

Financial assistance to directors – the Companies Act 71 of 2008

RICHARD JOOSTE*

Transactions between a company and its directors, which benefit the company at the company's actual or potential expense, are to an extent regulated by ss 37, 226 and 297 of the current Companies Act 61 of 1973. These provisions are flawed and this article examines the corresponding (but by no means equivalent) provisions of the new Companies Act 71 of 2008, which is expected to be brought into force in 2010. The article seeks to show that the new provisions are also unsatisfactory. It reveals that the provisions are in certain respects too far-ranging and that, in others, treat directors too leniently. The article also exposes problems of interpretation which impact significantly on the effectiveness of the new provisions. The article demonstrates that the provisions need legislative attention.

I INTRODUCTION

Those in control of a company are in a position of power, a position that has the potential for abuse, particularly where the company provides the controllers with loans or security. In recognition of the potential for abuse, the 1973 Companies Act¹ contains a number of provisions:

- prohibiting certain loans and provisions of security (s 226);²
- imposing a strict liability on directors in certain circumstances (s 37); and
- requiring special disclosure in the annual financial statements of certain transactions (ss 37, 295 and 296).

The corresponding (but by no means equivalent) provisions of the Companies Act 71 of 2008³ are to be found in s 45 and s 30(4)(a) read with s 30(6). Section 45 attempts to regulate certain transactions by prohibiting them unless certain requirements are satisfied.⁴ Section 30(4)

* BA, BCom (Hons) (Taxation) LLB (Cape Town) Diploma in Comparative Legal Studies LLM (Cantab). Attorney of the High Court of South Africa and Professor of Law, University of Cape Town.

¹ Act 61 of 1973, hereinafter referred to as 'the Companies Act, 1973'.

² For an analysis of s 226 see RD Jooste 'Loans to Directors – An Analysis of Section 226 of the Companies Act' (2000) 117 *SALJ* 269.

³ Hereinafter referred to as 'the new Act'.

⁴ Section 45(2). In explaining why s 226 of the Companies Act, 1973 permitted the transactions prohibited by s 226 in certain circumstances, Stegmann J held in *S v Pourolis* 1993 (4) SA 575 (W) at 589E that exceptions are provided 'presumably on the basis that in the excepted circumstances there are sufficient safeguards to establish a likelihood that the use of the company's assets for the benefit of its directors or managers or of companies controlled by them, will also be of benefit to the company and not at its expense'.

requires disclosure in a company's financial statements of the particulars of certain transactions.

This article seeks to analyse the new provisions. In doing so comparisons will be made with the corresponding provisions in the Companies Act, 1973 where it is deemed appropriate.

For ease of reference, s 45 is quoted in full:

45 (1) In this section, "financial assistance" –

- (a) includes lending money, guaranteeing a loan or other obligation, and securing any debt or obligation; but
- (b) does not include –
 - (i) lending money in the ordinary course of business by a company whose primary business is the lending of money;
 - (ii) an accountable advance to meet –
 - (aa) legal expenses in relation to a matter concerning the company; or
 - (bb) anticipated expenses to be incurred by the person on behalf of the company; or
 - (iii) an amount to defray the person's expenses for removal at the company's request.

(2) Except to the extent that the Memorandum of Incorporation of a company provides otherwise, the board may authorize the company to provide direct or indirect financial assistance to a director or prescribed officer of the company or of a related or inter-related company, or to a related or inter-related company or corporation, or to a member of a related or inter-related corporation, or to a person related to any such company, corporation, director, prescribed officer or member, subject to subsections (3) and (4).

(3) Despite any provision of a company's Memorandum of Incorporation to the contrary, the board may not authorize 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 2 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, and
- (b) the board is satisfied that immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test.

(4) 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.

(5) If the board of a company adopts a resolution to do anything contemplated in subsection (2), the company must provide written notice of that

resolution to all shareholders, unless every shareholder is also a director of the company, and to any trade union representing its employees –

- (a) within 10 business days after the board adopts the resolution, if the total value of all loans, debts, obligations or assistance contemplated in that resolution, together with any previous such resolution during the financial year, exceeds one-tenth of 1% of the company's net worth at the time of the resolution; or
- (b) within 30 business days after the end of the financial year, in any other case.

(6) A resolution 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).

(7) If a resolution or an agreement has been declared void in terms of subsection (6) read with section 218(1), a director of a company is liable to the extent set out in section 77(3)(e)(v) 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).

II ANALYSIS OF SECTION 45

(1) *Financial assistance*

What is immediately apparent when one compares s 45 of the new Act with s 226 of the Companies Act, 1973 is that s 45 covers a wider range of transactions than s 226. Section 226 covers loans and the provision of security⁵ and s 226(1A) provides that

- (a) 'loan' includes –
 - (i) a loan of money, shares, debentures or any other property; and
 - (ii) any credit extended by a company, where the debt concerned is not payable or being paid in accordance with normal business practice in respect of the payment of debts of the same kind.
- ...
- (c) 'security' includes a guarantee.

Section 45 of the new Act governs the provision of 'financial assistance' and provides for a number of inclusions and exclusions.⁶ The use of the word 'includes' in s 45(1)(a) indicates that the types of transactions

⁵ Section 226(1).

⁶ See the definition of 'financial assistance' in s 45(1).

referred to are not an exhaustive list of what constitutes financial assistance. If the list was intended to be exhaustive, one would have expected the term 'means' to have been used instead of 'includes'. The term 'financial assistance' is wide-ranging and accordingly s 45 is generally⁷ more extensive in its ambit than s 226. Transactions such as donations, sales at discounted prices and leases at favourable rentals would be covered by s 45 but not by s 226.⁸ It will be recognised that the extension of abnormal credit, which is included in the definition of a 'loan' in s 226,⁹ is clearly 'financial assistance' and would accordingly be covered by s 45 of the new Act.

Financial assistance for the purposes of s 45 does not include 'an amount to defray the person's expenses for removal at the company's request'.¹⁰ It is foreseeable that difficulties may arise regarding which expenses the legislature has in mind. How close must the connection be between the expense and the removal to qualify? Presumably costs of legal representation would be covered. It is also not clear whether expenses qualify for exemption only if there is an actual removal or whether expenses incurred in successfully negating an attempt at removal also qualify. These are issues in need of clarification. A further (perhaps minor) point is that in this exemption the financial assistance in question is referred to as an 'amount' whereas in all other instances the financial assistance refers to a transaction, for example, a loan. This needs to be tidied up.

