



UNIVERSITY  
OF  
JOHANNESBURG

## COPYRIGHT AND CITATION CONSIDERATIONS FOR THIS THESIS/ DISSERTATION

 creative  
commons



- Attribution — You must give appropriate credit, provide a link to the license, and indicate if changes were made. You may do so in any reasonable manner, but not in any way that suggests the licensor endorses you or your use.
- NonCommercial — You may not use the material for commercial purposes.
- ShareAlike — If you remix, transform, or build upon the material, you must distribute your contributions under the same license as the original.

### How to cite this thesis

Surname, Initial(s). (2012) Title of the thesis or dissertation. PhD. (Chemistry)/ M.Sc. (Physics)/ M.A. (Philosophy)/M.Com. (Finance) etc. [Unpublished]: [University of Johannesburg](https://ujcontent.uj.ac.za/vital/access/manager/Index?site_name=Research%20Output). Retrieved from: [https://ujcontent.uj.ac.za/vital/access/manager/Index?site\\_name=Research%20Output](https://ujcontent.uj.ac.za/vital/access/manager/Index?site_name=Research%20Output) (Accessed: Date).

**LOANS OR OTHER FINANCIAL ASSISTANCE TO DIRECTORS: A CRITICAL  
ANALYSIS OF SECTION 45 OF THE COMPANIES ACT 71 OF 2008**

**by**

**NDIVHUDZANNYI PRINCE NEMUTANZHELA**

**MINOR-DISSERTATION**

**Submitted in partial fulfilment  
of the requirements for the degree**

**MASTER OF LAWS (LLM)**

**in**

**CORPORATE LAW**

**in the**

**FACULTY OF LAW**

**at the**

**UNIVERSITY OF JOHANNESBURG**

**SUPERVISOR: PROFESSOR K E VAN DER LINDE**

**FEBRUARY 2016**

## ABSTRACT

The Companies Act 71 of 2008 replaced the Companies Act 61 of 1973. The objective of the Companies Act 71 of 2008 is, *inter alia*, to balance the rights and obligations of shareholders and directors within the companies. In line with this objective, section 45 of the Companies Act 71 of 2008 now allows a company to provide financial assistance to its directors and other persons. By allowing financial assistance, the Companies Act 71 of 2008 takes into consideration the interests of third parties and minority shareholders within the company. In this regard, it has allowed financial assistance subject to compliance with certain requirements and conditions. According to some of these requirements and conditions, the board of directors should, *inter alia*, ensure that immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test.

However, despite the aforesaid requirements, the provisions of section 45 are not satisfactory and, in certain respects, too far-reaching and treat directors too leniently. It is recommended, *inter alia*, that the legislature, in future amendments to the Companies Act 71 of 2008, should maintain a single solvency and liquidity test or scrap the test regards the provision of financial assistance to directors. Furthermore, terms and concepts such as “financial assistance” and “fair and reasonable” should be comprehensively defined.

A comparison between the South African and New Zealand jurisdictions revealed that the South African legislature can learn from the New Zealand Companies Act 105 of 1993. For instance, in New Zealand, the board of directors applies the solvency and liquidity test in instances where the shareholders authorise financial assistance.

**Keywords:** financial assistance; director; section 45 of the Companies Act 71 of 2008; liability of a director; section 161 of the New Zealand Companies Act 105 of 1993.

## CONTENTS

INTRODUCTION .....	2
ANALYSIS OF SECTION 45 OF THE 2008 ACT .....	7
<i>Introduction</i> .....	7
<i>Definitions of terms and concepts</i> .....	8
<i>Analysis of requirements for the provision of financial assistance</i> .....	16
<i>Validity of contracts and liability</i> .....	22
<i>Disclosure of financial assistance in annual financial statements</i> .....	24
LINK BETWEEN SECTION 45 AND SECTION 75 OF THE 2008 ACT .....	26
<i>Introduction</i> .....	26
<i>Scope of section 75</i> .....	26
<i>Disclosure of personal financial interest</i> .....	27
<i>Validity of contracts</i> .....	28
<i>The link with section 45</i> .....	29
POSITION IN NEW ZEALAND .....	31
<i>Introduction</i> .....	31
<i>Scope of section 161 of the 1993 New Zealand Companies Act</i> .....	32
<i>Definitions of terms and concepts</i> .....	32
<i>Requirements for payment of remuneration or the provision of other benefits</i> .....	33
<i>Solvency and liquidity</i> .....	34
<i>Consequences for non-compliance</i> .....	36
<i>Transactions involving self-interest and section 161 of the 1993 Act</i> .....	37
<i>Disclosure of remuneration and the value of other benefits in the annual report.</i> .....	38
CONCLUSIONS AND RECOMMENDATIONS .....	40
<i>Conclusions</i> .....	40
<i>Recommendations</i> .....	45
BIBLIOGRAPHY .....	47

## CHAPTER 1

### INTRODUCTION

Directors and management of a company are in a powerful position to exert influence on the company under their control.<sup>1</sup> Such position of power may potentially be abused by directors and management, to the detriment of the company and its shareholders as the company could provide its directors or managers with loans or security as some form of incentive. Furthermore, companies within the same group transact with one another. In this regard, a company could provide a loan to or security for a company within the same group of companies. The question arises as to how the company is protected from directors and management's potential abuse of power and diverting or placing at risk the company's assets and cash flow to, or for, their own benefit or other companies within the group. This position was previously regulated in terms of the provisions of sections 226, 37, 296 and 296 of the Companies Act of 61 of 1973.<sup>2</sup>

In terms of section 226(1)(a) of the 1973 Act, a company is prohibited from directly or indirectly making a loan to,<sup>3</sup> or providing security for,<sup>4</sup> any director or manager of the company or its holding company or any other company which was a subsidiary of its holding company.<sup>5</sup> In *Standard Bank of SA v Neugarten*<sup>6</sup>, Goldblatt AJ stated that

“The clear purpose of s 226 of the Act is to prevent directors or managers of a company acting in their own interests and against the interests of shareholders by burdening the company with obligations which are not for its benefit but for the benefit of another company and/or for the benefit of its directors and/or manager.”

Accordingly, section 226 endeavoured to regulate and prohibit transactions of this nature, subject to certain exceptions.<sup>7</sup> The legislature had provided such exceptions “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

---

<sup>1</sup> Cilliers, Benade, Henning, Du Plessis, Delpont, and Pretorius *Corporate Law* (1992) 148.

<sup>2</sup> Hereinafter referred to as the 1973 Act.

<sup>3</sup> In terms of section 226(1A) (1)(a) of the 1973 Act, “loan” includes a loan of money, shares, debentures of any property and 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.

<sup>4</sup> Section 226(1A)(1)(c) provides that “security” includes a guarantee.

<sup>5</sup> See Meskin, Galgut, Kunst, Delpont and Vorster *Henocheberg on the Companies Act* (2011) 432.

<sup>6</sup> 1988 1 SA 652 (W) 658.

<sup>7</sup> Jooste “Loans to directors-an analysis of section 226 of the Companies Act” 2000 12 SA Merc LJ 269 269.

of companies controlled by them, will also be of benefit to the company and not only at its expense.”<sup>8</sup>

Section 226(2) contains a number of exemptions from the operation of section 226(1). Section 226(2)(a), states that the prohibition in section 226(1) does not apply to a company making a loan to, or providing security on behalf of the company’s own director or manager, with the prior consent of all the members of the company or in terms of a special resolution relating to a specific transaction.

Section 226(2)(b) exempts 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 or for the purpose of enabling him properly to perform his duties as director or manager of that company.

Section 226(2)(c) exempts anything done in good faith in the ordinary course of the business of a company actually and regularly carrying on the business of the making loans or the provision of security. Section 226(2)(d) exempts the provision of money or making loans by a company for the purposes contemplated in section 38(2)(b)<sup>9</sup> and (c)<sup>10</sup> of the 1973 Act.

