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CORPORATE AND COMMERCIAL MATTERS

IN THIS ISSUE

COMMON AND RECURRING PRACTICAL QUESTIONS UNDER THE COMPANIES ACT, 2008

Since the Companies Act, No 71 of 2008 (Companies Act) came into force on 1 May 2011, legal practitioners have grappled with a number of issues brought about by this new legislation. We are now more than two years into the new company law regime. In this edition of Corporate & Commercial Matters we share several of the common issues and questions that have arisen in practice, and share some of the suggested answers or solutions to these.

Financial assistance

The provisions of s45 of the Companies Act have been the topic of much debate. Some still do not believe (or do not want to believe) that the section applies to intra-group financial assistance such as loans and cross-guarantees.

The financial assistance must be approved by the board (which must consider solvency, liquidity, fairness and reasonableness) and by a special resolution of the shareholders.

Ever since the section appeared in the Companies Bill there has been much debate as to the category of recipients referred to in s45(2), especially as the heading of s45 reads "Loans and other financial assistance to directors" whereas the text of the actual section goes considerably far beyond that. It is probably safe to say that, for the most part, the market has (perhaps grudgingly) accepted that financial assistance to related companies (eg group companies) is regulated by s45. But then come all of the practical and administrative difficulties. Do you have to convene the board to approve every individual piece of financial assistance? And the shareholders? How does one practically implement this section having regard to the fact that in some group structures financial assistance is given across the group on a very frequent basis?

What should be borne in mind is that the test in s45 is whether the board is satisfied that the financial assistance in question complies with s45(3). It is a subjective test (although when looking at the solvency and liquidity test in s4 of the Companies Act there are objective parameters. For instance there must be 'fair' valuations of assets and liabilities, and all 'reasonably foreseeable' contingent assets and/or liabilities must be taken into account). But the fact remains that the test in s45 is subjective. How the board obtains this satisfaction is not prescribed in the Companies Act. It is a practical question to be addressed by each individual company having regard to the nature of its business and operations.

For instance, the board of a company may very well be satisfied, after applying itself to the question, that if the company were to advance intra-groups loans in aggregate of up to say R5 million over the course of the ensuing four months at a particular interest rate (if any), such would not jeopardise the solvency and liquidity of the company as contemplated in s4 of the Companies Act and would be fair and reasonable to it. There should not be a problem with the board passing a more 'general' authority within such parameters it deems fit, without having authorise each and every transaction. Therefore, it is submitted that it is not

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necessary that each and every portion of financial assistance needs to be individually approved by the board. Whilst it may be argued that the requirement in s45(3) that the board must authorise the 'particular' provision of financial assistance implies otherwise, it is submitted that the word 'particular' must find its meaning within the context of the statute. To satisfy the requirement of the 'particular' financial assistance being authorised, it should be competent for the board resolution to authorise financial assistance within specified and objective parameters as may be practicable, as outlined in the suggestions below.

Suggestions on financial assistance

Set a framework within which a committee or other authorised delegate (eg CFO) can function.

Note, however, that s45 states that it is the board that must ultimately be satisfied that the giving of the financial assistance will not cause the funding company to fail the solvency and liquidity test and that the terms of the financial assistance are fair and reasonable to the company. Any delegation of the board's functions in this regard will not absolve the board of ultimate responsibility. It is in this light that a board must take a view as to what degree or level its involvement and oversight is necessary in the granting of specific financial assistance.

In light of the above, the following suggestions can be made when crafting the company's board resolutions with respect to financial assistance under s45 (and these can be applied to shareholder resolutions as well):

- Limiting the amount or maximum exposure of the financial assistance (ie by placing a monetary 'cap' on the value of the financial assistance authorised);
- Limiting the time period for which the authorisation is valid;
- Limiting the type of financial assistance (eg loans, guarantees, etc);
- Describing on a high level what sort of terms may attach to the financial assistance (eg interest rates, any 'guarantee fees' payable by a subsidiary which may be a beneficiary of a parent guarantee);
- Requiring that there be specific oversight by the audit committee (if any);
- Naming the entities that may be recipients of the financial assistance; and
- Limiting the purpose of such financial assistance (eg operational requirements, guarantees in respect of bank loans, etc.)

