], as the 2008 Act section includes commercial instruments previously not included in the ambit of the relevant section.

4.3.3.2. 'Options'

Furthermore, subsection (2) also provides for the subscription of 'options'. This provision casts the ambit of the 2008 Act even wider than it was shown the be cast in the preceding subchapters.

Once again the legislators erred in that the 2008 Act in whole and specifically section 44 does not define what the options will be with regards to financial assistance[81]. One could assume it would be the option to subscribe to or purchase the securities

[78] *Gold Fields Ltd v Harmony Gold Mining Co Ltd* 2005 (2) SA 506 (SCA).
[79] Cassim et al, fn 66, p 326.
[80] Yeats J and Jooste R "Financial Assistance – A New Approach" *South African Law Journal* (2009) Volume 126 [3] 566 at p 573.
[81] Yeats and Jooste, Fn 80, p574.

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of the granting company[82]. Yeats and Jooste however submitted that there is a very difficult task in restricting the scope of the word 'option', in that the word itself could widen the scope to such an extent as to include the acquisition of any of the company's property[83].

Respectfully, writer agrees with Yeats and Jooste[84] that case law decided in terms of Section 38 of the 1973 Act is not indicative, as the 1973 Act did not have 'options' included, and therefore a smaller scope. Clarification on this issue therefore could prove vital in cases to come.

4.3.4. 'Related or inter-related'

As defined in chapter 2.2., section 44 of the 2008 Act has been extended to include 'related or inter-related' parties. Section 38 of the 1973 Act only covered financial assistance in the company itself and had no bar on providing financial assistance to the purchase of shares in its subsidiary companies. Section 44 of the 2008 Act is therefore much wider in this sense as well[85].

4.4. Section 44(3)

This section is one of the two provisos to subsection (2) and reads as follows:

> "Despite any provision of a company's Memorandum of Incorporation to the contrary, the board may not authorise any financial assistance contemplated in subsection (2), unless –
>
> (a) the particular provision of financial assistance is –
>
> (i) pursuant to an employee share scheme that satisfies the requirements of section 97; or
>
> (ii) pursuant to a special resolution of the shareholders, adopted within the previous two years, which approved such assistance either for the specific

[82] Yeats and Jooste, Fn 80, p574.
[83] Yeats and Jooste, Fn 80, p574.
[84] Yeats and Jooste, Fn 80, p574.
[85] Cassim et al, fn 66, p 332, par 8.4.8.

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recipient, or generally for a category of potential recipients, and the specific recipient falls within that category; and

(b) the board is satisfied that –

(i) immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test; and

(ii) the terms under which the financial assistance is proposed to be given are fair and reasonable to the company[86]."

The subsection goes further in that except for the employee share scheme or special resolution by the shareholders (subsection (a)), the financial assistance may further only be granted if it happens in conjunction with the board's satisfaction of the requirements in subsection (b).

Some of the specific requirements will be discussed briefly in the following subchapters in order of appearance in the section as quoted above.

4.4.1. Shareholder resolution

Section 44(3)(a)(ii) further requires a resolution by the shareholders taken within the last two (2) years; however the solvency and liquidity test, referred to in subchapter 4.4.2., stipulates that the said test is calculated by the board on being able to pay its debts for a period of twelve (12) months or one (1) year. Logically then, if after more than a year of the decision being made by the shareholders, there might be the question of the solvency and liquidity test not being complied with and the board will have to reconsider the solvency and liquidity test.

The shareholder resolution requirement must be satisfied despite any contrary provisions in the Memorandum of Incorporation. As mentioned in subchapter 4.3.2., the Memorandum of Incorporation can further encumber the provisions or increase the difficulty of granting financial assistance, but cannot do away with the basic principles in section 44. This therefore means that a company would have to satisfy the requirement of the shareholder resolution *inter alia* in order for the financial

[86] Own emphasis.

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assistance to be valid. This requirement exists as a shareholder protection measurement[87].

4.4.2. The solvency and liquidity test

The solvency and liquidity test, in terms of section 4 of the 2008 Act as was discussed under Chapter 2.3., now finds application. The board appears not to be required to find that the company be solvent and liquid but that the transaction itself will satisfy this test. The test is based on reasonably probable circumstances, which unfortunately is not an unconditional factual test, and is juxtaposed to the subjective test of the directors or board being satisfied that it complies with the section 4-test.

Van der Linde's[88] article about the application of the solvency and liquidity test encapsulated in section 4 indicates that the test itself was incorporated in legislation to tend to the protection of creditors' rights, as mentioned in subchapter 2.3.

The word "immediately" also burdens the interpreter of the 2008 Act with a further uncertainty, whether it needs to satisfy the test immediately after the board made the decision or the agreement was concluded, or whether directly after the loan was granted or security given, i.e. directly after the transaction was completed.

What is worth noting is Yeats and Jooste's[89] opinion that board's satisfaction should be to ascertain that the company would in fact be solvent and liquid for the subsequent twelve (12) months, not that it would reasonably perceived to be solvent and liquid.

The last mentioned position therefore is a little more stringent than the section 4 solvency and liquidity test, in that the test set out in section 4 of the 2008 Act does not require actual solvency and liquidity, but only an estimation on the fairly valued assets and that the board would deem the company to be fit to pay their current and

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[87] Yeats and Jooste, fn 80, p580.
[88] Van der Linde K "The Solvency and Liquidity approach in the Companies Act 2008" *Tydskrif vir die Suid-Afrikaanse Reg* (2009) [Volume 2] 224 at p225.
[89] Yeats and Jooste, fn 80, p587.

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reasonably foreseeable future debts, irrespective of the fact that the debts arose due to the proposed transaction[90].