Section 226(2)(e) exempts the making of a loan or the provision of security with the approval of the company in general meeting for housing for its director or manager. In terms of section 226(2)(f) a loan made to, or security provided for, a director or manager of a subsidiary of the company will be exempt, if the director or manager is not also a director or manager of the company itself.

Jooste states that section 226 was poorly drafted and this had resulted in anomalies and inadvertent omissions.<sup>11</sup> He further states that interpretation of words such as ‘directly or indirectly’ meant that the prohibitions in section 226 could easily be evaded. The provisions of section 226 could also be circumvented through resignation and re-appointment of a director or manager with a loan having been made in the interim.

---

<sup>8</sup> *S v Pourolis & others* 1993 4 SA 575 (W) 589E.

<sup>9</sup> Section 38(2)(b) provides that the provisions of section 38(1) shall not be construed as prohibiting 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.

<sup>10</sup> Section 38(2)(b) provides that the provisions of section 38(1) shall not be construed as prohibiting 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.

<sup>11</sup> Jooste (n 7) 289.

Section 37 of the 1973 Act complemented section 226 by regulating loans made and security provided by a subsidiary to its holding company or fellow subsidiary. According to Blackman, section 37 was aimed at abuse by a holding company of its control over its subsidiaries.<sup>12</sup> Thus, this section endeavoured to counter the practice by which those who control a holding company sacrifice the interests of its subsidiary for the benefit of a holding company or fellow subsidiary by the use of the subsidiary's financial resources otherwise than for its own benefit.<sup>13</sup>

In terms of section 37, a subsidiary was not prohibited from providing a loan or security but was required to disclose the particulars of such loan or security in its annual financial statements.<sup>14</sup> Furthermore, section 37 also imposed liability for damages on the part of the directors and officers concerned in cases where the terms of the loan or provision of security were “not fair” to the subsidiary or “failed to provide reasonable protection for its business interests”.<sup>15</sup>

Section 37, like section 226, also had significant interpretative problems. McLennan submits that the words “failed to provide reasonable protection for its business interests” are vague.<sup>16</sup> In this regard, he questioned the circumstances under which a loan provided to a holding company or fellow subsidiary may be said to provide “reasonable protection” for the lender's business interests.<sup>17</sup> Furthermore, he argues that the personal liability imposed by section 37 is not desirable as this is covered by the common-law.

McLennan concludes as follows:

“If it is necessary to legislate at all in areas covered by common law, the purpose of such legislation should be to supplement or strengthen the common-law rules and to provide simpler and more effective remedies for those who need them. But if the legislation merely strikes at certain outward manifestations instead of attacking the problem at roots, it will prove, as in the past, to be either ineffective or worse – where, for example, it creates unnecessary difficulties of interpretation or destroys the validity of transactions that are inherently unobjectionable.”<sup>18</sup>

Sections 295 and 296 of 1973 Act supplemented section 226. Section 295 required a company to provide details in its annual financial statements of any loans or security granted by virtue of the provisions of section 226 whereas section 296 required disclosure in the

<sup>12</sup> Blackman *Commentary on Companies Act* (2002) 4-53.

<sup>13</sup> Meskin (n 5) 70.

<sup>14</sup> s 37(1).

<sup>15</sup> s 37(3)(a).

<sup>16</sup> McLennan “Loans by subsidiaries to holding companies” 1978 *SALJ* 240 243.

<sup>17</sup> McLennan (n 16).

<sup>18</sup> See McLennan (n 16) 246.

annual financial statements of loans to persons who later became directors or managers of the company.

In recognition of the flaws presented by the provisions of the 1973 Act, the legislature replaced the aforesaid provisions with the much wider provisions contained in the Companies Act 71 of 2008<sup>19</sup>. The objective of the 2008 Act is, *inter alia*, to balance the rights and obligations of shareholders and directors within the companies.<sup>20</sup> According to Sutherland, the 2008 Act endorses the traditional focus on efficacy and the interests of shareholders.<sup>21</sup> The 2008 Act came into effect on 1 May 2011.<sup>22</sup>

The 2008 Act has, among other things, specifically allowed a company to provide financial assistance to its directors and other persons. Section 45 of the 2008 Act specifically deals with the provision, by a company, of loans and other 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.<sup>23</sup>

By allowing financial assistance, the 2008 Act takes into consideration the interests of third parties and minority shareholders within the company. In this regard, it has allowed financial assistance subject to compliance with certain requirements and conditions.<sup>24</sup> According to these requirements and conditions, the board of directors should, *inter alia*, ensure that immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test.<sup>25</sup> Therefore, these requirements and conditions could serve as a means to protect the interests of shareholders against the exhaustion of the company's capital.<sup>26</sup> Section 226 and section 37 of the 1973 Act did not contain such stringent requirements and conditions. For instance, section 226 and section 37 did not require compliance with the solvency and liquidity test. This provided inadequate protection to the interests of the shareholders and creditors.

---

<sup>19</sup> Hereinafter referred to as the 2008 Act.

<sup>20</sup> s 7(i) of the 2008 Act.

<sup>21</sup> Sutherland "The State of Company Law in South Africa" 2012 1 *Stell LR* 161 161.

<sup>22</sup> *Government Gazette* 34239 (26 April 2011).

<sup>23</sup> Section 45 of the 2008 will be analysed in the next chapter.

<sup>24</sup> s 45(3), (4) and (5).

<sup>25</sup> s 45(3)(b).

<sup>26</sup> The requirements of section 45 of the 2008 Act will be discussed in detail in the next chapter.



Jooste is of the view that the provisions of section 45 are also not satisfactory and, in certain respects, too far-reaching and treat directors too leniently.<sup>27</sup> He is further of the view that the provisions of section 45 of the 2008 Act have some significant interpretative problems which impact its effectiveness.<sup>28</sup>

This dissertation aims at analysing the provisions of section 45 regarding financial assistance to a director of the company or of a related or inter-related company. The dissertation will evaluate whether the provisions of section 45 of the 2008 Act need legislative attention as Jooste suggests.

The dissertation will also analyse the link between section 45 and section 75 of the 2008 Act. It will further provide an analytical comparison of the rules of financial assistance by a company under the 2008 Act and the New Zealand Companies Act 105 of 1993<sup>29</sup>. In New Zealand, a company was generally prohibited from providing a loan to its director.<sup>30</sup> The introduction of the 1993 New Zealand Companies Act changed this position. Consequently, a company in New Zealand may now provide a loan to its director subject to certain requirements.<sup>31</sup> It is for this reason that the rules of financial assistance under the 1993 New Zealand Companies Act will be considered.

The dissertation will also provide solutions and recommendations in the event that the provisions of section 45 of the 2008 Act are found to be still inadequate.

---

<sup>27</sup> FHI Cassim, MF Cassim, R Cassim, Jooste, Shev and Yeats *Contemporary Company law* (2012) 336.

<sup>28</sup> Jooste "Financial assistance to directors- the Companies Act 71 of 2008" 2010 *Acta Juridica* 165 165.

<sup>29</sup> Hereinafter referred to as the 1993 New Zealand Companies Act.

<sup>30</sup> Morrison *Company and Securities Law: Companies Commentary, precedents*, (2001) 1/42. Also

See Jones *Company Law in New Zealand-A guide to the Companies Act 1993* (1993) 161.

<sup>31</sup> The requirements in terms the 1993 New Zealand Companies Act will be analysed in detail in chapter 4.

## CHAPTER 2

### ANALYSIS OF SECTION 45 OF THE 2008 ACT

#### 1 *Introduction*

Section 45 of the 2008 Act regulates the situation where a company provides loans and other financial assistance to directors and other persons. Section 45(2) provides as follows:

“Except to the extent that the Memorandum of Incorporation of a company provides otherwise, the board may authorise 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).”

