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CORPORATE & COMMERCIAL ALERT

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Section 44 of the Companies Act and Post Acquisition Finance

Often the provisions of s44 of the Companies Act, No 71 of 2008 (Act) are overlooked when companies who previously obtained the requisite s44 financial assistance shareholder approval (in connection with the acquisition of shares of the company or of a related company) decide to vary the terms of such financial assistance post the relevant share acquisition.

Section 44 of the Companies Act and Post Acquisition Finance

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Often the provisions of s44 of the Companies Act, No 71 of 2008 (Act) are overlooked when companies who previously obtained the requisite s44 financial assistance shareholder approval (in connection with the acquisition of shares of the company or of a related company) decide to vary the terms of such financial assistance post the relevant share acquisition.

Consider the following scenario: Company A wishes to subscribe for shares in Company B. Company C (being a subsidiary of Company A) facilitates the subscription by advancing a loan equal to the subscription price to Company A after obtaining the requisite s44 shareholder approval. One year after the subscription, Company A and Company C agree to a reduction of the interest rate and to a write-off of a portion of the original loan amount.

There are aspects to be considered in this regard.

Section 44 regulates situations where a company (lending company) provides financial assistance (by way of a loan, guarantee, the provision of security or otherwise) for the purpose of, or in connection with the subscription of any option or securities issued or to be issued by the that 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 (Financial Assistance). Save for certain exceptions, the lending company may only give such Financial Assistance if (i) it has obtained a special resolution of its shareholders, adopted within the previous two years, which approved such assistance either for the specific recipient, or generally for a category of potential recipients, and the specific recipient falls within that category (ii) the board of the lending company is satisfied that immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test (as contemplated in s4 of the Act); and that the terms under which the financial assistance is proposed to be given are fair and reasonable to the lending company.

The Act clearly addresses instances where approval is sought for the initial Financial Assistance, however, it remains unclear if the lending company providing the financial assistance ought to obtain a new s44 special resolution from its shareholders in an instance where the lending company wishes to amend/ refinance the initial financial assistance, long after the shares have been acquired and paid for (for example, by varying the interest rate or a variation of any other payment terms applicable thereto).

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Section 44 of the Companies Act and Post Acquisition Finance

The lending company must always consider whether the “direct object” of the amendment to the terms of the financial assistance, for instance, is the amendment for the purpose of enabling the borrower to retain the acquired shares.

Section 44 is only applicable where the financial assistance is “for the purpose of” or “in connection with” the acquisition of securities, it can thus be argued that if no additional shares are being acquired by the borrower the lending company would not have to obtain a new s44 special resolution from its shareholders. It can also be argued, however, that the term “in connection with” extends the application of s44 to instances where the lending company and the holder of the shares agree to amend/refinance the original loan, as such amendment/refinance would arguably still be “in connection with” the acquisition of the shares.

In the interpretation of the financial assistance provisions of the 1973 Companies Act (which are helpful in the interpretation of s44) the court in *Gardner v Margo* 2006 3 All SA 229 (SCA) distinguished between the “direct object” and the “end goal” of a transaction and that it is the direct object of the transaction that is relevant in determining if the transaction is financial assistance.

The court in the Gardner case further held that -

“[i]f the direct object is not the provision of financial assistance by the company for the purpose of or in connection with the purchase of its share, then it is irrelevant if the ultimate goal of the transaction is to enable a person to purchase such shares”.

The lending company must always consider whether the “direct object” of the amendment to the terms of the financial assistance, for instance, is the amendment for the purpose of enabling the borrower to retain the acquired shares, if so, it may be prudent to obtain a fresh s44 special resolution.

Comparatively, the UK Companies Act specifically prohibits the giving of further financial assistance by the lending company if such financial assistance would have the effect of directly or indirectly reducing the borrower’s original liability under financial assistance given by the lending company to the borrower for the purpose of, or in connection with the acquisition of shares. This prohibition lasts indefinitely and covers instances of refinancing an amendment to the original financial assistance or a refinance.

The directors of the lending company should carefully consider the terms and the direct object of the amendment/refinance as this will determine whether or not there is a need for a new s44 special resolution. In the above scenario the reduction of the interest rate possibly would not create a problem, as Company C will still recover the loan amount from Company B, however, it would be prudent to rather obtain a new s44 special resolution for the waiver of a portion of the loan amount as this is a material variation to the original financial assistance.

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