4.4.3. Fair and reasonable to the <u>company</u>[91]

Writer emphasised the word "company" in the heading of this sub-chapter and in chapter 4.4's quote of subsection (3)(b)(ii) from the 2008 Act, as it definitely indicates that the terms need not be fair and reasonable to the person or juristic entity acquiring the financial assistance, but to the company granting said assistance. Also, said terms are not required to be fair and reasonable with regards to the transaction. If for instance a transaction is in the best interest of the company, but the terms are not fair and reasonable to the company, it would still be a contravention of this section and therefore void in terms of section 44(5) of the 2008 Act, as discussed below.

With regards to the fairness and reasonability of the terms, there is no clear indication as to what this would be, and would depend on the facts. If the board does not comply with the proviso of fairness and reasonability, the board members may incur liability in terms of a breach of their fiduciary duties[92].

Yeats and Jooste[93] also discussed the implication of 'fair and reasonable', and which factors should be taken into consideration. *Inter alia* they raised the question of whether the transaction will be beneficial to the company and or if there had to be a reasonable *quid pro quo* for the requirement to be satisfied[94]. Was the inclusion of 'fair and reasonable' only an extra measure to ensure the company had provided 'security'[95]? This was also the questions that Cassim et al[96] discussed under their discussion of fair and reasonable.

As the 2008 Act as a whole and this section in particular does not clarify what fair and reasonable would entail, the provisions of section 37(3)(c) of the 1973 Act can

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[90] Section 4(2)(b) of the Companies Act 71 of 2008.
[91] Own emphasis.
[92] Delport PA *The New Companies Act Manual* (2011) *LexisNexis* 2nd Edition p 54.
[93] Yeats and Jooste, fn 80, p 576.
[94] Yeats and Jooste, fn 80, p 577.
[95] Yeats and Jooste, fn 80, p 577.
[96] Cassim et al, fn 66, p 330.

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be indicative of the fairness and reasonableness of the terms, and can be summarised as:

(i) When the financial position of the parties involved is taken into account, whether a loan must have been granted or whether security should have been given;

(ii) Where a loan was granted, if security must have been or was given in the circumstances, and if the said security is adequate to cover the loan;

(iii) The consideration including other benefits or interest provided for the loan or security;

(iv) The term of the loan or security; and

(v) The method required for the settlement of the loan or release of the security.

This added requirement has been recognised as a further encumbrance in the negotiation of financial assistance, and makes it even more difficult than the predecessor provision[97]. Davis et al[98] stated that the requirement of fairness and reasonableness is commendable, only if, however, courts have proper regard for the interests of minority shareholders in applying this provision.

4.5. Section 44(4)

There is a further requirement, and the second proviso, before financial assistance may be given, included in the following subsection:

> "In addition to satisfying the requirements of subsection (3), the board must ensure that any conditions or restrictions respecting the granting of financial assistance set out in the company's Memorandum of Incorporation have been satisfied."

As discussed under subchapter 4.3.2., the company's Memorandum of Incorporation can pose further, more stringent steps to the procedure whereby the board needs to abide before any financial assistance may be given. As mentioned in the said subchapter, the Memorandum of Incorporation may however not take away the

[97] Section 38 of the Companies Act 61 of 1973.

[98] Davis D, Cassim F, Geach W, Mongalo T, Butler D, Loubser A, Coetzee L & Burdette D *Companies and other Business Structures in South Africa* (2012) Second Edition Oxford University Press, p 84.

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procedure in terms of section 44, as section 44 is an unalterable provision in this extent.

4.6. Section 44(5)

The validity of financial assistance is addressed in this sub-section. The subsection is quoted:

> "A decision by the board of a company to provide financial assistance contemplated in subsection (2), or an agreement with respect to the provision of any such assistance, is void to the extent that the provision of that assistance would be inconsistent with –
> (a) this section; or
> (b) a prohibition, condition or requirement contemplated in subsection (4)."

It is therefore clear that when the granting of financial assistance is contrary to section 44 or the provisions or rules in terms of the Memorandum of Incorporation[99], the said assistance will be invalid with regard to the contraventions and those elements which are in accordance with the Act and the Memorandum of incorporation will still be valid and enforceable.

However, in terms of section 218 of the 2008 Act, nothing contrary to the Act is void unless a Court declares it to be void[100].

If the board contravenes this section, the directors may be held liable for any loss or damage a person may incur due to the contravention in terms of section 218(2)[101]. The director's liability is however discussed in the following chapter.

4.7. Section 44(6)

This is the liability section wherein the implication of non-compliance with the 2008 Act by a director is explained. There are no more sanctions, and this is as far as the

[99] Section 44(5)(b) of the Companies Act 71 of 2008.
[100] Section 218(1) of Act 71 of 2008.
[101] Of Act 71 of 2008.

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liability will go for the granting of financial assistance that is *contra* the 2008 Act. Section 44(6) therefore reads:

> "If a resolution or an agreement is void in terms of subsection (5) a director of the company is liable to the extent set out in section 77(3)(e)(iv) if the director –
> (a) was present at the meeting when the board approved the resolution or agreement, or participated in the making of such a decision in terms of section 74; and
> (b) failed to vote against the resolution or agreement, despite knowing that the provision of financial assistance was inconsistent with this section or a prohibition, condition or requirement contemplated in subsection (4)."

Section 77(3)(e)(iv) stipulates that a director will be liable for "any loss, damages or costs sustained by the company as a direct or indirect consequence" of the director not voting against the section 44 financial assistance, or acting *contra* the Memorandum of Incorporation.

This therefore indicates that a director will not be liable if he or she was in attendance at a meeting of the board, but indeed voted against a resolution of agreement to grant financial assistance, even though he or she might have been outvoted.

The further important thing to note is that section 77 of the 2008 Act specifically includes 'prescribed officers', but section 44(6) only refers to directors, and can be a debatable issue as to whom was supposed to vote against the provision of financial assistance, but should a 'prescribed officer' also be held liable, this is where the import of chapter 2.5. find application.