As can be seen from the provisions of section 45(2) above, the scope of section 45 is wide and regulates financial assistance to an extensive group of persons.<sup>32</sup> However, the focus of this dissertation is to analyse the regulation of financial assistance to a director of the company or of a related or inter-related company.<sup>33</sup>

Furthermore, section 45(2) also contains new terms and concepts such as related, inter-related and prescribed officer. The question arises as to whether or not the legislature has clearly defined these terms and concepts. In terms of section 5(2) of the 2008 Act, the court may consider, to the extent appropriate, foreign company law when interpreting or applying the provisions of the 2008 Act. In light of this provision, it is submitted that courts should also consider foreign jurisdictions from which certain of the new terms and concepts have been drawn as assistance to their proper interpretation.<sup>34</sup>

It is, therefore, pivotal to consider some of the terms and concepts introduced by the 2008 Act before I analyse section 45 of the 2008 Act and its application in further detail.

---

<sup>32</sup> The scope of section 45 is wider than that covered by section 226 and section 37 of the 1973 Act. Section 226 covers directors and officers, and companies and other body corporates under the control of such directors and officers. Section 37 regulates loans to and the provision of security by a subsidiary to its holding company or fellow subsidiary.

<sup>33</sup> The dissertation will also not focus on the provisions of section 226 and section 37 of the 1973 Act. However, limited reference will be made to some of the provisions of the aforesaid sections.

<sup>34</sup> Cassim (n 27) 315.

## 2 Definitions of terms and concepts

### 2.1 Financial assistance

The legislature's intention to introduce the 2008 Act was to solve the problems inherent in the 1973 Act. However, it appears that there still exist uncertainties regarding some aspects of the South African company law. The 2008 Act, or section 45 in particular, does not provide a comprehensive definition of the term "financial assistance". The question that arises is whether or not the rationale for not laying down a comprehensive definition of the term "financial assistance" was in line with what the court had stated in the English case of *Anglo Petroleum Ltd v TFB (Mortgages) Ltd*.<sup>35</sup> The court stated in that case that it is unwise for the legislature to lay down a precise definition of "financial assistance".<sup>36</sup> However, the court also warned that the absence of clear definition of "financial assistance" could give rise to uncertainties and ambiguities. It appears that the legislature has indeed heeded this call and opted not to provide a comprehensive definition of "financial assistance" but attempted to manage ambiguity by providing a wide definition of the term "financial assistance". I am, however, of the view that the lack of the definition of "financial assistance" may create uncertainty.

In terms of section 45(1), "financial assistance" includes lending money, guaranteeing a loan or other obligation, and securing any debt or obligation. Jooste states that the fact that the definition only includes the aforesaid transactions does not mean that the list is exhaustive.<sup>37</sup> If this was the intention of the legislature, one would have expected the term "means" to have been used instead of "includes". It could, therefore, be concluded that this definition of "financial assistance" does not provide an exhaustive definition regarding the subject.

Section 45(1) further contains a negative provision relating to what should not be considered as "financial assistance". In this regard, it provides that "financial assistance" does not include lending money in the ordinary course of business by a company whose primary business is the lending of money. Furthermore, section 45(1) expressly excludes an accountable advance to meet legal expenses in relation to a matter concerning the company or anticipated expense to be incurred by the person on behalf the company, or an amount to cover a person's expenses for removal at the company's request.

<sup>35</sup> 2008 1 BCLC 185 (CA).

<sup>36</sup> *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* 2008 1 BCLC 185 (CA) 190-192. See also *Lipschitz No v UDC Bank Ltd* 1979 1 SA 789 (A) 805.

<sup>37</sup> Jooste (n 28) 168 indicates that transactions such as donations, sales at a discount prices and leases at favourable rentals would be covered by the definition of 'financial assistance'.

Jooste is of the view that the precise scope of “financial assistance” for the purposes of section 45 is not clear.<sup>38</sup> For instance, according to him, it is not clear which expense would qualify for the exemption referred to above. As a consequence, he suggests that the legislature should clarify this vagueness.

Delpont states that since the 2008 Act does not define the term “financial assistance”, the common law definition in terms of the provisions of the 1973 Act must be used to determine whether or not there was financial assistance.<sup>39</sup> In *Gradwell v Rostra Printers Ltd*<sup>40</sup>, the court formulated the so-called “impoverishment test” and this has been always used by courts to ascertain whether or not “financial assistance” was provided. According to this test, the financial status of the company before and after the transaction is evaluated.<sup>41</sup> It, therefore, follows that, if the company is in a worse financial position by the transaction, it is impoverished.<sup>42</sup>

However, the court in *Lipschitz NO v UDC Bank Ltd* specifically warned against the use of the “impoverishment test” in all circumstances as the only test or even an accurate test to prove that financial assistance had been provided.<sup>43</sup> According to the court, financial assistance includes other acts which do not necessarily involve the impoverishment of the company or the use at all of its pecuniary resources.<sup>44</sup> The provision by a company of a guarantee or security, for instance, does not necessarily involve the actual or even probably disbursement or use of the company’s funds.

It appears from the aforesaid that the courts would still be reliant on previously decided cases in order to establish guidelines about what constitutes “financial assistance”.

I am of the view that the courts would still find it difficult to apply the principles laid down in other cases. This will further give rise to uncertainties and ambiguities.

## 2.2 Direct or indirect financial assistance

In terms of section 45(2) a company may provide “direct or indirect” financial assistance to its director or that of a related or inter-related company. The 2008 Act does not define the term “direct or indirect”. As indicated above, section 45 of the 2008 Act replaced section 226

<sup>38</sup> Jooste (n 28) 168.

<sup>39</sup> Delpont *The New Companies Act Manual* (2011) 55.

<sup>40</sup> 1959 4 SA 419 (A).

<sup>41</sup> See Delpont (n 39) 55.

<sup>42</sup> See Delpont (n 39) 55.

<sup>43</sup> 1979 1 SA 789 (A) 805 798.

<sup>44</sup> Cassim (n 27) 319.

of the 1973 Act. The provision of section 226 also contains the words “directly or indirectly”.<sup>45</sup> Neither the 1973 Act nor section 226 defines the words “directly or indirectly”. However, these words were interpreted in *S v Pourolis*<sup>46</sup>. The court stated the following in relation to section 226 of the 1973 Act:

“The words ‘directly or indirectly’ merely emphasise that the prohibition applies whether the loan is constituted by a payment made by the lender directly to the borrower; or indirectly upon the borrower’s becoming obliged to repay to the lender a sum of money which has become a loan from the lender to the borrower in any of a number of possible indirect ways. The prohibited indirect ways do not encompass any transaction which does not result in contract of a loan between a lender company and a borrower who is disqualified in relation to such lender company.”<sup>47</sup>

It is clear from the aforesaid that the prohibited indirect ways do not include a transaction which does not result in a contract of a loan between a company and a director.<sup>48</sup> Therefore, the prohibition does not extend to the use of a conduit.<sup>49</sup> For instance, the prohibition does not apply to instances whereby a company makes a loan to the director’s wife or close relative with the intention that the director should indirectly benefit through the wife or close relative.

It is submitted that the words “directly or indirectly” are included in section 226 to strengthen its provision.<sup>50</sup> However, Jooste submits that the interpretation of the words “directly or indirectly” in *S v Pourolis* means that the prohibitions in section 226 could easily be evaded.<sup>51</sup> According to him, section 226 could be evaded in instances whereby a director resigns and is reappointed after a loan has been made in the interim.<sup>52</sup>

It is further submitted that the rationale in *Pourolis* is not applicable to section 45 of the 2008 Act because of the generality of the term “financial assistance”.<sup>53</sup> The definition of “financial assistance” expressly covers all instances where a company may provide “direct or indirect” financial assistance to its director or that of a related or inter-related company. It is clear from the definition of “financial assistance” that direct financial assistance will be where a

---

<sup>45</sup> Section 226(1) states that no company “shall directly or indirectly make a loan . . .”.

<sup>46</sup> 1993 4 SA 575 (W).

<sup>47</sup> See (n 46) 601.

<sup>48</sup> Blackman (n 12) 8-310.

<sup>49</sup> Jooste (n 28) 169.

<sup>50</sup> Blackman (n 12) 8-311.

<sup>51</sup> Jooste (n 7) 289.

<sup>52</sup> Jooste (n 7) 282.