Where s 226 of the Companies Act, 1973 is perhaps wider than s 45 of the new Act is in respect of a loan of something other than money. It could be argued that in certain cases such a loan is not financial assistance. For example, if a company allows a director the free use of the company's yacht,¹¹ this was covered by s 226,¹² but it is arguable that it is not financial assistance for the purposes of s 45.

The precise ambit of 'financial assistance' for the purposes of s 45 is not clear. A similar problem arises in relation to s 38 of the Companies Act, 1973 which makes it unlawful for a company to financially assist in the acquisition of its own shares or shares in its holding company 'by means of

⁷ See below for a possible exception.

⁸ If the price or rental is, however, nominal so as to evade the law, then such a contract could be construed as a loan and accordingly covered by s 226. As was said in *Treasurer-General v Lippert* (1880) ISC 291 (per Smith J) 'the Court should look to what a transaction is intended to be, and really is, rather than to what it is described as being'. In other words, if a transaction is designedly disguised so as to escape the provisions of the law but actually falls within those provisions, it is *in fraudem legis* and will be considered to be within the provisions of the law (*Dadoo Ltd and Others v Krugersdorp Municipal Council* 1920 AD 530; *S v Pourolis* 1993 (4) SA 575 (W) at 590–5).

⁹ See s 226(1A)(ii).

¹⁰ Section 45(1)(b)(iii).

¹¹ Such free use would constitute a loan for use (*commodatum*).

¹² Section 226(1A)(i) expressly includes a loan of any property and not only money.

a loan, guarantee, the provision of security or otherwise'.¹³ A fair amount of case law has built up with regard to what falls within the ambit of the words 'or otherwise' in s 38, which may have a role to play in determining the scope of financial assistance in s 45. It must of course be borne in mind that financial assistance in the context of s 38 is more limited than it is in s 45 because it has to be for the purpose of or in connection with the acquisition of shares to fall foul of s 38. For s 45 to operate the objective of the assistance is, of course, irrelevant.¹⁴ It will also be observed that s 45 does not use the words 'or otherwise' but that does not, it is submitted, give s 45 a narrower scope than s 38 of the Companies Act, 1973.

Section 45(2) refers to 'direct or indirect financial assistance' whereas s 226(1) refers to the making of a loan 'directly or indirectly'.¹⁵ In *S v Pouolis and Others*¹⁶ the court said¹⁷ in relation to s 226 that the prohibited indirect ways of giving a loan to a director do not include any transaction which does not result in a contract of a loan between the lending company and a borrower who is disqualified in relation to such company. It followed, the court held, that the prohibition does not extend to the use of a conduit, such as where a company makes a loan to the wife or a close relative of a director with the intention that the director should indirectly receive a benefit through the wife or relative.¹⁸ Accordingly, in *S v Pouolis*¹⁹ it was held that where a subsidiary makes a loan to its holding company to enable the holding company to make a loan to a company, X, controlled by a director of the subsidiary, the subsidiary has

¹³ Similar wording is to be found in s 44(2), the new Act's counterpart to s 38 of the old Act.

¹⁴ With regard to interpretation of the new Act generally, s 5 thereof states that it must be interpreted in a manner that gives effect to the purposes set out in s 7. Section 7, in turn, lists some of the most fundamental underlying principles of the new legislation. Section 5(2) permits a court interpreting or applying the legislation to consider, to the extent appropriate, foreign company law. In the light hereof, although the South African case law dealing with s 38 will most certainly remain relevant and applicable, courts should also look to the foreign jurisdictions from which certain of the new terms and concepts have been drawn as an aid to their proper interpretation. It is notable that the corresponding version of this section as contained in the 2007 Bill permitted a person, court or tribunal interpreting or applying the legislation to consider, to the extent appropriate, foreign company law. In the current version 'person' and 'tribunal' have been removed from this subsection. Presumably the drafters thought it would lead to confusion and legal uncertainty if natural and juristic persons were permitted to craft their own interpretations of sections of the legislation based on foreign company law and therefore deleted these words in the current version. The points made in this footnote are also made in an article on s 44 (which regulates the financial assistance by a company for the acquisition of its shares), not yet published, co-authored by J Yeats and RD Jooste.

¹⁵ It is of note that s 44 of the new Act, which deals with financial assistance for the acquisition of shares, does not use the term 'direct or indirect financial assistance' or 'directly or indirectly'. The reason for this is unclear, as s 44 and s 45 mirror each other in many other respects.

¹⁶ 1993 (4) SA 575 (W).

¹⁷ *Ibid* 660.

¹⁸ See *Pouolis* at 591, rejecting the view of Phillip M Meskin (ed) *Henochsberg on the Companies Act* 4 ed (1994) vol 1 at 433.

¹⁹ *Supra*, at 596–8.

not contravened s 226 by ‘indirectly’ making a loan to X.²⁰ It will be seen below, in dealing with the recipients of the financial assistance to whom s 45(2) applies, that a loan to the wife or a close relative of a director is covered by s 45.²¹ In those circumstances where the conduit used to benefit a director indirectly is not a recipient referred to in s 45(2), it appears that s 45(2) could nevertheless still apply on the basis that the director is the recipient of indirect financial assistance. It could be argued that the rationale in *Pourolis* is not applicable because of the generality of the term ‘financial assistance’ used in s 45 but not in s 226.

Excluded in the definition of ‘financial assistance’ in s 45 is ‘lending money in the ordinary course of business by a company whose primary business is the lending of money’.²² Exempted from the prohibitions in s 226 is: ‘in respect of anything done *bona fide* in the ordinary course of the business of a company actually and regularly carrying on the business of the making of loans or the provision of security’.²³ A comparison of the proposed and current provision shows four differences:

- Good faith (*bona fides*) is relevant in the current provision, but is not relevant in the proposed one. Theoretically this means that if a loan is made in bad faith and meets the other requirements of the proposed provision, it is nevertheless excluded from the prohibition in s 45.
- The extent of the business in question is irrelevant in the current provision. In the proposed provision the exclusion operates only if it is the ‘primary’ business which presumably means ‘the greater part of the business’.
- It is not a requirement for the exclusion in the proposed provision to operate that the business must be ‘actually and regularly’ carried on. This is a requirement of the current provision.