Writer further agrees with Yeats and Jooste[102] that the threat of liability in terms of a criminal offence was an effective deterrent, and that the removal of the criminal liability was a mistake. Possible civil liability is not such a big threat and can mean more illegal grants of financial assistance, especially where the worst thing to come of it is a slap on the wrist or a fine.

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CHAPTER 5

The differences between the 2008 and 1973 Acts with regards to Financial Assistance for the purpose of purchasing, subscription to, exchange of shares

Jooste[103] took the task upon himself to compile a book with all the relevant sections in the 1973 Act with their replacement in terms of the 2008 Act next to it. This aided in the process of comparison between the two Acts[104].

The best way to compare these two Acts is in brief that the 1973 Act starts out with a prohibition on financial assistance, and then gives exceptions to the prohibition. The successor in terms of section 44 of the 2008 Act is not prohibitive and indicates that financial assistance for the purpose of purchasing shares may be granted, although it is limited by its subsections.

The transgression of section 44 of the 2008 Act is not a criminal offence, as opposed to the section 38 of the 1973 Act. The 1973 Act might have had the criminal offence, as stated to be a great deterrent, but it did not have any civil liability placed on the directors in terms of their fiduciary duties. This was instituted in the 2008 Act.

Section 44 of the 2008 Act contains the requirement of the satisfaction of the solvency and liquidity test.

[102] Yeats and Jooste, fn 80, p 584.
[103] Jooste R "The Comparative Guide to the Old and New Companies Acts" Juta.
[104] The 1973 Act's section 38 and the 2008 Act's section 44, Jooste, fn 103, p 92 – 93.

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CHAPTER 6

Section 45 of the Companies Act 71 of 2008: Loans or other financial assistance to directors and the overlaps with Section 44 of the Companies Act 71 of 2008: Financial assistance for the subscription of securities

6.1. Section 44(1) and Section 45(1)

Whereas section 45 of the 2008 Act gives a clear indication of what 'financial assistance' will entail, in that it is defined under subsection (1) as including "lending money, guaranteeing a loan or other obligation, and securing any debt or obligation"[105]. This is a clearer indication of what financial assistance will be with regards to directors, but is further only similar to section 44 in the extent that both sections will not be deemed financial assistance where loans are made in the ordinary course of business.

Once again, as is the position with section 44 of the 2008, the "primary business" of the company is a factual question which will again utilise the Memorandum of Incorporation and the real, actual business of the company as indicated in the *Mitchell's Plain*-case[106]. This indicates that the financial assistance in terms of sections 44 and 45 overlap, albeit that section 44 of the 2008 is not as extensive as section 45.

6.2. Section 44(2) and Section 45(2)

The ambit of section 45 of the 2008 Act's ambit also reads a lot wider than the 1973 Act, in that it, the same as section 44, now includes related and inter-related parties[107].

As with the section 44 financial assistance, the Memorandum of Incorporation can qualify the procedure in granting financial assistance, but cannot allow or disallow the granting thereof. It can therefore place further limitations and or conditions on the

[105] Section 45(1)(a) of Act 71 of 2008.
[106] *Mitchell's Plain Town Centre Merchants Association v McCleod* 1996 (4) SA 159 (A) 168.

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financial assistance. Section 44(2) gives a brief indication as to what financial assistance could include, all which is encapsulated in section 45(1).

The board authorises the financial assistance. This is a further overlap or similarity in the financial assistance provisions. Subsections (2) in both financial assistance provisions indicate to whom the financial assistance can be given, and both include related and inter-related parties, being a further overlap.

6.3. Section 44(3) and Section 45(3)

Once again, section 45(3)(a) also qualifies further the authorisation for the financial assistance to directors in that even if a provision of the Memorandum of Incorporation provides otherwise, the board may not authorise any financial assistance if it is in terms of an employee share scheme that meets the conditions required in terms of section 97 of the 2008 Act[108]; or in terms of a special resolution of the shareholders taken within the preceding two (2) years which approved said assistance for the specific recipient or in general for a category of recipients wherein the recipient falls[109]. This rings true for section 44(3)(a) as well.

Both sections 44(3)(b) and 45(3)(b) also require the board to satisfy themselves that the solvency and liquidity test has been complied with[110] and terms fair and reasonable to the company were given for the proposed financial assistance[111]. Subsection 45(3) is also almost a direct replica of the section 44(3) provisions. Once again the fairness and reasonability can be deducted from the provisions of section 37(3)(c) of the 1973 Act. A great example would be where financial assistance was granted to a Black Economic Empowerment-compliant candidate, but the loan was unreasonable towards the company as it put the company in a cash restricted dilemma.

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[107] Sections 44(2) and 45(2) overlap.
[108] Section 45(3)(a)(i) of Act 71 of 2008.
[109] Section 45(3)(a)(ii) of Act 71 of 2008.

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6.4. Section 44(4) and Section 45(4)

These subsections read exactly the same, and both require that if the Memorandum of Incorporation impose any further conditions or restriction, they also need to be complied with[112]

6.5. Section 44(5) and Section 45(6)

These two provisions also read exactly the same and state that the provision of the assistance is void to the extent of the inconsistency with the applicable section and the further conditions or restrictions contained in the Memorandum of Incorporation[113].

6.6. Section 44(6) and Section 45(7)

A further almost identical provision, the only difference lying the director's liability as section 44(6) refers to section 77(3)(e)(iv) and section 45(3)(e)(v). Both require the director to have been present at a meeting whereby a decision was made in terms of section 74 and failed to vote against the resolution for the director to be liable.

6.7. Section 45(5): The only real difference between the provisions of financial assistance contained in the Companies Act 71 of 2008

Section 45 goes a little further than section 44, in that approval of financial assistance in terms of section 45 has a few extra procedural steps contained in subsection (5).