<sup>53</sup> Jooste (n 28) 170.

company directly provides financial assistance to a director or to a director of a related company or inter-related company.

Indirect financial assistance will be where a company, for instance, provides financial assistance to the wife or a close relative of a director with the intention that the director should indirectly benefit through the wife or close relative. Another example of indirect financial assistance will be where a company provides financial assistance to a trust of which a director is a beneficiary.<sup>54</sup>

However, it may be argued that, there was no need for the legislature to insert the words “direct or indirect” in section 45. For instance, the use of a conduit to circumvent section 45 is in any case covered due to the ambit of “related” and “inter-related”.<sup>55</sup> The broad definition of “related” and “inter-related” persons read with the provisions of section 45 casts the net much wider.<sup>56</sup> Perhaps, the intention of the legislature was to close any potential loopholes by inserting these words.<sup>57</sup>

### 2.3 Director

“Director” means a member of the board of a company or an alternate director of a company.<sup>58</sup> This includes any person occupying the position of a director or alternate director, by whatever name designated. The use the word “includes” indicates that the definition of a “director” is inclusive and not exhaustive. It is submitted that this definition does not purport to define the word “director” as such and only applies for the purposes of the 2008 Act.<sup>59</sup>

“Alternate director” means a person elected or appointed to serve, when necessary, as a member of the board of a company in substitution for a particular elected or appointed director of that company.<sup>60</sup> An alternate director may act as a director only when his appointer is absent.<sup>61</sup> An alternate director ceases to hold office of a director whenever the

---

<sup>54</sup> Jooste (n 28) 174.

<sup>55</sup> See Delpont *Henochsberg on Companies Act 71 of 2008* (2015) 193. The concept of “related” and “inter-related” will be discussed below.

<sup>56</sup> Jooste (n 28) 173.

<sup>57</sup> *Olley v Maasdorp and Another* 1948 4 SA 657 (A) 665.

<sup>58</sup> See s1 of the 2008 Act.

<sup>59</sup> Delpont (n 55) 22.

<sup>60</sup> See section 1 of the 2008 Act

<sup>61</sup> Cassim (n 27) 405.

director who appointed him ceases to be a director.<sup>62</sup> Such appointment may also be terminated by way of giving notice to the company secretary.<sup>63</sup>

In addition, it is submitted that the South African law recognises the following types of directors: *de jure* director, temporary director, nominee director, puppet director, *de facto* director, shadow director<sup>64</sup> and executive, non-executive and independent directors.<sup>65</sup>

#### 2.4 Prescribed officer

The 2008 Act has introduced the concept of a “prescribed officer” to South African company law. A “prescribed officer” is defined as a person who, within a company, performs any function that has been designated by the Minister in terms of section 66(10).<sup>66</sup> Section 66(10) provides that the Minister may make regulations designating any specific function or functions within a company to constitute a prescribed office for the purposes of the 2008 Act. The Minister has exercised this power and has defined a ‘prescribed officer’ in regulation 38 of the Companies Regulations, 2011.<sup>67</sup> Regulation 38 provides as follows:

- “(1) 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-
- (a) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or
  - (b) 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.
- (2) This regulation applies to a person contemplated in sub-regulation (1) irrespective of any particular title given by the company to-
- (a) an office held by the person in the company; or
  - (b) a function performed by the person for the company.”

It is submitted that the aforesaid definition is framed too loosely due to the inclusion of phrases that are capable of very wide construction.<sup>68</sup> For instance, phrases such as “exercises general executive control”, “significant portion”, “regularly participates” and “material

<sup>62</sup> See Cassim (n 27) 405.

<sup>63</sup> See Cassim (n 27) 405.

<sup>64</sup> See Locke “Shadow directors: lessons from abroad” 2002 14 *SA Merc LJ* 420. Also see Idensohn “The regulation of shadow directors” 2010 22 *SA Merc LJ* 326.

<sup>65</sup> Cassim (n 27) 406-411. For a more detailed analysis of different interpretations of terms “director”, “*de jure* director” and “*de facto* director” see Du Plessis “Some subtle distinctions in the term “director”” 1995 1 *TSAR* 153. Furthermore, for detailed discussion of different interpretation “nominee director” and “puppet director” see Du Plessis “Nominee directors versus puppet, dummy and stooge directors: reflections on these directors and their nominators or appointors” 1995 2 *TSAR* 310.

<sup>66</sup> See s1 of the 2008 Act.

<sup>67</sup> *Government Gazette* 34239 (26 April 2011).

<sup>68</sup> Idensohn “The meaning of ‘prescribed officers’ under the Companies Act 71 of 2008” 2012 *SALJ* 717 718.

degree” are not defined or qualified by the provisions of the 2008 Act.<sup>69</sup> This entails that the interpretation and application of the aforesaid phrases are left to the courts.

The 2008 Act refers to a “prescribed officer” in almost all provisions relating to directors. It is submitted that the intention of the legislature is to ensure that prescribed officers are subject to the same strict duties and accountabilities.<sup>70</sup> The provisions that apply to the directors and prescribed officers include, *inter alia*, the provisions dealing with the provision of financial assistance by a company to directors<sup>71</sup> and the disclosure of directors’ personal financial interests in company transactions<sup>72</sup>.

The relationship between the concepts of “prescribed officer” and “director” is not clarified in the 2008 Act. This creates challenges. Idensohn submits that the use of the words “Despite not being a director” in regulation 38 could mean that a person need not to be a director in order to be a “prescribed officer” or it could mean that a person will not be a prescribed officer if that person is already a director.<sup>73</sup> Consequently, she prefers the latter interpretation because it separates the concept of a “prescribed officer” from the concept of a “director” and reserves the concept of a “prescribed officer” to persons who are not directors. I agree with Idensohn that the latter interpretation makes sense on the basis that a director is already subjected to all the same provisions and regulations as a “prescribed officer” in his capacity as a director, and there is no need to also classify that director as a “prescribed officer”.

Idensohn further states the following:

“when determining the meaning of a ‘prescribed officer’, the primary interpretive imperative must be to find a principled interpretation that is coherent with theoretical basis and ambit of the common law fiduciary principles ‘in accordance’ with which those statutory fiduciary duties apply. The courts have a long history of applying those common law principles to various company officers, senior employees and other persons involved in the management of companies, and there is a significant amount of case law available in that regard. If they continue to apply those principles consistently in relation to persons who participate directly in a company’s management, the definition of a ‘prescribed officer’ should be interpreted as including only those who, in terms of the common law, have, or would be held to be, subject to fiduciary duties of the same nature and extent as directors. This will include all persons whose participation is of a direct nature and equivalent to that of a director in terms of authority and control.”<sup>74</sup>

---

<sup>69</sup> See Idensohn (n 68) 718 .

<sup>70</sup> Cassim (n 27) 415.

<sup>71</sup> s 45.

<sup>72</sup> s 75.

<sup>73</sup> Idensohn (n 68) 719.

<sup>74</sup> Idensohn (n 68) 734.



Accordingly, she indicates that “interpreted in this way, the “prescribed officer” is not a new or extended concept in our law, but simply a legislative attempt to capture, re-label and regulate the common law fiduciary in statutory form.”<sup>75</sup>

In terms of regulation 38, a person may only be regarded as a “prescribed officer”, if the functions of that person or office comply with the criteria as outlined in that regulation.<sup>76</sup> For instance, a company secretary may be regarded as a “prescribed officer” if the functions of that company secretary meet the criteria outlined in regulation 38. Therefore, despite the fact that certain provisions of the 2008 Act that apply to directors also apply to prescribed officers, the functions that are performed by a person would determine whether or not that person is a “prescribed officer”.

However, the exercise of identifying persons who are non-director managerial participants but exercise sufficient influence or control to justify the consequences that attach to “prescribed officer”, creates interpretative difficulties.<sup>77</sup> This is attributable to the fact that such persons participate in or exercise their influence or control in various ways, to various degrees and they may do so either personally or directly, or indirectly through another person or persons.