Also excluded from the meaning of ‘financial assistance’ in s 45 are ‘accountable advances’ to cover ‘legal expenses in relation to a matter concerning the company’ or ‘anticipated expenses to be incurred by the person on behalf of the company’.²⁴ The qualification that the advance must be ‘accountable’ is significant, as it appears to mean that if the person involved does not have to account for how the advance is expended it is ‘financial assistance’ within the meaning of s 45 (and understandably so). Section 226 is confusing in this regard. Advances of this kind, whether ‘accountable’ or not, do not fall within the ambit of the prohibited

²⁰ Note that the Court incorrectly said that the holding company’s loan would contravene s 226. This would be so only if the holding company itself had a holding company (see s 226(1)(a)(iii)).

²¹ Such a person is ‘related’ to the director. See below.

²² See s 45(1)(b)(i).

²³ See s 226(2)(c) of the Companies Act, 1973.

²⁴ Section 45(b)(ii).

transactions in s 226(1), yet s 226(2)(b) exempts from the prohibitions in s 226(1) ‘anything done to provide any director or manager with funds to meet expenditure incurred or to be incurred by him for the purposes of the company concerned’. Section 226(2)(b) thus purports to exempt from s 226 a transaction that is not prohibited in the first place! It is of note that the exemption in s 226(2)(b) is not an outright exemption. It is subject to the requirement of prior general meeting approval or repayment within six months of the next annual general meeting.²⁵ The exclusion in s 45(b)(ii), under discussion, is an outright exclusion – there are no strings attached – which is understandable considering that the expenses have to be fully accounted for. It is commendable that ‘non-accountable’ advances are covered by s 45 as they present an obvious opportunity for abuse – that such advances escaped regulation by s 226 is a serious flaw in the provision.

(2) *Who must be financially assisted?*

Who are the recipients of the financial assistance to which s 45 applies? As can be seen in s 45(2), the provision does not only cover directors. Again, s 45 is wider in this respect than s 226. The recipients include, in addition to a director, *inter alia*, a ‘prescribed officer’. A ‘prescribed officer’, in terms of s 1, ‘means the holder of an office, within a company, that has been designated by the Minister in terms of section 66(11)’. At the time of writing, such designation has not been effected. The Companies Act, 1973²⁶ defines an ‘officer’ in the following terms: ‘“officer”, in relation to a company, includes any managing director, manager or secretary thereof but excludes a secretary which is a body corporate’. A distinction is thus drawn between a manager and a secretary indicating that a secretary is not a manager. It is likely that the Minister will designate the same persons as ‘prescribed officers’. If so this would mean that s 45 is wider than s 226 which covered only directors and managers and not secretaries. The extension is to be welcomed as it is possible that in certain instances the position of a secretary might be abused.

The persons who may not be financially assisted in terms of s 45(2), unless the requirements of s 45 are satisfied, are described as follows, using Company X as the company providing the assistance:

1. a director or prescribed officer of Company X;
2. a director or prescribed officer of a company related or interrelated to Company X;
3. a company or corporation that is related to or interrelated to Company X;

²⁵ Section 226(3).

²⁶ See s 1.

4. a member of a corporation that is related to or interrelated to Company X; or
5. a person related to Company X or related to any of the persons in 1 to 4 above.

To determine when the ‘related’ or ‘interrelated’ relationship referred to in 2 to 5 above exists, one must turn to s 2 of the new Act which provides:

2. (1) 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 2 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) For the purpose of subsection (1), a person controls a juristic person, or its business, if –
 - (a) in the case of a juristic person that is a company –
 - (i) that juristic person is a subsidiary of that first person, as determined in accordance with section 3(1)(a); or
 - (ii) that first person together with any related or inter-related person, is –
 - (aa) directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with securities of that company, whether pursuant to a shareholder agreement or otherwise; or
 - (bb) has the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board;
 - (b) in the case of a juristic person that is a close corporation, that first person owns the majority of the members’ interest, or controls directly, or has the right to control, the majority of members’ votes in the close corporation;
 - (c) in the case of a juristic person that is a trust, that first person has the ability to control the majority of the votes of the trustees or to appoint the majority of the trustees, or to appoint or change the majority of the beneficiaries of the trust; or
 - (d) that first person has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary

commercial practice, would be able to exercise an element of control referred to in paragraph (a), (b) or (c).

(3) With respect to any particular matter arising in terms of this Act, a court, the Companies Tribunal or the Panel may exempt any person from the application of a provision of this Act that would apply to that person because of a relationship contemplated in subsection (1) if the person can show that, in respect of that particular matter, there is sufficient evidence to conclude that the person acts independently of any related or inter-related person.

It will be recognised immediately that s 45(2) is aimed not only at financial assistance given to individuals but also to certain companies and corporations as well. The same applies in s 226, but not to the same extent. Section 226 extends its tentacles to companies and other bodies corporate controlled by directors or officers. Section 37 of the Companies Act, 1973 complements s 226 by regulating loans to and the provision of security by a company on behalf of its holding company or fellow subsidiary. The regulation in s 226 is different to that of s 37, taking the form of prohibitions (subject to various exemptions) whereas s 37 contains no prohibitions but requires disclosure in the annual financial statements and liability for damages on the part of the responsible directors and officers in the event that the terms of the loan or provision of security are 'not fair to the company or failed to provide reasonable protection for its business interests'.²⁷

As can be seen from the wide definition of 'related' and 'interrelated' persons, read with s 45(2), the new Act casts its net much wider than s 226 and s 37. The extent of its operation is tempered to some extent by s 2(3), which enables a court, the Companies Tribunal or the Panel to exempt any person from the operation of s 45 if there is sufficient evidence that the 'related' or 'interrelated' relationship is such that the person acts independently of the related or interrelated person. It follows that if, for example, a company makes a loan to its subsidiary, or a director thereof (his sole directorship), because the company acts independently of the subsidiary (and the director), it is possible that the company could be exempted from the operation of s 45 by invoking s 2(3). However, it may not always prove to be factually or legally simple to determine whether companies are related or inter-related, especially in complex group structures. Although s 2(3) provides relief, the onus remains on the company to prove it is acting independently and, even if such an application is not made or proves unnecessary, the directors will need to apply their minds to determine whether a particular transaction falls within the ambit of s 45 or not. This may prove to be difficult, time-consuming and expensive for the company and may make the practical

²⁷ Section 37(3)(a).

application of s 45 challenging without necessarily providing significant additional protection for creditors and shareholders.²⁸

A loophole in s 226 exists where a loan (for example) is made to a trust of which a director of a company is a beneficiary. If the director is also a trustee of the trust, then s 226 applies because the loan has been made to the trustee (if only one) or the trustees jointly.²⁹ If, however, the director is not also a trustee, then, applying *Pourolis*,³⁰ s 226 is not applicable (in other words, the loan has not been made indirectly to the director).