The board must provide written notice of the resolution to grant financial assistance to all shareholders, unless all the shareholders are also directors of the company

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[110] Section 45(3)(b)(i) of Act 71 of 2008.
[111] Section 45(3)(b)(ii) of Act 71 of 2008.
[112] Please refer to subchapter 4.5. for the discussion and quote of section 44(4).
[113] Please refer to subchapter 4.6. for the discussion and quote of section 44(5).

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and to any trade union representing the company's employees. These notices have to be sent within certain time periods for the board not to contravene section 45[114].

The peculiarity with this imposition is that the resolution permitting the board to authorise financial assistance was in the first instance decided upon by the shareholders themselves. This section appears to require the additional notice, which is basically a superfluous step in informing shareholders of something they decided upon already.

The written notice further also needs to comply with section 6 of the 2008 Act and section 12 of the Electronic Communications and Transactions Act[115] with regards to 'writing'.

According to Henochsberg[116], failure to notify shareholders and or employees of the company in terms of the requirement set out in section 45(5) will not void the contract. As is aptly said in Henochsberg[117], "notification is a requirement that follows from the transaction and is not a requirement for the transaction". Third parties might be able to use the statutory Turquand rule as set out in section 20 of the 2008 Act and in terms of common law, if they are *bona fide*.

6.8. Conclusion

It is evident that the financial assistance provisions are almost completely similar, and that it could have probably been contained in one (1) provision. The legislator however opted for two (2) provisions, and an extra further procedural step to be followed where the financial assistance to be granted is to a director or a related or inter-related party.

This was probably done for the added "protection" of the shareholders in that they are required by law to receive a further notice of the financial assistance, even if the failure to comply with the sending of the notice does not void the contract[118].

[114] Section 45(5)(a) and (b) of the Companies Act 71 of 2008.
[115] Act 25 of 2002.
[116] Henochsberg on the Companies Act, 71 of 2008 [Issue 4] Vol 1 p 196.
[117] Henochsberg, fn 116, p 196.
[118] Henochsberg, fn 116, p 196.

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CHAPTER 7

International Comparisons

7.1. English Law

7.1.1. The United Kingdom Companies Act of 1985

It can be said that the root of the provision against financial assistance can be found in the Greene Committee Recommendations[119]. The prohibition was enacted to discontinue a "mischief" as referred to in the recommendations that existed when a company loaned money utilised in effect to buy its own shares.

As Lowry and Dignam[120] states, the modern terminology to describe arrangements where companies issued loans to acquire its own shares can be described as "leveraged buyouts". This clearly indicates that the acquisition is financed by debt. The Jenkins Committee[121] opined that the reasoning for the prohibition was not to maintain capital, but, and writer finds this specific sentence a true ringer: "the potential dangers which indebted acquirers pose to creditors"[122].

In *Chaston v SWP Group*[123] Lord Arden specifically stated that the "mischief" has not changed in subsequent years, and that "the resources of the target company and its subsidiaries should not be used directly or indirectly to assist the purchaser financially to make the acquisition"[124].

Even more recent, the case of *Anglo-Petroleum Ltd v TFB (Mortgages) Ltd*[125] it was stated by Lord Toulson that the prohibition was specifically motivated or aimed at the prevention of the utilisation of the resources of a target company being enlisted to aid the buyer financially in his acquisition, albeit direct or indirect aid.

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[119] Cmnd 2657, 1926 as discussed in Dignam A and Lowry J *Company Law* (2014) Eighth Edition Oxford University Press p 137, par 7.36.
[120] Authors of book in fn 119, p138, par 7.36.
[121] Report of the Company Law Committee (Jenkins Report) Cmnd 1749 (1962) para 173.
[122] Lowry and Dignam, fn 119, p 138, par 7.37.
[123] *Chaston v SWP Group plc* [2003] 1 BCLC 675 (CA) 686.
[124] *Chaston*-case, fn 123.
[125] *Anglo-Petroleum Ltd v TFB (Mortgages) Ltd* [2008] 1 BCLC 185 (CA).

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Private companies were however allowed to grant financial assistance if the completed the so-called "whitewash" procedure enshrined in sections 151 to 155 of the Companies Act of 1985.

The English legislature was also faced with the question of what financial assistance would entail, and it was found that[126]:

> "There is no definition of giving 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 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."

Financial assistance was definitely not a loan made in the ordinary course of business, as indicated in the case of *Belmont Finance Corp Ltd v Williams Furniture Ltd (No 2)*[127]. According to Pennington[128], the whole of the transaction for the acquisition had to be considered in order to ascertain whether there was indeed financial assistance.

7.1.2. The United Kingdom Companies Act of 2006

The position with regards to financial assistance has however changed in the English law, as the 1985 United Kingdom Companies Act was repealed and succeeded by the Companies Act of 2006, which came into effect in October 2008.

Due to the 2005 White Paper, which lead to the implementation of the Companies Act of 2006, a private company could now financially assist for the purpose of the acquisition of its own shares. The "whitewash" procedure referred to in the previous chapter is no longer required. The thought behind this change was that there are other safeguards for creditors, for example insolvency laws, and that the prohibition of financial assistance in private companies is superfluous.

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[126] *Charterhouse Investments Trust Ltd v Tempest Diesel Ltd* (1986) 1 BCLC 1.
[127] *Belmont Finance Corp Ltd v Williams Furniture Ltd (No 2)* [1980] All ER 393 (CA).
[128] Pennington RR *Company Law* (1995) Seventh Edition Butterworths, p 479.