Another practical step which has been taken by some company groups in light of s45 is to establish a single treasury company which deals with all inter-company financial assistance. Such an arrangement may have limited benefits but, depending on the structure and its implementation, it may help to alleviate the administrative and logistical issues of having to obtain s45 approvals in every one of the group companies.

Financial assistance given by banks and other financial institutions

Sometimes overlooked in practice is the applicability of s45 to the provision of financial assistance by banks and other financial institutions. Whilst s45 does contain a general exemption for those companies whose primary business is the lending of money (see s45(1)(b)(i)), one should note that, on the wording of that exemption, it is only financial assistance in the form of lending of money which is exempted. Other forms of financial assistance such as preference share funding, guarantees and subordinations given by a financial institution to or for the benefit of persons related/connected to it as envisaged in s45(2) are still regulated by s45 of the Companies Act.

An example which arises in practice every so often is where a financier controls the investee company/borrower (eg it is the majority shareholder) and provides equity finance or other financial assistance (other than the lending of money) to that investee company. It must not be assumed that the general exemption in s45 applies - each case must be considered on its own facts and circumstances. These considerations also apply to financial assistance in connection with the acquisition of shares under s44 of the Companies Act.

Regulated companies and the application of takeover law

Because of the expanded application of the takeover regulations in the world of private companies, one finds in practice that parties often overlook the fact that the takeover regulations could be applicable to their transaction.

A 'regulated company' is any public company and state-owned company, but also includes any private company (a (Pty) Ltd) where more than 10% of its voting securities were transferred amongst unrelated persons in the past 24 months. The size of the private company and the number of its beneficial shareholders is irrelevant, unlike the case under the previous Securities

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Regulation Panel (SRP) Code. If one intends to implement an 'affected transaction' in respect of a regulated company, one has to comply with the takeover laws in parts B and C of Chapter 5 of the Companies Act as well as the takeover regulations, or otherwise obtain an exemption from the Takeover Regulation Panel. Either way, costs and time are involved.

An 'affected transaction' is any of the transactions listed in s117(1)(c) of the Companies Act which are, at the risk of gross oversimplification, takeovers and mergers in respect of regulated companies whether by means of share or asset acquisitions.

Often a question in practice is - what if the parties accidentally overlooked the question of takeover law and implemented the transaction anyway? The Companies Act expressly states, in s121, that an affected transaction must not be implemented unless you either have clearance or an exemption from the Panel. Thus, if one implements without complying, one is breaching the Companies Act. As is the case with the majority of the provisions in the Companies Act, as well as many other statutes, it is not expressly spelled out what the consequences are for transactions which contravene the statute.

There is s218(1) of the Companies Act which states that, unless the particular section says that the (non-compliant) agreement is void, such agreement is not void until declared as such by the court. That section however merely postpones rather than answers the question. The point is rather, if the matter were to be challenged and taken to court, what would the outcome be? There is a great deal of case law dealing with this type of issue, ie where a statute is silent on the consequences of non-compliance. Various factors are highlighted by the courts to be taken into consideration in determining the issue. Ultimately, these factors boil down to one question: is it necessary to void the transaction to achieve the purpose and objects of the statute, or are there sufficient alternative remedies to protect the beneficiaries of the statutory provisions? Whilst there are strong arguments that a transaction breaching the takeover provisions is not void (because there are a number of other protections and remedies available to minority shareholders), it is to some extent a value judgement taken by the courts, and the matter is not clear-cut as we do not have a court precedent as yet under the Companies Act.

In the meantime, one is strongly advised to ascertain, at an early stage in any transaction involving a sale of shares or sale of business of a private company, whether the target company, the seller and/or any of the subsidiaries of the target company are 'regulated companies' - this is done by having regard to the history of share transfers in the relevant company.