Turning to s 45, a different situation presents itself. A trust is a juristic person for the purposes of the new Act.³¹ Accordingly, when the loan is made it is to the trust and not to the trustees. If a company makes a loan to the trust and a director of the company controls³² the trust, then s 45 will apply. This is so because the director is related to the trust.³³ It is clear that the director does not have to be a trustee in order to be related to the trust, although the most likely case of such relationship would be where he is a trustee.

If the director is a beneficiary of the trust but does not control it, the director and the trust are not 'related persons'³⁴ and accordingly if the company makes a loan to the trust the trust is not one of the recipients in s 45(2) (referred to in 2 to 5 above). However, it may be argued that, in such a case, the company is providing the director with indirect financial assistance and, accordingly, the issues of control of the trust and whether or not the director is related or interrelated to the trust, are irrelevant.

If s 45 is applicable in this situation, there seems to be no reason why it should not also be applicable in the following situation:

Company X makes a loan to Company Y. None of the relationships or interrelationships referred to in s 45(2) exist between the two companies. A director of Company X is a shareholder of Company Y. None of the relationships or interrelationships referred to in s 45(2) exist between the director and Company Y.

By reason of the director's shareholding in Company Y, it appears that, on the basis of the reasoning in the previous paragraph, Company X is

²⁸ The latter point is also made in relation to s 44 (which regulates financial assistance by a company for the acquisition of its shares) in an article (not yet published) by J Yeats and R D Jooste.

²⁹ The Companies Act, 1973 does not deem a trust to be a juristic person.

³⁰ See earlier.

³¹ See s 1, definition of 'juristic person'.

³² The director controls the trust for the purposes of s 2 of the new Act in two situations: (i) if the director 'has the ability to control the majority of the votes of the trustees to appoint the majority of the trustees, or to appoint or change the majority of the beneficiaries of the trust' (s 2(2)(c)); or (ii) if the director 'has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary commercial practice, can exercise an element of control referred to in [1]' (s 2(2)(c)-(d)).

³³ See s 2(1)(b).

³⁴ See s 2(1)(b).

providing the director with indirect financial assistance and s 45 applies. If this is so, the ludicrous situation arises that every time a company makes a loan to another company, it must check to see if any of its directors is a shareholder of the other company, in order to ascertain whether it has to comply with s 45. In fact the ambit of s 45 is so extensive as a result of the wide definitions of the 'related' and 'interrelated' relationships in s 2 that companies are, in any event, in all situations where they have entered into a transaction constituting financial assistance, going to be put to extensive enquiries to determine if s 45 is applicable. However, it may be the case, as in this example, that because the Company X is acting independently of Company Y, that Company X can invoke s 2(3) in order to get an exemption from the operation of s 45(2).

It will be recognised that if the director is not a shareholder of Company Y but a director, s 45 has no application. Because the director is not related or interrelated to Company Y, Company Y is not one of the recipients referred to in s 45(2) and the loan is not indirect assistance to the director himself/herself, so s 45(2) cannot apply.

(3) *The requirements of s 45*

To avoid a contravention of s 45 a number of requirements or conditions must be satisfied. This is so despite anything to the contrary contained in the Memorandum of Incorporation.³⁵ The requirements or conditions are those prescribed by s 45 and the Memorandum of Incorporation.³⁶ The Memorandum of Incorporation may also prohibit or restrict the provision of financial assistance generally or particular transactions that constitute financial assistance.³⁷

In summary, the requirements of s 45 that must be met in order to avoid a contravention of the section are:

- the financial assistance must be pursuant to an employee share scheme³⁸ or pursuant to a special resolution;³⁹
- the 'solvency' and 'liquidity' test must be satisfied;⁴⁰ and
- written notice to shareholders and any trade union representing its employee must be given by the board if it adopts a resolution to provide financial assistance.⁴¹

³⁵ See s 45(3).

³⁶ See s 45(4).

³⁷ See s 45(2) and (4).

³⁸ Section 45(3)(a)(i). The scheme must satisfy the requirements of s 97.

³⁹ Section 45(3)(a)(ii). The special resolution must have been adopted within the previous two years and must have approved such assistance for the specific recipient, or generally for a category of potential recipients and the specific recipient falls within that category.

⁴⁰ Section 45(3)(b)(i).

⁴¹ Section 45(5).

When one compares the requirements of s 45 with s 44 (financial assistance for the acquisition of shares) what is noticeable is that s 44 (but not s 45) has as one of its requirements 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’. It is difficult to discern why this requirement does not also appear in s 45. The requirement seems to be of equal importance in both the s 44 and s 45 contexts. The requirement was in fact included in s 45 in the 2007 Companies Bill but deleted in the new Act in terms of the amendments agreed to and made by the Portfolio Committee presumably as a result of pressure from the directors’ lobby. Of course, if the financial assistance to a director is for the acquisition of shares, then s 44 applies and the ‘fair and reasonable’ requirement will have to be satisfied.

What immediately stands out when one compares the requirements for exemption from the prohibition in s 45 and the exemptions in s 226 and s 37 is that in all circumstances s 45(3)(b) requires compliance with the solvency and liquidity test. This test did not feature at all in s 226 and s 37 of the Companies Act, 1973.

The solvency and liquidity test is set out in s 4 of the new Act. Section 4(1) provides:

- (1) For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all 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.

It is of note that s 45(3)(b) provides that the *board must be satisfied* that the solvency and liquidity test is complied with. Does this mean that the test is met as long as the directors are satisfied that the test has been met, no matter how unreasonable that belief may be? In other words, is the test whether or not the board is satisfied, a subjective test? An indication that the test requires some objectivity is the reference to ‘all reasonably foreseeable financial circumstances’ in s 4(1) and the requirements of s 4(2)(b) which provides:

- (2) For the purposes contemplated in subsection (1) –

...