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The prohibition against the financial assistance by public companies is now encapsulated in section 678(1) of the Companies Act 2006. This was done by the implementation of the Second Company Law Directive[129]. Article 23 of the said Directive[130] is quoted as follows:

> "Where a person is acquiring or proposing to acquire shares in a public company, it is not lawful for that company, or a company that is a subsidiary of that company, to give financial assistance directly or indirectly for the purpose of the acquisition before or at the same time as the acquisition takes place."

Lowry[131] is of the opinion that section 679(1)[132] "bolstered" section 678(1)[133] seeing as the first-mentioned section extends the prohibition to even be applicable on subsidiary public companies aiding in the purchase or acquisition of shares in their private subsidiary company[134].

The scope of 'financial assistance' in the English law is also limited to certain actions[135]. There is a fixed list[136], whereas the South African counterpart there is no definition or a specific action *per se*, but the tests to determine whether the action is 'financial assistance'. There is however the valuation in both jurisdictions of the net assets of the company[137]. Where the net assets are reduced in a material extent if the financial assistance was given, or it does not have any assets is a residual further proscription added in terms of section 677(1)(d)[138].

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129 EEC 77/91 (OJ L26/1 31.1.1977).
130 Same as fn 129 above.
131 Lowry and Dignam, fn 119.
132 Of the Companies Act 2006.
133 Of the Companies Act 2006.
134 Lowry and Dignam, fn 119, p 140, par 7.42.
135 Section 677 read together with Section 683(1) and (2).
136 Lowry and Dignam, fn 119, p 140, par 7.43.
137 Lowry and Dignam, fn 119, p 140, par 7.44.
138 Of the Companies Act 2006.

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7.1.3. Sanctions

The breach of the prohibition is a criminal offence in terms of section 680[139]. The offence will lead to the liability of the company for the payment of a fine and responsible officers being liable to "imprisonment or a fine or both"[140].

In *Brady v Brady*[141] the court found that had financial assistance not yet been given, and the granting thereof would be illegal, the contract or agreement cannot be enforced. Where the financial assistance was granted contrary to the law, the transaction is void. This means that the recipient of the assistance is sitting with an unenforceable agreement, as per *Heald v O'Connor*[142].

7.1.4. Comparisons between the Companies Acts of England and South Africa

Both the South African and English legislation and jurisprudence focus on the 'principal purpose' (as it is referred to in English case law) and 'incidental part of a larger purpose'.

What is enlightening in the legislation of England is that it is still a prohibition with exceptions and specific sanctions. The South African legislation is vague in that if the financial assistance is contrary to the provisions contained in section 44[143], then it may be void if a court so decides[144].

South Africa does not have any sanctions for the contravention of the financial assistance provisions, as were once encapsulated in the 1973 Act. The 2008 Act however does make provision for the fiduciary duty and personal liability of the directors, also seen in the English legislation.

The basic principle remains the same though, and the aim behind the English and South African legislation is the same: protection of creditors and shareholders, and no misappropriation of a company's assets in assisting take-overs. The solvency and liquidity movement in South African law however is a strong provision.

[139] Of the Companies Act 2006.
[140] Lowry and Dignam, fn 119, p 146, par 7.56.
[141] *Brady v Brady* [1989] AC 755.
[142] *Heald v O'Connor* (1971).

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7.2. Ireland

7.2.1. Prohibition against a company assisting the purchase of its own shares

Section 3 of the Companies Act 1959 introduced a general prohibition against a company giving financial assistance towards the purchase of its own shares. This position was later on substantially liberalised with the instatement of section 60 of the Companies Act 1963. The Companies Act 1963 was enacted in terms of the Jenkins Committee[145] which Britain at that stage did not follow[146]. Section 60 was repealed by the Companies Act 1983, but only in terms of public companies in terms of article 23 of the Second EEC Companies Directive[147].

The legislation is designed as the other countries' to prevent a company from financing its own takeover. Many methods were employed to hide these types of transactions, and Ussher[148] referred to the English case of *Wallersteiner v Moir*[149] where Lord Denning said:

> "The transactions are extremely complicated, but the end result is clear. You look to the company's money and see what has become of it. You look to the company's shares and see into whose hands they have got. You will then soon see if the company's money has been used to finance the purchase."

In Ireland the courts also found the 'impoverishment test' itself to be insufficient an indication of whether financial assistance had been granted, but stated, as in the Jenkins Committee Report that creditors and minority shareholders rights would have been subject to an illegitimate risk.

The prohibition is contained in section 60(1) of the Companies Act of 1963:

> "Subject to subsections (2), (12) and (13), it shall not be lawful for a company to give, 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

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[143] Companies Act 71 Of 2008.
[144] Section 218 of the 2008 Act.
[145] Report of the Company Law Committee (Jenkins Report) Cmnd 1749 (1962), fn 121.
[146] Ussher P *Company Law in Ireland* (1986) Sweet & Maxwell, p319 [outdated handbook, but the position remains the same].
[147] Fn 129.
[148] Ussher P, fn 146, p 319.
[149] *Wallersteiner v Moir* [1974] 1 WLR 991, p 1014.

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connection with a purchase or subscription made or to be made by any person of or for any shares in the company, or where the company is a subsidiary company, in its holding company."

Subsection (13) contains exceptions like share incentive schemes for the benefit of employees or even when the loan is made in the ordinary course of business. This section seems to be very similar to the provisos contained in section 44 of the South African Companies Act of 2008. It was further stated in *Steen v Law*[150] that the relaxation of any terms of a loan in the ordinary course of business, will *prima facie* take it out of the ordinary course of business.

The IBA Corporate and M&A Law Committee of 2013 do however intend to have a new consolidated Companies Act introduced, whereby some of these provisions above and those to follow with regards to financial assistance will be reformed[151].