Section 226 of the 1973 Act also regulated loans made to the so-called “managers” of companies. It equated a “manager” and a director.<sup>78</sup> In terms of section 1 of the 1973 Act, a “manager” is defined as “any person who is a principal executive officer of the company for time being, by whatever name he may be designated and whether or not he is a director”. According to Jooste, a person who performed executive functions and was in charge of a major section of the company was regarded as a “manager” for purposes of section 226.<sup>79</sup>

## 2.5 Related or inter-related

The 2008 Act has introduced new concepts such “related and inter-related persons”. Section 2(1) of 2008 Act contains different definitions of “related”<sup>80</sup> depending on the nature of the parties to the relationship. The term “related” define three relationships, namely those

<sup>75</sup> Idensohn (n 68) 735.

<sup>76</sup> Also see Delpont (n 55) 28(2).

<sup>77</sup> Idensohn (n 68) 721.

<sup>78</sup> Jooste (n 7) 272.

<sup>79</sup> Jooste (n 7) 272.

<sup>80</sup> In terms of section 1 of the 2008 Act, “related”, when used in respect of two persons, means persons who are connected to one another in any manner contemplated in section 2(1)(a) to (c).

between or amongst two or more natural persons, juristic persons and, natural and juristic persons.<sup>81</sup> A director<sup>82</sup> is related to another individual if he is married to that individual, or lives together with that individual in a relationship similar to a marriage.<sup>83</sup> Furthermore, a director is related to another individual if he is separated from that individual by no more than two degrees of natural or adopted consanguinity or affinity.<sup>84</sup>

In terms of section 2(1)(b) of the 2008 Act, a director is related to a company<sup>85</sup> if he or she directly or indirectly controls<sup>86</sup> the company, as determined in accordance with subsection 2.

Section 2(1)(c) provides that a company<sup>87</sup> is related to another company 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)."

Section 1 of the 2008 Act defines "inter-related" when used in respect of three or more persons to mean persons who are related to one another in a linked series of relationships such that two of the persons are related and one of them is related to the third and so forth in an unbroken series. The concept of "inter-related" is illustrated as follows:

"... if Company X is related to company Y and company Y is related to Mr A and Mr A is related to Mr B and Mr B is related to Trust C and Trust C is related to close Corporation D, then Company X, Company Y, Mr A, Mr B, Trust C and Close Corporation D are interrelated persons"

It is submitted that the rationale for the inclusion of the concept of "related and inter-related" persons is to protect the company and its creditors in instances whereby a company transacts

<sup>81</sup> In terms of section 1 of 2008 Act, "individual" means a natural person and "person" includes a juristic person. Furthermore, section 1 of the 2008 Act provides that "juristic person" includes a foreign company and a trust, irrespective of whether or not it was established within or outside of the Republic.

<sup>82</sup> It should be noted that the 2008 Act uses term "individual". However, for purposes of this dissertation the term "director" is used.

<sup>83</sup> See s 2(1)(a)(i) of the 2008 Act.

<sup>84</sup> See s 2(1)(a)(ii) of the 2008 Act.

<sup>85</sup> It should be noted that the 2008 Act uses term "juristic person". However, for purposes of this dissertation the term "company" is used.

<sup>86</sup> Section 2(2) of the 2008 Act sets out definitions of "control" which apply in the case of companies, close corporations and trusts, all of which may be "related or inter-related persons".

<sup>87</sup> It should be noted that the 2008 Act uses term "juristic person". However, for purposes of this dissertation terms "company" is used.

with another person that is related or inter-related to the company.<sup>88</sup> For instance, the relationship between the company and such person may influence the decision to provide financial assistance to the detriment of the company. In this regard, section 2(3) of the 2008 Act provides that, with respect to any particular matter arising in terms of the 2008 Act, a court, the Companies Tribunal or the Takeover Regulation Panel may exempt any person from the application of a provision of the 2008 Act that would apply to that person because of a relationship contemplated in section 2(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.<sup>89</sup>

### 3 *Analysis of requirements for the provision of financial assistance*

In terms of section 45 of the 2008 Act, the board may not authorise any financial assistance to a director of the company or of a related or inter-related company unless the following requirements are complied with:<sup>90</sup>

#### 3.1 Employee share scheme

Any financial assistance authorised by the board must be pursuant to an employee share scheme that satisfies the requirements laid down by section 97<sup>91</sup> of the 2008 Act.<sup>92</sup>

Section 95(1)(c) of the 2008 Act provides as follows:

“employee share scheme” means

“. . . a scheme established by a company, whether by means of a trust or otherwise, for the purpose of offering participation therein solely to employees, officers and other persons closely involved in the business of the company or a subsidiary of the company, either—

- (i) by means of the issue of shares in the company; or
- (ii) by the grant of options for shares in the company”.

<sup>88</sup> Cassim (n 27) 208.

<sup>89</sup> Also see section 117(2) of the 2008 Act which provides that, two or more related or inter-related are regarded to have acted in concert, unless there is satisfactory evidence that they acted independently in any particular matter for purposes of Part B and C of the 2008 Act and the Takeover Regulations.

<sup>90</sup> s 45(3) and (4).

<sup>91</sup> Section 97 deals with standards for qualifying employee share schemes.

<sup>92</sup> s 45(3)(a)(i) of the 2008 Act.

### 3.2 Special resolution

Where the financial assistance is not pursuant to an employee share scheme that satisfies the requirements of section 97, a special resolution adopted by the shareholders of the company within the previous two years is required.<sup>93</sup> This entails that such special resolution must be passed before the provision of financial assistance and can only be forward looking. Thus, the special resolution cannot ratify financial assistance already provided by the company.<sup>94</sup>

Furthermore, the special resolution may approve the financial assistance for a specific recipient, for example, a specific director of a company or of a related or inter-related company. This does not necessarily mean that the special resolution should specify the specific recipients as long as it specifies the category of potential recipients. It is, however, submitted that the special resolution must adequately describe the type of financial assistance as this cannot be left to the directors.<sup>95</sup>

### 3.3 Solvency and liquidity test

The board may not authorise any provision of financial assistance to a director of a company or of a related or inter-related company, unless it is satisfied that immediately after such provision of financial assistance, the company would satisfy the solvency and liquidity test.<sup>96</sup> Delpont submits that the test in terms of section 45(3)(b)(i) is a subjective test in that the board must be satisfied that the company will satisfy the solvency and liquidity test immediately after giving the financial assistance.<sup>97</sup>

The solvency and liquidity test is set out in section 4 of the 2008 Act. It comprises two elements, namely a solvency element and a liquidity element.<sup>98</sup> A company satisfies the solvency test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at the time, the fairly valued assets of the company are equal to or exceed the fairly valued liabilities of the company.<sup>99</sup> Thus, solvency test entails that the assets of the company must exceed its liabilities after the provision of financial assistance.

A company satisfies the liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at the time, it appears that the company

<sup>93</sup> s 45(3)(a)(ii) of the 2008 Act.

<sup>94</sup> Jooste (n 28) 178.

<sup>95</sup> Jooste (n 28) 178.

<sup>96</sup> s 45(3)(b)(i).

<sup>97</sup> Delpont (n 39) 54.

<sup>98</sup> Van der Linde "The solvency and liquidity approach in the Companies Act 2008" 2009 *TSAR* 224 225.

<sup>99</sup> s 4(1)(a).

will be able to pay its debts as they become due in the ordinary course of business for a period of either twelve months after the date on which the test is considered, or in the case of a distribution, twelve months following that distribution.<sup>100</sup> Thus, the liquidity test entails that, after the provision of financial assistance, the company must be able to pay its debts as they become due in the course of business.

Section 4(2)(a)(i) and (ii) provide that for the purpose of the 2008 Act, any financial information to be considered concerning the company must be based on accounting records that satisfy the requirements laid down by section 28 and financial statements that satisfy the requirements laid down by section 29. Therefore, the financial assistance to be considered by the company should be based on such accounting records and financial statements.