- (b) subject to paragraph (c), the board or any other person applying the solvency and liquidity test to a company –
 - (i) must consider a fair valuation of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities, irrespective of whether or not arising as a result of the proposed distribution, or otherwise; and
 - (ii) may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances; . . .

The 'employee share scheme' requirement is more onerous than the corresponding exemption in s 226(2)(d). Section 226(2)(d) exempted 'the provision of money or making of loans by a company for the purposes contemplated in section 38(2)(b) and (c)'. Section 38 is the provision prohibiting a company from providing financial assistance for the acquisition of its shares or those of its holding company. Section 38(2)(b) exempts:

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;

Section 38(2)(c) exempts:

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;

The 'employee share scheme' requirement in s 45 is more onerous in that, firstly, the requirements laid down by s 97 must be complied with⁴² in order for the scheme to qualify, whereas no such qualification was required by s 226. Secondly, s 45 does not go beyond an employee share scheme the way s 38(2)(c) does. Thus a loan, for example, by a company to one of its managers⁴³ to assist the manager in acquiring shares in the company is exempted outright by s 38(2)(c) but still requires a special resolution for the purposes of s 45.

⁴² Section 97 requires that to qualify as an employee share scheme for the purposes of s 45, a company must, *inter alia*, appoint a compliance officer who is responsible for the administration of the scheme and who is required to comply with various duties laid down by s 97.

⁴³ It is assumed that a 'manager' will be designated as a 'prescribed officer'. See earlier.

Where the financial assistance is not pursuant to an employee share scheme it must in all instances⁴⁴ be ‘pursuant to a special resolution of the shareholders, adopted within the previous 2 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.’⁴⁵ The special resolution does not have to be passed at a formal meeting. It may be passed by way of a ‘round robin’ resolution voted for by the majority required at a formal meeting.⁴⁶ The special resolution must be passed *prior* to the provision of financial assistance. This is clear from the wording ‘adopted within the previous 2 years’ in s 45(3)(a)(ii). Thus ratification is not possible. The special resolution does not have to specify the specific recipients as long as it specifies the category of potential recipients. It appears, however, that the resolution must specify the type of financial assistance and cannot leave it to the discretion of the directors to decide on the type. This is apparent from the wording ‘... the particular provision of financial assistance is ... pursuant to a special resolution ... which approved such assistance’ in s 45(3)(a)(ii). What may prove to be problematic is the resolution approving financial assistance generally for a category of potential recipients. Needless to say, this requirement will have administration and cost implications for companies (especially large public companies and listed companies). A pragmatic board may therefore decide to propose a suitably drafted resolution at, for example, the annual general meeting every two years. The question then arises whether a category or categories of potential recipients may be so widely framed as to effectively give the board the discretion whether to provide the assistance or not without consulting the shareholders again. So, for example, would it satisfy the requirements of the section if the shareholders resolve that the company may provide financial assistance to any person if, in the opinion of the directors, the provision of such financial assistance would serve to further the BEE objectives of the company? If so, this would largely remove the protection ostensibly afforded to shareholders by the resolution requirement. However, there is nothing which appears from the section which militates against such an interpretation, nor is there anything in the new Act which prevents the passing of a number of such ‘boilerplate’ resolutions, widely framed, in respect of a number of different categories of recipients every two years as a matter of course. It is to be noted that the previous version of this section as contained in the 2007 Bill provided for an identical resolution to be

⁴⁴ Section 45 is unlike s 226 which provided for certain exemptions that required less than a special resolution (see the exemptions in s 226(2)(b) and (e)).

⁴⁵ Section 45(3)(a)(ii).

⁴⁶ See s 60 of the new Act. This, of course, was not permitted by the previous Act.

valid for a period of five years, so the reduced period represents improved protection in at least this respect.⁴⁷

The requirement in s 45(5) regarding notice by the board of a company to the company's shareholders and any trade union representing its employees is one that must be complied with in all circumstances. It is not clear why notice to the shareholders is required considering that if a special resolution is required (ie if the financial assistance is not pursuant to an employee share scheme), the shareholders will in any event have to be given notice of the meeting at which the shareholders will be called upon to vote on the special resolution.⁴⁸ The rationale for the differentiation in s 45(3)(a) and (b) calling for different periods of notice, depending on the company's 'net worth', is unclear. It is unsatisfactory that 'net worth' is not defined. The requirement of notice to any trade union representing the company's employees is an illustration of the legislature's apparent recognition that the body of employees of a company also constitutes a stakeholder whose interests must be taken into account in certain circumstances for good corporate governance purposes. Thus the company's shareholders are not in all instances regarded as the only constituency whose interests must be taken into account.

(4) *The consequences of contravening s 45*

A contravention of s 45 has no criminal consequences. This is in keeping with the clear policy evident in the new Act to decriminalise company law (which is questionable especially in the context of s 45).⁴⁹ The Companies Act, 1973 made a contravention of s 37 and s 226 a criminal offence.⁵⁰

Section 45(6) provides that 'a resolution by the board to provide financial assistance' 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' –

⁴⁷ The points made in this paragraph regarding a resolution approving financial assistance generally, are also made by J Yeats and RD Jooste in an article on s 44 (not yet published) which regulates financial assistance by a company for the acquisition of its shares.

⁴⁸ Notice of meetings is dealt with in s 62 of the new Act. Section 62(1) requires at least 15 business days' notice in the case of a public company or a non-profit company that has voting members, and 10 business days' notice in any other case. A company's Memorandum of Incorporation may provide for longer minimum notice periods (s 62(2)).

⁴⁹ A punitive sanction that appears possible is a fine of an administrative nature flowing from a failure to comply with a compliance notice issued by the Companies and Intellectual Property Commission established in terms of s 185 of the new Act (see s 171 of the new Act). An administrative fine can be imposed by the court in an amount not exceeding the greater of 10% of the respondent's annual turnover during the preceding financial year and R1 000 000 (see s 175(1) of the new Act). Whether such a fine will prove to be sufficient deterrent is questionable. The constitutionality of the fine may also be in doubt.