7.2.2. Shareholder resolution

In terms of the Irish Companies Act section 60(7), the shareholders have to take a special resolution not more than twelve (12) months prior to the financial assistance being given. This resolution has the stringent extra qualification that it needs to be unanimously decided upon by all the shareholders entitled to vote, or a further thirty (30) day delay will be required before financial assistance may be given. This delay gives dissenting shareholders an opportunity to apply to court to cancel the special resolution, as was made in *Securities Trust Ltd v Associated Properties Ltd*[152].

7.2.3. Solvency declaration

Further in terms of section 60, a director must shortly before the meeting at which the special resolution will be proposed file a statutory declaration at the registrar of companies declaring whom the financial assistance will be made to, and that the

[150] *Steen v Law* [1964] AC 287 (PC).

[151] McLaughlin M "Ireland – Financial Assistance – IBA Corporate and M&A Law Committee 2013" http://webcache.googleusercontent.com/search?q=cache:ONfe2HUkz2MJ:www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D46C22787-F9E0-4D20-B501-775254EAEFEF+&cd=1&hl=en&ct=clnk&gl=za (as viewed on the 2nd of November 2014).

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company will be able to pay its debts in full as they become due after the financial assistance has been given[153].

7.2.4. Sanctions

In terms of section 60(15), the penalties for infringement of the prohibition is a criminal penalty and could amount to a fine of £2,500[154] or the possibility of imprisonment, or even both.

Personal liability of the director will occur where a director made a declaration with regards to the solvency without reasonable grounds for making it as well as the criminal penalties that will apply.

Section 60(14) also gives the civil consequences of non-compliance, and the transaction will in terms thereof be voidable at the instance of the company against a person who had notice of breach of the prohibition. This notice was required as indicated in the *Bank of Ireland Finance Ltd*-case[155] where bank never received actual notice, and the agreement was therefore not void.

7.2.5. Comparisons between the Companies Acts of Ireland and South Africa

In a comparative stance, the provisions are fairly similar in that both legislatures require shareholder resolutions (although the Irish resolution is a lot more stringent), and the company's solvency needs to be ascertained. Both the Irish and the South African provisions also provide for the voidability of the transaction. The Irish provision is however in line with the South African section 38 provision in the 1973 Act in that a breach of the provision will lead to criminal liability and the section 44 provision in the 2008 Act that he could also be personally liable.

The biggest difference lies in the fact that the Irish provision is a prohibition, whereas South Africa had a shift from the prohibition of financial assistance.

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[152] *Securities Trust Ltd v Associated Properties Ltd* (High Court, McWilliam J; November 19, 1980).
[153] Section 60(2)(b), (3) and (4).
[154] Ussher, fn 146, p 322 – writer needed confirmation if position is still the same with regards to the fine.
[155] *Bank of Ireland Finance Ltd v Rockfield Ltd* [1979] IR 21.

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7.3. New Zealand's Law

7.3.1. Financial assistance in New Zealand

In *Re Wellington Publishing Co Ltd*[156] the concept of financial assistance was discussed and found as follows:

> "The expression 'financial assistance' is an indefinite one and it is beyond normal experience to regard the expression as applying to the payment of a dividend. The payment of a dividend is part of the normal functions of a company, and indeed, in the final analysis is probably as much the reason for the company's existence as is the earning of profits the reason for an individual trader being in business."

7.3.2. Fair and reasonable terms to the company

In section 76(2) in the New Zealand Companies Act 1993, their financial assistance provision reads as follows:

> "A company may give financial assistance ... if the board has previously resolved that –
>
> (a) The company should provide the assistance; and
> (b) Giving the assistance is in the best interest of the company; and
> (c) The terms and conditions under which the assistance is given are fair and reasonable to the company."

It is striking that New Zealand's legislature also specifically provide for the terms to be fair and reasonable to the company, however it differs from the South African provision as it is preceded with the proviso that the financial assistance must further be in the best interest of the company.

As is discussed in Cassim et al[157] the proviso of the 'best interest of the company' could be aimed at protecting the shareholders of the company, and the terms that are 'fair and reasonable to the company' could be aimed at protecting the creditors. If this is however the case it would seem that our South African provision only encompasses creditor protection.

[156] *Re Wellington Publishing Co Ltd* [1973] 1 NZLR 133 at 136.

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Jones[158] commented in his book that:

> "In exercising the power to repurchase the shares of a company, directors of the company must to do so in good faith, and in what each director considers to be in the best interests of the company, as required by the duty of loyalty imposed on each director by the 1993 Act. An interesting issue is whether the duty of loyalty subsumes the requirements of s 60(3) [this subsection includes the best interests and fair and reasonable requirements] ... In large part it probably does so."

Section 60(3) of the New Zealand Companies Act finds application at share acquisitions by the company itself, if the board finds it in the best interest of the company. Jones[159] is further quoted with regards to financial assistance as follows:

> "As with the power of the board to repurchase shares, the directors of a company in exercising the power to provide financial assistance must do so in what each director considers to be the best interests of the company, as required by the duty of loyalty imposed on each director by the 1993 Act. It is difficult to give guidance to directors in these circumstances as to what additional considerations are required of them to be satisfied that the assistance is of benefit to shareholders not receiving the assistance and the terms and conditions of the assistance are fair and reasonable to those shareholders. The better view is that if the directors satisfy the duty of loyalty in resolving to give the financial assistance, then they will probably satisfy these additional requirements."

As discussed in Cassim et al[160], writer respectfully agrees with the authors that the best interest of the company is similar to our fiduciary directors' duties, and could indicate an "interplay between directors' duties and what is required of the board under s 44 of the Act[161]".

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[157] Cassim FHI, Cassim MF, Cassim R, Jooste R, Shey J & Yeats J *Contemporary Company Law* (2012) Second Edition Juta, at p 331.
[158] Jones DO *Company Law in New Zealand – A Guide to the Companies Act 1993* (1993) Butterworths-Heinemann p 34.
[159] Jones, fn 158, p 34.
[160] Cassim et al, fn 157, p 332.
[161] The Companies Act 71 of 2008.