Indemnifying/insuring directors and prescribed officers

Compared to the previous Companies Act, 1973 (in particular s247 thereof) (Previous Act), the new Companies Act has significantly expanded the scope and ability of a company to indemnify and/or take out insurance protecting its directors and officers for breach of their duties. This is dealt with in s78 of the Companies Act, which allows a company to indemnify or insure its directors and officers but subject to the limits in that section.

There are two kinds of insurance contemplated in s78 of the Companies Act:

- Insurance where the director is the insured who has the benefit of the insurance cover, should he incur liability;

- Insurance where the company is the insured in instances where, for example, the company is sued by a third party on the basis of vicarious liability for the acts of its directors, or where the company itself suffers loss as a result of its directors' breach of duty (such as a depletion of its funds due to theft).

By way of illustration of the type of insurance that is available out there, Bekink[1] notes that a typical Lloyds 'D&O' (directors and officers) insurance policy usually contains two parts. They are commonly known as Side A and Side B cover. Side A provides cover for the individual director (as the insured), for instance where a director has negligently entered into a contract with a third party on behalf of the company which the company is not able to honour. Side B offers reimbursement to the company itself (as the insured) to the extent that the company has indemnified the director for any claim made against the director. However, it should be observed that with Side B cover the company is not indemnified in its own right, but is reimbursed as a result

[1] Mildred Bekink "Indemnification and Aspects of Directors' and Officers' Liability Insurance in terms of s78 of the Companies Act 71 of 2008" (2011) 23 SA Merc LJ 88.

of incurring expenses due to claims made against the director. Some policies offer in addition what is referred to as Side C or 'corporate/entity' cover. This type of insurance provides cover for both directors' and company liability, in instances where the company faces primary or vicarious liability for the acts and defaults of its directors.

However, each company should approach its insurers with a view to ascertaining what kind of cover is available in this regard. It is not to say that insurers actually offer all the types of cover which are permitted by s78.

The recommendation or otherwise to a company to take out D&O insurance protecting its directors is mostly a principle and commercial issue. Some hold the view that, without such insurance, it would be difficult for companies to attract suitable persons willing to serve as directors or prescribed officers. However, a committee launched in the UK to investigate this matter found that there was no foundation for such an assertion[2]. Nevertheless, it can be forcefully argued that the Companies Act has introduced heightened potential liability[3] of directors and that this ought to be counterbalanced by suitable indemnities or insurances. On the other hand, the existence of such insurance may cause directors to exercise less diligence than they ordinarily would, in the comfort that they are 'covered'.

There are also tax issues to be considered, for instance the deductibility of the premiums. Two other points should be borne in mind:

- The first is the potential application of s45 of the Companies Act. It is arguable that certain forms of indemnification or insurance may amount to 'financial assistance' given by a company to its directors as contemplated in s45 of the Companies Act. In this regard, a company should ensure that it has its s45 approvals in place (including a special resolution of shareholders) before entering into certain indemnification or insurance arrangements. Under the Previous Act, only loans and security provided to directors were regulated (s226) - indemnities and insurance would probably not have been covered before. But the provision is now wider and includes any form of financial assistance, whether by way of loan, guarantee or otherwise.
- The second point relates to the company's insurer's right of subrogation. Before a company goes ahead and indemnifies its directors (ie where the company itself, and not an insurer, indemnifies the director and holds him harmless against certain losses), consideration must be given to whether the company should first consult its insurers before giving such an indemnity. Insurers have a right of subrogation once they have covered the insured company, which means the insurer can proceed against the culpable director, in the company's name, that caused loss to the company. The problem however is that the insurer 'steps into the shoes' of the insured company; thus if a company indemnifies the director in question, the insurer's right of recovery is prejudiced. The insurance policy would invariably provide that such prejudice is a ground for the insurer to repudiate the company's claim under the insurance policy. Any compromise of the right against the director must be with the insurer's consent.

Please contact any of the partners in our Corporate & Commercial Practice Area for advice or guidance on any of the above or related issues.

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[2] See Cassim et al Contemporary Company Law (2011) at p522.

[3] Section 77 of the Companies Act contains a whole host of instances where directors may be held personally liable for loss or damages suffered by the company. Section 218(2) contains a far-reaching civil liability provision which any third party can use.

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