⁵⁰ See ss 37(2) and 226(4)(b).

- section 45; or
- a prohibition, condition or requirement regarding financial assistance in the company's Memorandum of Incorporation.⁵¹

Despite the voidness referred to in s 45(6), no resolution or agreement is unlawful unless a court declares it to be void. Section 218(1) of the new Act, which is of general application, provides:

Nothing in this Act renders void an agreement, resolution or provision of an agreement, resolution, Memorandum of Incorporation or rules of a company that is prohibited, void, voidable or may be declared unlawful in terms of this Act, unless a court declares that agreement, resolution or provision to be void.

Section 218(1) is a puzzling provision, although a similar provision is to be found elsewhere.⁵² It is not clear why it is deemed necessary for a court to affirm what the legislature has already determined to be the case. The status of things done in terms of what is stated in the new Act to be void, before it has been declared to be void, is also left uncertain.⁵³ It is submitted that the approach adopted in s 115(1) of the Consumer Protection Act 68 of 2008 is preferable to the approach taken by the drafters of the Competition Act 89 of 1998 and the Companies Act, 2008 as it provides more legal certainty. Furthermore it does not deprive the court of its power to adopt a more flexible approach should the circumstances require and to rule that an act or agreement is valid notwithstanding the fact that it constitutes a transgression of a particular legislative provision. Section 115(1) provides:

Civil actions and jurisdiction

115. (1) If an agreement, provision of an agreement, or a notice to which a transaction or agreement is purported to be subject, has been declared by a provision of this Act to be void, that agreement, provision or notice must be regarded as having been of no force or effect at any time, unless a court has declared that the relevant provision of this Act does not apply to the impugned agreement, provision or notice.

If voidness has been declared by a court in terms of s 218(1), s 45(7) imposes liability on any director who was present at the meeting when the board approved the resolution or agreement, or where no formal board

⁵¹ Section 45(6).

⁵² See s 65(1) of the Competition Act 89 of 1998, which provides:

'65. Civil actions and jurisdiction – (1) Nothing in this Act renders void a provision of an agreement that, in terms of this Act, is prohibited or may be declared void, unless the Competition Tribunal or Competition Appeal Court declares that provision to be void.'

⁵³ A provision similar to s 218(1) was included in an earlier draft of the Consumer Protection Act 68 of 2008 but after protestations has been replaced by a reverse provision which provides that something is void unless a court rules otherwise. See s 115(1) of the Consumer Protection Act.

meeting was held, participated in the making of such a decision by way of a ‘round robin’ resolution.⁵⁴ The liability arises if the director failed to vote against the resolution, despite *knowing* that the provision of financial assistance was inconsistent with s 45 or the company’s Memorandum of Incorporation.⁵⁵ Liability accordingly hinges on a subjective enquiry into the director’s knowledge at the relevant time.

The liability of directors for breach of s 45 is liability for any loss, damages or costs sustained by the company as a direct or indirect consequence of the voidness of the resolution or agreement.⁵⁶

If the board of a company has made a decision contrary to s 45 the company, or any director who has been or may be held liable, may apply to a court for an order setting aside the decision.⁵⁷ The court may make an order setting aside the decision in whole or in part, absolutely or conditionally and any further order that is just and equitable in the circumstances, including an order:

- to rectify the decision, reverse any transaction, or restore any consideration paid or benefit received by any person in terms of the decision of the board;⁵⁸ and
- requiring the company to indemnify any director who has been or may be held liable in terms of this section, including indemnification for the costs of the proceedings under this subsection.⁵⁹

The rationale for the order in the last bullet is difficult to comprehend. As seen above, a prerequisite for liability is *knowledge* on the part of the director at the time of voting on the resolution that the financial assistance was inconsistent with s 44 or the company’s Memorandum of Incorporation.⁶⁰ Why should a director be indemnified when he/she knew of such inconsistency and yet failed to vote against the resolution?

For the same reason it is difficult to understand s 77(9) which provides:

(9) In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that –

- (a) the director is or may be liable, but has acted honestly and reasonably; or
- (b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.

⁵⁴ Section 74 of the new Act permits ‘round robin’ resolutions.

⁵⁵ Section 45(7)(b). See also s 77(3)(e)(iv).

⁵⁶ Section 45(7) read with s 77(3)(e)(v).

⁵⁷ Section 77(5)(a).

⁵⁸ Section 77(5)(b)(ii)(bb).

⁵⁹ Section 77(5)(b)(ii)(bb).

⁶⁰ Section 45(7)(b). See also s 77(3)(e)(iv).

Again, why should a director be let off the hook when he/she knew of the inconsistency and yet failed to vote against the resolution? Regarding s 77(9)(a), how can such conduct be honest and reasonable? In addition, if the director has such knowledge at the time that the resolution is voted on, is there not *ipso facto* 'wilful misconduct or wilful breach of trust'? Regarding s 77(9)(b) it is also by no means clear what 'circumstances of the case, including those connected with the appointment of the director'⁶¹ justify excusing such director from liability.

Similar misgivings arise in relation to the reference to s 77(9) in s 77(10). Section 77(10) provides:

(10) A director who has reason to apprehend that a claim may be made alleging that the director is liable, other than for wilful misconduct or wilful breach of trust, may apply to a court for relief, and the court may grant relief to the director on the same grounds as if the matter had come before the court in terms of subsection (9).

The above analysis of the liability provisions with their indemnification and relief provisions leaves one wondering whether there is a serious attempt to impose liability. The directors' lobby has obviously been hard at work. This clearly does not bode well for good corporate governance.

The proceedings to recover any loss, damages or costs may not be commenced more than three years after the act or omission that gave rise to the liability.⁶² The wording in s 77(7) is different from the wording in s 12 of the Prescription Act 68 of 1969, which states that the three-year prescription period for extinction of a debt shall begin to run as soon as the debt is due and that a debt shall not be deemed to be due until the creditor has knowledge of the identity of the debtor and of the facts from which the debt arises. The commencement dates of the three-year period in these two pieces of legislation may be different and it is not clear which would prevail in the event of such a conflict.⁶³

The confusion regarding the voidness of a transaction contravening s 45 referred to above also continues in this section.⁶⁴ In terms of s 77(3)(e)(iv) it appears that the directors' liability arises only once the relevant resolution or agreement has been declared void, yet the three-year prescription period runs from the date of the act or omission that gave rise to the liability. Is one to understand from this that the taking of a prohibited resolution marks the beginning of the three-year period but

⁶¹ Section 77(9)(b).