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7.3.3. Comparisons between the Companies Acts of New Zealand and South Africa

Both New Zealand's and South Africa's provisions do not contain a definition as to what financial assistance would entail. What is striking in the comparison with New Zealand's provision is that section 44 also contains the fairness and reasonability to the company.

Another interesting comparison is the financial assistance requirement of in the best interest of the company, which our 2008 Act encapsulated in the directors' fiduciary duties provision.

7.4. Australian Law

7.4.1. Prohibition on the granting of financial assistance

Section 129(1)(c) of the Companies Code stipulated that a company is "prohibited from loaning money on the security on the security of its shares or those of its holding company[162]". This rationale is also based on the *Trevor v Whitworth*-case[163] wherein the purpose lies to circumvent self-purchase of its own shares.

In the case of *E H Dey Pty Ltd v Dey*[164] McInerny J's dictum is quoted as follows:

> "In my view, the prohibition is not confined to financial assistance to the purchaser: it is directed to financial assistance to whomever given, provided that it be for the purpose of a purchase of shares or in connexion with a purchase of shares."

This is also the position that should have been taken in the case of *Gardner v Margo*[165]*.*

The Companies Code was however subject to the Corporate Law Simplification Program review, as introduced by the Commonwealth. The new provisions were implemented in the Company Law Review Act of 1998 and is currently contained in

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[162] Australian Government Takeovers Panel "Companies and Securities Law Review Committee" p 5 par [112] http://www.takeovers.gov.au/content/Resources/cslrc/cslrc_discussion_paper_no_5.aspx (as viewed on the 2nd of November 2014).
[163] [1887] 12 App Cas 409 (HL) 416.
[164] *E H Dey Pty Ltd v Dey* [1996] VR 464 at 460.

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the Corporations Act of 2001. Section 260A(1)(a) prevents companies from giving financial assistance to a person for the acquisition of "shares, or units of shares, in the company or the holding company if the transaction would materially prejudice the interests of the company or its shareholders, or materially prejudice the company's ability to pay its creditors"[166]. The shareholders can however approve the financial assistance in terms of section 260B.

The Act also provides for the exception of non-application where the loan was made in the ordinary course of commercial dealing or in the ordinary course of moneylending business[167].

7.4.2. Consequences of breach of the prohibition

Breach of a transaction prohibited in terms of section 129 of the Companies Code voided the transaction and made it unenforceable, as well as having civil and criminal consequences[168]. The defaulting officers could be held liable for a criminal penalty or a fine.

The penalty could be for a period of up to two (2) years and the fine up to $ 10,000. The company itself would be free from criminal liability as this would effectively hurt the shareholders indirectly. The courts could further order the convicted person to compensate the company or any person as the court specifies.

This position also changed with the implementation of the Act, and now the directors will be held liable in terms of their fiduciary duties, but dissident members can contact the Australian Securities and Investments Commission. Section 260D[169] states that a person who is involved in a company's contravention, is in

[165] *Gardner v Margo* 2006 (6) SA 33 (SCA).
[166] Fletcher K "Financial Assistance around the Pacific Rim: the persistence of dysfunctional provisions" http://www.clta.edu.au/professional/papers/conference2006/2006KF_FAAPR.pdf (as viewed on the 2nd of November 2014).
[167] Section 260C.
[168] Fn …p 5 – 6, par [114] – [117].
[169] Of the Corporations Act 2001.

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contravention of this subsection[170] and furthermore, if the involvement is dishonest, will be committing a criminal offence[171].

7.4.3. Comparison between the financial assistance provisions of Australia and South Africa

The provisions seem quite similar as both require shareholder approval before financial assistance can be given.

Also, both countries' legislature opted to decriminalise the contravention of the provision, but directors will acquire liability in terms of their fiduciary duties towards the company and its shareholders.

7.5. Canada

7.5.1. Prohibition of financial assistance in Canada

Section 44[172] of the Canada Business Corporations Act[173] reads as follows:

> "(1) Prohibited loans and guarantees – Subject to subsection (2), a corporation or any corporation with which it is affiliated shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise
>
> (a) to any shareholder, director, officer or employee of the corporation or of an affiliated corporation or to an associate of any such person for any purpose, or
> (b) to any person for the purpose of or in connection with a purchase of a share issued or to be issued by the corporation or affiliated corporation,
>
> where there are reasonable grounds for believing that
>
> (c) the corporation is or, after giving the financial assistance, would be unable to pay its liabilities as they become due, or

[170] Section 260D(2).
[171] Section 260D(3).
[172] Uncanny that it is even the same number as South Africa's provision in terms of section 44 of the Companies Act 71 of 2008.
[173] RSC 1985, c C-44.

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(d) the realizable value of the corporation’s assets, excluding the amount of any financial assistance in the form of a loan and in the form of assets pledged or encumbered to secure a guarantee, after giving the financial assistance, would be less than the aggregate of the corporation’s liabilities and stated capital of all classes.”

Subsection (2) then further indicates where financial assistance is permissible, and indicate the ordinary course of business as an exemption to the rule.

7.5.2. Contravention of the prohibition

Directors who authorise assistance, as indicated in the preceding subchapter, will be held personally liable to the corporation for the amount. The Canada Business Corporations Act does however afford a director a certain defence if they had been acting in good faith[174].

7.5.3. Comparison of the provisions of Canada and South Africa

A lot of the South African and British provisions are quite similar in concept. This is no different provision. South Africa and Canada both do not permit financial assistance for the purchase and or subscription of shares in their own companies, if after the transaction they will not satisfy the solvency and liquidity tests they each have.

Both legislatures could lead to criminal liability, but the Canadian Act does however afford a defence which the South African Act does not have.