Furthermore, section 4(2)(b)(ii) provides that the board or any other person applying the solvency and liquidity test must consider a fair valuation of the company's assets and liabilities in conjunction with any reasonably foreseeable contingent assets and liabilities. In addition, section 4(2)(b)(ii) provides that the board or any other person applying the solvency and liquidity test may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances.

Van der Linde states that the solvency and liquidity test as outlined in section 4 of the 2008 Act imposes an objective test rather than a subjective test.<sup>101</sup> According to her, the determining factor is the existence of a ground or reason upon which a conclusion could be reasonably reached. Furthermore, she indicates that a resolution by the board that it has "reasonably concluded" that the company will satisfy the test is set as an additional requirement in certain instances.<sup>102</sup> However, section 45 of the 2008 Act does not require the board to adopt a resolution that it has "reasonably concluded" that the company will satisfy the test.

It is clear from the aforesaid that the provisions of sections 45 and 4 of the 2008 Act impose different tests with regard to the application of solvency and liquidity test. Section 45 imposes a subjective test by the inclusion of the word "the board is satisfied that" whilst section 4 generally imposes an objective test by the use of the words "reasonably foreseeable".

---

<sup>100</sup> s 4(1)(b).

<sup>101</sup> Van der Linde (n 98) 235. See also Jooste "Issues relating to the regulation of distribution by the 2008 Companies Act" 2009 *SALJ* 627 642.

<sup>102</sup> See van der Linde (n 98) 235. Also see s 46(1)(c) of the 2008 Act.

Consequently, it is submitted that the application of the solvency and liquidity test in terms of section 4 of the 2008 Act would depend on the section that puts the test in operation as other elements could be required.<sup>103</sup> The application of the solvency and liquidity test should be subjective in instances where the board authorises the company to provide financial assistance to a director of a company or of a related or inter-related company. The application of the subjective test will further strengthen the protection of both shareholders and creditors.

However, I support the view that the application of different tests is confusing and there is no need for different solvency and liquidity requirements.<sup>104</sup> An overall objective reasonableness test appears to be the most appropriate.

Section 4 of the 2008 Act does not contain provisions regards the consequences in instances where the board fails to apply the solvency and liquidity test. It appears that liability for failure to apply the solvency and liquidity test arise based on the section that puts the test in operation. For instance, section 45(3)(b) of the 2008 Act requires the board to be satisfied that immediately after the provision of financial assistance, the company would satisfy the solvency and liquidity test. The liability of a director will arise for failure to comply with this requirement.<sup>105</sup> The liability of a director for failure to comply with the requirements of section 45 will be fully discussed later in this dissertation.

In terms of section 218(2), any person who contravenes any provision of the 2008 Act is liable to any other person for a loss or damage suffered by that person as a result of that contravention. This entails that if the directors authorise financial assistance by a company and fail to apply the solvency and liquidity test, such directors will be liable for a loss or damage suffered by the shareholders or creditors.

### 3.4 Fair and reasonable terms

The board may not authorise any financial assistance to a director of a company or of a related or inter-related company, unless it is satisfied that the terms under which the financial assistance is proposed to be given are fair and reasonable to the company.<sup>106</sup>

The 2008 Act does not define “fair and reasonable to the company”. The question arises whether the transaction should benefit the company for the terms to be “fair and reasonable to

---

<sup>103</sup> Delpont (n 55) 33.

<sup>104</sup> Yeats and Jooste “Financial assistance-a new approach” 2009 *SALJ* 566 587.

<sup>105</sup> s 45(7) of the 2008 Act.

<sup>106</sup> s 45(3)(b) of the 2008 Act.

the company”.<sup>107</sup> It is submitted that the ‘fair and reasonable’ test is not in respect of the effect on, or benefit for, the company but the terms of the financial assistance.<sup>108</sup> Therefore, the transaction needs not to benefit the company for the terms to be “fair and reasonable to company”, however, such terms should not harm the company.

Another question that arises is whether or not there should be a fair and reasonable security provided to the company for the terms to be “fair and reasonable to the company”.<sup>109</sup> Yeats and Jooste are of the view that, if this is the case, the provisions of section 37(3)(c) of the 1973 Act might provide some guidance in determining what is ‘fair and reasonable to the company’.<sup>110</sup> Section 37(3)(c) provides as follows:

“In enquiring, for the purposes of paragraph (a), whether or not any terms or conditions were fair to the company or failed to provide reasonable protection for its business interests, regard shall be had, without prejudice to the generality of the enquiry, to-

- (i) whether, in view of the financial position of the parties, the loan should have been made or the security should have been provided at all;
- (ii) in the case of a loan, whether security has been or should in the circumstances have been provided therefor, and whether any security provided therefor is adequate;
- (iii) the consideration for the loan or security, including any interest or other benefit received therefor;
- (iv) the term of the loan or security; and
- (v) the manner of repayment of the loan or discharge of the security.”

It appears from the provisions of section 45(3)(b) that the board must apply the subjective test to determine whether or not the terms under which the financial assistance is proposed to be given are fair and reasonable to the company. I am, therefore, of the view that the directors of the company are best suited to make a sound decision regarding what would be fair and reasonable to the company when authorising the financial assistance. Furthermore, it appears that the rationale for the inclusion of the “fair and reasonable” criterion in section 45 is to impose liability on the directors if they act recklessly when authorising the company to provide financial assistance.

---

<sup>107</sup> Yeats and Jooste (n 104) 577.

<sup>108</sup> Delpont (n 54) 194.

<sup>109</sup> See Yeats and Jooste (n 104) 577 .

<sup>110</sup> See Delpont (n 55) 194.

### 3.5 Memorandum of incorporation

The memorandum of incorporation may prohibit or restrict the company to provide financial assistance to its director.<sup>111</sup> Delpont is of the view that the memorandum of incorporation must permit the company to provide financial assistance.<sup>112</sup> I do not agree with this view. The 2008 Act does not require that there should be expressed permission in the memorandum of incorporation that the company should provide financial assistance.

In terms of section 45(4), the board must ensure that any other restrictions or conditions regarding the provision of financial assistance that may be contained in the company's memorandum of incorporation has been satisfied. As a result, the company should comply with any restrictions or conditions of the memorandum of incorporation pertaining to the provision of financial assistance.

### 3.6 Written notice of resolution to all shareholders and trade unions

Section 45(5) requires that, after the adoption of any resolution of the board to provide financial assistance to a director of a company or of a related or inter-related company, the company must provide written notice thereof to all its shareholders, unless every shareholder is also a director of the company.

The aforesaid notice must be given within ten business days after the board adopts the resolution, if the total value of all loans, debts, obligations or assistance, together with any previous financial assistance exceeds one-tenth of 1% of the company's net worth at the time of the resolution, or in any other case, within 30 business days after the end of the financial year.

Delpont argues that giving notice to shareholders is odd as they will be required to pass the special resolution.<sup>113</sup> I agree with this view because for shareholders to pass a special resolution they should have been given notice of the meeting at which they cast their votes on the special resolution.<sup>114</sup> Further, the giving of a written notice will cause an undue administrative burden and unnecessary expense for the company.<sup>115</sup>

---

<sup>111</sup> s 15(2)(b) of the 2008 Act.

<sup>112</sup> Delpont (n 39) 31.

<sup>113</sup> Delpont (n 39) 57 n 20.

<sup>114</sup> Jooste (n 28) 179.

<sup>115</sup> Wainer "The new Companies Act: peculiarities and anomalies" 2009 *SALJ* 806 819.



Section 45(5) also requires the company to provide written notice to any trade union representing its employees. The question arises as to why such notice should be given to any trade union not any “registered trade union” as defined in section 1 of the 2008.<sup>116</sup> This will cause unnecessary administrative burden for the massive company as it will be required to enquire whether or not each employee is affiliated to a trade union. Therefore, it would make sense if such notice must be provided only to a registered trade union.

Furthermore, it is not clear why the information has to be provided to the trade union, as the trade union does not appear to be empowered by the 2008 Act to do anything particular with that information.<sup>117</sup> A trade union can only use such information in instances where the financial assistance is not consistent with the provisions of the 2008 Act.<sup>118</sup> Perhaps the legislature’s aim is to attempt to promote transparency and high standards of corporate governance as the disclosure to a trade union may go a long way towards establishing a better relationship between a company and a trade union.