⁶² Section 77(7).

⁶³ The same problem arises in relation to liability for a breach of s 44 (financial assistance for the acquisition of shares) referred to by J Yeats and RD Jooste in an article not yet published.

⁶⁴ The points made in this paragraph are the same as those made in relation to s 44 (financial assistance for the acquisition of shares) in an article not yet published by J Yeats and RD Jooste.

that the liability attached to that transgression arises only once the court has declared the resolution void, ie possibly three years or more (depending on the length of the case) after the act occurred? How does this interact with the potential common-law liability based on the directors' duties of care and skill in a prohibited act of this nature – does liability arise at the time of the act (as one would expect and as seems to be the case in terms of s 77(2)(a)) which would mean that this occurs at a different point in time than the statutory liability? Does common-law liability still exist in this context irrespective of whether the act which gives rise to such liability is ultimately declared void in terms of s 77(3)(e)(iv) or not? Finally, it would seem that the simplest way for a director to avoid liability in terms of this section would be not to attend the meeting or participate in the making of the decision at all if he is uncertain whether the requirements of s 44 will be complied with or not or if he would prefer not to vote against a particular resolution for political reasons. If the decision is not taken at a formal meeting but by way of a round robin resolution and a director refrains from voting, it appears from s 45(7)(a) that the director will not incur liability. A counter to this may be that by being presented with the round robin resolution the director has 'participated in the making of such a decision' as specified in s 45(7)(a).

Section 45 read with s 77(3)(v) only imposes liability for damages, costs and loss to the company. Section 226 of the Companies Act, 1973 extends the liability to 'any other person who had no actual knowledge of the contravention . . .'.⁶⁵ Sight must not be lost, however, of s 20(6)(a) of the new Act which provides that a '[s]hareholder of a company has a claim for damages against any person who fraudulently or due to gross negligence causes the company to do anything inconsistent with' the new Act or the company's Memorandum of Incorporation.⁶⁶ A contravention of s 45 by a company could accordingly give rise to a claim for damages by a shareholder of the company against any person who fraudulently or due to gross negligence⁶⁷ causes the company to do anything inconsistent with s 45. A director's liability to the company, not being dependent on fraud or gross negligence, is a stricter liability than liability to shareholders. It is unclear why liability should differ in this way. Loss to the shareholders is as serious as loss to the company. Presumably a director who has voted against the contravening transaction could not be said to have 'caused' the contravention and therefore no liability to shareholders could arise. It is to be noted that the three-year prescription period in s 77(7) has no application to liability in terms of s 26(6). Accordingly the prescription of

⁶⁵ Section 226(4)(a).

⁶⁶ Where there is inconsistency with the Memorandum there is no liability if the action has been ratified by the shareholders by special resolution (s 45(6)(b)).

⁶⁷ Fraud or gross negligence is not a requirement of s 226(4)(c) of the Companies Act, 1973.

the claim will be governed by the Prescription Act. So the problems related to prescription of a claim by the company referred to above do not arise. Presumably shareholders could claim for a drop in the value of their shares resulting from the fraud or negligence of the culprit.

Section 26(6) of the 1973 Act is narrower than s 226(4)(a) of the 1973 Act in that the latter but not the former extends a liability claim to any person and not only shareholders. However, s 218(2) of the new Act does extend liability to any person. It provides: 'Any person who contravenes any provision of the Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention'. No requirement of fraud or gross negligence is required like s 20(6)(a) and it appears that where the claimant is a shareholder there is a conflict between s 20(6)(a) and s 218(2). Again, as is the case with liability in terms of s 26(6), the prescription provision in s 77(7) has no application to liability in terms of s 218(2) and accordingly prescription will be governed by the Prescription Act and the problems referred to above do not arise.

It will be recognised that because of the wide range of possible recipients of the financial assistance covered by s 45, the transaction may be with a third person who is unaware that the transaction is in contravention of s 45. Does the law provide any protection for such person? Can such person prevent the transaction from being declared void?

The answer appears to lie in s 20(7) of the new Act which provides:

A person dealing with a company in good faith, other than a director, prescribed officer or shareholder of the company, is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement.

Section 20(7), which seems to be an attempt at a codification of the so-called common-law *Turquand* rule,⁶⁸ appears to protect the third person, as long as the third person did not know of the contravention and ought not reasonably to have known. Whether or not the third person has this actual or 'deemed' knowledge will depend on the facts of the particular case. This presumably means that even though s 45(6) provides that the transaction is void it will nevertheless not be void because of the application of s 20(7). It is submitted that it would have been preferable if a breach of s 45 rendered the transaction 'voidable' instead of 'void',

⁶⁸ See *Royal Bank v Turquand* (1885) SE & B 248; affd (1856) 6E & B327; [1843–60] All ER Rep 435. In *Farren v SunService SA Photo Trip Management (Pty) Ltd* 2004 (2) SA 146 (CPD) it was decided that the *Turquand* rule did not apply to an internal requirement laid down by statute.

particularly considering that even though s 45(6) provides that the transaction is void, s 218(1) provides that it is not void unless it is declared by the court to be void. Section 45(6) should also expressly provide that the transaction is voidable subject to the application of s 20(7).

The reference in s 20(8) to the fact that s 20(7) should be construed concurrently with ‘any common law principle relating to the presumed validity of the actions of a company in the exercise of its powers’ is obscure. The common-law principle being referred to appears to be the doctrine of estoppel. However, why it would be necessary to prove estoppel when it is far easier to use s 20(7) is unclear.⁶⁹

It is to be observed that the consequences of a contravention of s 45 discussed above can emanate from non-compliance with any of the requirements of s 45. So the consequences can flow from failure to pass the requisite special resolution, failure to meet the solvency and liquidity test, failure to comply with the conditions or restrictions set out in the Memorandum of Incorporation or failure to give the written notice to shareholders required by s 45(5).

How does the voidness of a transaction envisaged by s 45 impact on related transactions? Take as an example a simplified version of the facts in *Kirsten v Bankorp Ltd*.⁷⁰ X makes a loan to company A. It is a term of the loan contract that company A will lend the money thus borrowed by it to company B, which is controlled by one of the company A’s directors. The loan made to Company B contravenes s 45 and is accordingly void. How does the contravention of s 45 affect the loan by X to company A?