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CHAPTER 8

Conclusion

The 2008 Act only came to effect on the 1st of May 2011. It is therefore fair to say that its relatively new status cannot yet indicate the success or alas failure in terms of the change from the capital maintenance rules. There are many an opinion as to the changes made and if it is in line with corporate law regimes of other countries.

Most countries have specific provisions with relation to the financial assistance provisions, and the subsequent provision thereof. Most of the European Union members are required to have at least the provision restricting financial assistance to the limit of a company's available reserves where public companies are involved. Some countries go further and prohibit any form of financial assistance.

Take for instance Turkey's new Turkish Commercial Code numbered 6762[175] which introduced the prohibition to their country. The basic gist is always the same – no country should fund their own share buyback, and the company needs to remain solvent and liquid.

What researcher has found is that the South African provision contained in section 44 of the 2008 Act can be seen as being brought in line with the aims of modern economic country, although there still seems to be a lot of legal uncertainties, and the application will only be seen after a few years and cases heard in terms of the 2008 Act.

When referring to other countries, though, there are many a similarity and it could be said that the legislator had a few outside influences when the Act was drafted.

Researcher will therefore depart with a cliché, but a valid one: "Only time will tell[176].

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[174] Smith M "Financial Assistance under the Canada Business Corporations Act" http://www.parl.gc.ca/Content/LOP/researchpublications/prb9941-e.htm (as viewed on the 1st of November 2014).

[175] Erdem & Erdem Law Office "The Prohibition against Financial Assistance under the New TCC" http://www.erdem-erdem.com/en/articles/the-prohibition-against-financial-assistance-under-the-new-tcc/ (as viewed on the 1st of November 2014).

[176] If the financial assistance provisions in the Companies Act 71 of 2008 is a successful provision that will benefit companies and corporations in the South African corporate world.

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CHAPTER 9:

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Companies Amendment Act 37 of 1999

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9.1.2. International Law

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The Companies Act of 1985

The Companies Act of 1986

The Companies Act of 2006

9.1.2.2. Ireland

Companies Act 1959

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Companies Act 1963

Companies Act 1983

9.1.2.3. New Zealand

New Zealand Companies Act 1993

9.1.2.4. Australia

Company Law Review Act of 1998

Corporations Act 2001

9.1.2.5. Canada

Canada Business Corporations Act, RSC 1985, c C-44

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9.2.1. National Case Law

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Capitec Bank Ltd v Qorus Holdings Ltd 2003 (3) SA 302 (W)

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Chaston v SWP Group plc [2003] 1 BCLC 675 (CA) 686

Heald v O'Connor [1971] 1 WLR 497 (QB)

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ANNEXURE A:

Precedent for the Board Resolution for the Authorisation of Financial Assistance

Authorisation of Financial Assistance[177]

BACKGROUND:

(*Insert background information if necessary, including in the background information a description of the financial assistance to be granted)*[178].

The shareholders have approved the provision of financial assistance described above[179] by way of a special resolution as required in terms of (*insert section of the Act*)[180].

The restrictive conditions on the provision of financial assistance in (*insert article*) of the Memorandum of Incorporation of the company have been satisfied[181].

RESOLVED:

THAT the board has applied the solvency and liquidity test in terms of section 4 of the Companies Act 71 of 2008 to the proposed financial assistance described above and is satisfied that considering all reasonably foreseeable financial circumstances of the company[182]:

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[177] Sections 44 and 45 (of the Companies Act 71 of 2008) regulate the provision of financial assistance by a company to another party in certain circumstances. Both provisions are dealt with in this one precedent as their requirements affecting the board resolutions approving the financial assistance are the same.

[178] For example: "Pursuant to a Framework Agreement to be concluded between the company and Party A, the company is to advance (*insert amount)* to Party A to enable Party A to subscribe for (*number and type)* shares in the company ("Advance")" or "Pursuant to the conditional Loan Agreement to be concluded between the company and Director A ("Loan Agreement") the company is to advance (*amount)* to Director A (referred to below as the "Loan")".

[179] It is preferable to refer to the financial assistance specifically wherever it appears in the resolution, for example by using terms defined in the Background section. Using one of the examples in fn above, this would read "The shareholders have approved the provision of the Advance by way of a special resolution…".

[180] For financial assistance given for the purchase or subscription of securities in the company or a related or inter-related company, the reference should be to "section 44(3)(a) of the Companies Act 71 of 2008" and for financial assistance given to a director of the company or to a related company or to any other person contemplated in section 45(2) (regardless of the purpose), the reference should be to "section 45(3)(a) of the Companies Act 71 of 2008.

[181] Ss 44(4) and ss 45(4). If applicable replace with "There are no restrictions or conditions on the provision of financial assistance as contemplated above, in the Memorandum of Incorporation of the company".

[182] This is a conflation of s 4 and s 44(3)(b)(i) or s 45(3)(b)(i).

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- the assets of the company, as fairly valued, will equal or exceed the liabilities of the company as fairly valued; and
- it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of twelve (12) months,

immediately after providing the financial assistance[183].

THAT the board is satisfied that the terms under which the financial assistance is proposed to be given, are fair and reasonable to the company[184].

THAT the company grant the proposed financial assistance described above.

PRESENT AT THE MEETING:

DATE AND PLACE OF THE MEETING:

[183] The consideration of the test by the board need not be recorded in the resolution but it is possibly the most appropriate place for it to be noted. Alternatively the board's satisfaction with the application of the test may be recorded in the Background section. In terms of ss 44(3)(b)(i) and ss 45(3)(b)(i) the board must be satisfied that the company will satisfy the solvency and liquidity test immediately after providing the financial assistance.

[184] Ss 44(3)(b)(ii) and ss 45(3)(b)(ii) require that the board be satisfied that the terms are fair and reasonable to the company. This need not be in the body of resolutions themselves, but can be included in the Background section.

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