#### 4 *Validity of contracts and liability*

In terms of section 45(6) of the 2008 Act, a decision by the board of a company to provide financial assistance to a director of a company, or, of a related or inter-related company, 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 section 45 or a prohibition, condition or requirement in the memorandum of incorporation of the company. For instance, if a company provides financial assistance and it appears subsequently that, at the time of the provision of the financial assistance, the company did not comply with the solvency and liquidity test, a decision by the board to provide such financial assistance or an agreement with respect to the provision of any such assistance is void.

Section 45(7) provides that, if a resolution or an agreement is void in terms of section 45(6), a director of the company is liable to the extent set out in section 77(3)(e)(v) if he was present at the meeting when the board approved the resolution or agreement, or participated in the making of such decision in terms of section 74, and failed to vote against the resolution or

---

<sup>116</sup> Section 1 provides that “registered trade union” means a trade union registered in terms of section 96 of the Labour Relations Act, 1995.

<sup>117</sup> See Wainer (n 115) 819.

<sup>118</sup> See Wainer (n 115) 819.

agreement, despite knowing<sup>119</sup> that the provision of financial assistance was inconsistent with section 45 or any prohibition, condition or requirement imposed by the company's memorandum of incorporation.

It is clear from the aforesaid, that the director must vote against the resolution or agreement for the provision of financial assistance which is inconsistent with section 45, if the director is present in the meeting, in order to escape liability. Furthermore, a director may escape liability by simply not attending the meeting.<sup>120</sup> This is one of the flaws presented by the provisions of the 2008 Act.

The extent of the liability of a director for breach of section 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.<sup>121</sup> The liability of a director will be joint and several with any other person who is or may be held liable for the same act.<sup>122</sup>

A director who has been, or may be, held liable in terms of section 77(3)(e), may apply to a court for an order setting aside the decision of the board to provide financial assistance contrary to section 45.<sup>123</sup> The court may make an order setting aside the decision in whole or in part, absolutely or conditionally.<sup>124</sup> The court may also make 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.<sup>125</sup> Therefore, the court may order that a director should restore financial assistance provided to him by a company. For instance, a director may be ordered to, *inter alia*, pay back any money received from the company. Furthermore, the court may make an order requiring the company to indemnify any director who has been or may be held liable, including indemnification for costs of the proceedings under that section.<sup>126</sup>

---

<sup>119</sup> In terms of section 1 of the 2008 Act, "knowing", "when used with respect to a person, and in relation to a particular matter, means that person is either-

- (a) had actual knowledge of the matter;
- (b) was in a position in which the person reasonably ought to have –
  - (i) had actual knowledge
  - (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or
  - (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter".

<sup>120</sup> Jooste (n 28) 183.

<sup>121</sup> s 45(7) read with s 77(3)(e)(v) of the 2008 Act.

<sup>122</sup> s 77(6) of the 2008 Act.

<sup>123</sup> s 77(5)(a) of the 2008 Act.

<sup>124</sup> Section 77(5)(b)(i) of the 2008 Act.

<sup>125</sup> s 77(5)(b)(ii)(aa) of 2008 Act..

<sup>126</sup> s 77(5)(b)(ii)(bb) of the 2008 Act.

In terms of section 77(7), the proceedings to recover any loss, damages or costs for which a director is or may be held liable may not be commenced more than three years after the act or omission that gave rise to that liability. However, if, 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, on any terms the court considers just if it appears to the court that the director is or may be liable, but has acted honestly and reasonably and 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.<sup>127</sup>

### 5 Disclosure of financial assistance in annual financial statements

The 2008 Act contains extensive mandatory requirements regarding disclosure in the company's annual financial statements of remuneration and other benefits paid to a director of a company or of a related company. In terms of section 30(4)(a) of the 2008 Act, a company which is required in terms of the 2008 Act to have its annual financial statements audited is required to disclose in the annual financial statements, *inter alia*, the amount of remuneration received by each director.

Director's remuneration is defined in section 30(6) of the 2008 Act. The definition of remuneration includes, *inter alia*,

"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.<sup>128</sup>

It is submitted that the above definition of "remuneration" presents some difficulties regarding its interpretation.<sup>129</sup> Jooste is of the view that it is problematic that the definition expressly refers only to the value of "interest".<sup>130</sup> According to him, "interest" relates to a

<sup>127</sup> s 77(9) of the 2008 Act.

<sup>128</sup> s 30(6)(g) of the 2008 Act. In terms of section 30(6)(f) of the 2008 Act, "remuneration" also includes financial assistance to a director, past director or future director, or person related to any of them, for the subscription of options or securities, or the purchase of securities, as contemplated in section 44 of the 2008 Act.

<sup>129</sup> Jooste (n 28) 187.

<sup>130</sup> Jooste (n 28) 187.

loan not any other type of financial assistance, including a guarantee. Therefore, if the financial assistance is something other than a loan, there is nothing to disclose. I do not think that this is the intention of the legislature. This is merely one of the flaws presented by the provisions of the 2008 Act and needs to be addressed. However, Jooste further states the following:

“A possible interpretation in relation to a guarantee, perhaps the interest referred to is not interest deferred, waived or forgiven by the company providing the guarantee but by a person making a loan. if a lender makes a loan to a director of a company and defers, waives or forgives any interest or charges a lower than fair market rate of interest and the company guarantees the repayment of the loan, then the company 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.”<sup>131</sup>



---

<sup>131</sup> Jooste (n 28) 187.

## CHAPTER 3

### LINK BETWEEN SECTION 45 AND SECTION 75 OF THE 2008 ACT

#### 1 *Introduction*

Section 75 of 2008 Act regulates the position of the director who has personal financial interests in the company business. The provisions of section 75 are clearly in line with the director's duty to disclose any personal financial interests.<sup>132</sup> It is submitted that the provision of section 75 confirms the common law position that full disclosure to, and approval by, the company is required to avoid liability.<sup>133</sup> The purpose of section 75 is to ensure that the integrity of board decisions is not compromised by directors' personal financial interest(s).

The 2008 Act defines "personal financial interest" in relatively broad terms. Section 1 of the 2008 Act provides as follows:

"personal financial interest", when used with respect to any person-

- (a) means a direct material interest of that person, of a financial, monetary or economic nature, or to which monetary value may be attributed; but
- (b) does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (act No. 45 of 2002), unless that person has direct control over the investment decisions of that fund or investment."

It is clear from the above that any non-financial interests of a director fall outside the ambit of the definition of "personal financial interest". The provision of financial assistance by a company to its director or to a director of a related or inter-related company in terms of section 45 of the 2008 Act will, however, fall within the scope of this definition. Therefore, the provision of such financial assistance should be classified as a matter in which a director has a personal financial interest. This entails that the provisions of section 75 should be applicable to transactions executed in terms of section 45.

#### 2 *Scope of section 75*

The scope of section 75 is much wider and therefore, the board should consider its rights and obligations carefully. For the purposes of section 75, a "director" includes "an alternative

---

<sup>132</sup> Delpont (n 55) 287.

<sup>133</sup> Havenga "Directors' exploitation of corporate opportunities and the Companies Act 71 of 2008" 2013 *TSAR* 257 264.

director”, “prescribed officer” and “a person who is a member of a committee of the board of company irrespective of whether the person is also a member of the company’s board”.<sup>134</sup> Furthermore, “related person”, when used in reference to a director, has the meaning set out in section 1 of the 2008 Act, but also includes a second company of which the director or a related person is also a director, a close corporation of which the director or related person is a member.<sup>135</sup>

The provisions of section 75 do not apply to a director of a company in respect of a decision that may generally affect all directors of the company in their capacity as directors or a class of persons, despite the fact that the director is one member of that class of persons, unless the only members of the class are directors or persons related or inter-related to the director, or in respect of a proposal to remove that director from office as contemplated in section 71.