In *Kirsten* the court found that the loan by Company A to Company B was a contravention of s 226 of the Companies Act, 1973 and the loan by X to Company A was not affected by the contravention, unless it could be

⁶⁹ Section 20(7) and (8) should be read with s 19(4) and (5) which provides:

‘(4) Subject to subsection (5), a person must not be regarded as having received notice or knowledge of the contents of any document relating to a company merely because the document –

(a) has been filed; or
(b) is accessible for inspection at an office of the company.

(5) A person must be regarded as having received notice and knowledge of –

(a) any provision of a company’s Memorandum of Incorporation contemplated in section 15(2)(b) if the company’s Notice of Incorporation or a Notice of Amendment has drawn attention to the provision, as contemplated in section 13(3); or
(b) the effect of subsection (3) on a personal liability company.’

From a reading of these sections it would appear that although the *Turquand* rule may now have been afforded statutory recognition, this has been done notwithstanding the negation of the doctrine of constructive notice by s 19. This approach seems to indicate that the drafters rejected the idea of the modern formulation of the *Turquand* rule as an extension of the doctrine of estoppel. The modern formulation holds that all the rule does is to temper the doctrine of constructive notice. The rule simply prevents the company from arguing that a third party is precluded from relying on estoppel due to their deemed knowledge of the internal requirement in question. See MS Blackman et al *Commentary on the Companies Act* vol 1 at 446–9.

⁷⁰ 1993 (4) SA 649 (C).

shown that X knew that company A intended to lend the money it borrowed in contravention of s 226. The court held that X was entitled to presume that company A would act lawfully, which in *Kirsten* meant obtaining the necessary consent or special resolution required by s 226(2)(a). It would seem, based on the rationale in *Kirsten* that the loan by X to Company A would not be affected by the contravention of s 45 of the new Act.

III DISCLOSURE IN THE ANNUAL FINANCIAL STATEMENTS

The Companies Act, 1973 contained a number of provisions requiring special disclosure of some of the loans and provisions of security exempted from the prohibitions in s 226.⁷¹ The Companies Act, 1973 also requires special disclosure of loans and provisions of security by a company to its holding company and fellow subsidiaries⁷² as well as loans and the provisions of security by a company to persons before they became directors or managers of the company.⁷³

The new Act also contains disclosure provisions. A company which is required to be audited is required in terms of s 30(4) to include in its annual financial statements ‘particulars showing . . . the remuneration, as defined in subsection (5), and benefits received by each director, or individual holding any prescribed office in the company’.⁷⁴ The definition of ‘remuneration’ which is in s 30(6), includes, *inter alia*:

- (f) financial assistance to a director, past director or future director, or person related to any of them, for the subscription of shares, as contemplated in section 44; and
- (g) with respect to any loan or other financial assistance by the company to a director, past director or future director, or a person related to any of them, or any loan made by a third party to any such person, as contemplated in section 45, if the company is a guarantor of that loan, the value of—
 - (i) any interest deferred, waived or forgiven; or
 - (ii) the difference in value between—
 - (aa) the interest that would reasonably be charged in comparable circumstances at fair market rates in an arm’s length transaction; and
 - (bb) the interest actually charged to the borrower, if less.

It appears from these disclosure requirements that not all the provisions of financial assistance covered by s 45 have to be disclosed. First, the

⁷¹ See s 295 which required special disclosure of the loans and provisions of security exempt in terms of s 226(2)(b) and (c).

⁷² See s 37.

⁷³ See s 296.

⁷⁴ Section 30(4)(a).

provision of financial assistance to a prescribed officer is not included. Secondly, difficulty arises with the interpretation of s 30(6)(g). This provision expressly refers to any loan or other financial assistance as well as a guarantee by a company of a loan to a director et al. However, it is clear from s 30(6)(g) read with s 30(4) that what must be disclosed in the annual financial statements is the value of *interest*, either interest deferred, waived or forgiven⁷⁵ or notional interest.⁷⁶ The problem is that 'interest' relates to a loan. It does not relate to any other type of financial assistance, including a guarantee. So if the financial assistance is a guarantee or something else other than a loan, there is nothing to disclose. A possible interpretation in relation to a guarantee, perhaps, is that the interest referred to is not interest deferred, waived or forgiven by the company providing the guarantee but by the person making the loan. For example, if a lender makes a loan to a director of Company A and defers, waives or forgives any interest or charges a lower than fair market rate of interest and Company A guarantees the repayment of the loan, then Company A is required to disclose in its annual financial statements the interest deferred, waived or forgiven or the difference between the interest charged by the lender and the interest that would have been charged if it had been charged at a fair market rate, as the case may be. The difficulty with this interpretation is, of course, that it is odd that disclosure is not required where the director has to pay interest at a fair market rate. If Company A is guaranteeing repayment of the loan why does that make a difference? The company is exposed in either event. And why should Company A have to disclose the difference between the interest charged on the loan and the interest that would have been charged if it had been charged at a fair market rate when it is not the lender? This interpretation, of course, also does not explain how financial assistance, other than a loan or guarantee, can be brought within the purview of the disclosure provision.

IV CONCLUSION

A comparison of the provisions of the Companies Act, 1973 and the new Act aimed at preventing abuse of the powerful position that directors are in, indicates that in some respects the proposed new provisions are more stringent than the current, but that in other respects the converse is true. The new provisions cast their tentacles far wider, drawing in a far more extensive range of transactions, as well as parties to such transactions, to which the provisions apply. The extent of such range is such that a vigilant, law-abiding company will be faced with an onerous task in assuring itself that it has complied with the law. It is submitted that the net

⁷⁵ Section 30(6)(g)(i).

⁷⁶ Section 30(6)(g)(ii).

has been cast too wide, capturing situations that are no threat to the company in question, situations that do not involve any potential abuse of the powerful position of directors. On the other hand, the liability provisions are too heavily weighted in favour of directors – the confusing powers of the court to relieve recalcitrant directors are unfounded. An analysis of the new provisions also brings to light a host of problems of interpretation not apparently envisaged by the legislature. Legislative amendment is clearly necessary to address the situation.