Furthermore, section 75 does not apply to a company or its director, if that director holds all of the beneficial interests of all of the issued securities of the company and is the only director of that company.

### 3 *Disclosure of personal financial interest*

Section 75 of the 2008 Act prescribes various procedures that should be followed for disclosure of a director’s personal financial interests. Such procedures depend on the number of directors the company has and the time of disclosure.

#### 3.1 Disclosure to shareholders

A sole director of a company who does not hold all of the beneficial interests of all of issued securities of the company may not approve or enter into any agreement in which he has a personal financial interest or determine any other matter in which he has a personal financial interest.<sup>136</sup> However, such director may approve or enter into such agreement or make such determination only if the agreement or determination is approved by an ordinary resolution of the shareholders after he has disclosed the nature and extent of his personal financial interest to the shareholders. The rationale for this is to avoid instances whereby a company with one director will have to make this type of a disclosure to him- or herself.<sup>137</sup>

---

<sup>134</sup> s 75(1)(a) of the 2008 Act.

<sup>135</sup> s 75(1)(b) of the 2008 Act.

<sup>136</sup> s 75(3) of the 2008 Act.

<sup>137</sup> Cassim (n 27) 573.

### 3.2 Written notice

In terms of section 75(4), a sole director who does not hold all of the beneficial interests of all the issued securities of the company as referred to above, may disclose his personal financial interest at any time and in advance, by delivering to the board or shareholders, a notice in writing setting out the nature and extent of that interest, to be generally used for the purposes of section 75 until changed or withdrawn by further written notice from that director.

### 3.3 Meeting of the board

Section 75(5) provides that if a director of a company has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows that a related person has a personal interest in the matter, the director must disclose<sup>138</sup> the interest and its general nature before the matter is considered at the meeting.<sup>139</sup> Such director is also required to leave<sup>140</sup> the meeting after disclosure of material information.<sup>141</sup> The purpose of this requirement is to prevent a director from influencing any decisions by the board in relation to the matter in which he is interested. Furthermore, the director is not allowed to vote on the resolution and must not sign such resolution.<sup>142</sup>

### 3.4 Company's material interest

Furthermore, a director is required to promptly disclose to the board or the shareholders the nature and extent of personal financial interest acquired in an agreement or other matter in which the company has a material interest, after the agreement or other matter has been approved by the company. Such director must also disclose the material circumstances relating to acquisition of that personal financial interest.<sup>143</sup>

## 4 *Validity of contracts*

### 4.1 Decision by the board or approval by the board or company

The non-disclosure by a director of a personal financial interest in a matter before the board renders invalid any decision taken by the board, or a transaction or agreement approved by

<sup>138</sup> The 2008 Act does not prescribe the manner of disclosure. Therefore, the disclosure may be oral or in writing.

<sup>139</sup> s 75(5)(a).

<sup>140</sup> It should be noted that, in terms of section 75(f) of 2008 Act, a director that is required to recuse himself from the meeting of the board is deemed to be present for purposes of calculating the prerequisite quorum, but the remainder of the directors still have to achieve the required support for the resolution to be passed.

<sup>141</sup> s 75(5)(d).

<sup>142</sup> See s 75(5)(e) and (g).

<sup>143</sup> s 75(6) of the 2008 Act.

the board or by a company.<sup>144</sup> However, a decision by the board, or a transaction or agreement approved by the board or shareholders, can be validated despite having been approved without proper disclosure, if it is subsequently ratified by an ordinary resolution of the shareholders following the disclosure of that interest.<sup>145</sup>

#### 4.2 Declaration by the court

The court is allowed, on application by any interested person, to declare valid a transaction or agreement that had been approved by the board, shareholders, as the case may be, despite the failure of the director to satisfy the disclosure requirements of section 75.<sup>146</sup> Delpont argues that this will render the common law rule which states that the contract is voidable at the instance of the company inapplicable.<sup>147</sup>

#### 5 *The link with section 45*

As indicated earlier, I am of the view that the provisions of section 75 should be applicable to transactions executed in terms of section 45. A director of a company or of related or inter-related company who requires financial assistance from a company should be subjected to the provisions of section 75. Therefore, such a director must make full disclosure in respect of the financial assistance sought in the manner prescribed by section 75.

A director who seeks financial assistance from the company should disclose the nature and extent of such assistance to the board and shareholders. Furthermore, if the required financial assistance is to be discussed in the meeting of the board, the director should disclose the nature of his interest and any material information in relation to the matter. Such director must also recuse himself from the meeting and must not take part in the consideration of the matter.

If a director fails to make full disclosure about the financial assistance as referred to above, the decision by the board to authorise such assistance, or a transaction or agreement approved by the board or company should be invalid. However, such decision or transaction or agreement may of course also be validated, if it is subsequently ratified by an ordinary resolution of the shareholders following the disclosure of the interest. The court may declare

---

<sup>144</sup> s 75(7)(a) of the 2008 Act.

<sup>145</sup> s 75(7)(b) of the 2008 Act.

<sup>146</sup> s 75(8) of the 2008 Act.

<sup>147</sup> Delpont (n 39 ) 96.



valid financial assistance or agreement to grant financial assistance that had approved by the board despite the failure of the director to satisfy the disclosure requirements.

I am of the view that the application of the provisions of section 75 to the transaction executed in terms section 45 will enhance the protection of the shareholders and creditors. Furthermore, it should be noted that the 2008 Act aims to promote transparency and high standards of corporate governance. It is also my view that the disclosure of the details of financial assistance, for instance, to shareholders will go a long way towards establishing greater trust between the board and the shareholders.



## CHAPTER 4

### POSITION IN NEW ZEALAND

#### 1 Introduction

One of the objectives of this dissertation is to determine how New Zealand's company law regulates the giving, by a company, of loans or other financial assistance to directors. Prior to the company law reform in New Zealand, the giving of a loan by a company to directors or a guarantee or provision of security in connection with a loan to a director by third party was regulated in terms of the New Zealand's Companies Act 63 of 1955 (the 1955 Act).<sup>148</sup>

In terms of the 1955 Act, a company was generally prohibited from providing a loan to its directors.<sup>149</sup> The introduction of the 1993 New Zealand's Companies Act<sup>150</sup> changed this position. It is submitted that the 1993 New Zealand Companies Act provided a more flexible regime for financial transactions by a company.<sup>151</sup> In this regard, a number of transactions by a company that were previously prohibited are now allowed in terms of the 1993 New Zealand Companies Act.<sup>152</sup> Similarly, the South African 2008 Act now allows a company to conclude transactions that were previously prohibited in terms of the 1973 Act. For instance, a company in South Africa was also not allowed to provide a loan to its directors.<sup>153</sup>

In essence, the purpose of the 1993 New Zealand Companies Act is to facilitate the economic development of the New Zealand's economy while providing shareholders with protection by the inclusion of significant remedies for shareholders.<sup>154</sup> In terms of the 1993 New Zealand Companies Act, the board of a company may, subject to any restrictions contained in the constitution of that company, authorise the making of loans by the company to a director and the giving of guarantees by the company for debts incurred by a director.<sup>155</sup> To be precise, section 161 of the 2003 New Zealand Companies Act regulates these transactions and the provision of other benefits to company's directors.

---

<sup>148</sup> Morrison (n 30) 1/42. Also see Jones (n 30) 161.

<sup>149</sup> Morrison (n 30) 1/46.

<sup>150</sup> Hereinafter referred to as the 1993 New Zealand Companies Act.

<sup>151</sup> See Morrison (n 30)1/46.

<sup>152</sup> Tomasic *Company law in East Asia* (1999) 609.

<sup>153</sup> s 226 of the 1973 Act.

<sup>154</sup> Tomasic (n 152) 599.

<sup>155</sup> Section 161(1)(c) and (d). Unauthorised in this context, means that the particular transaction has either not been approved by a valid director's resolution under section 161(1). See Williams *Corporations and Partnerships in New Zealand* Kluwer (2011) 234.

## 2 *Scope of section 161 of the 1993 New Zealand Companies Act*

Section 161 of the 1993 New Zealand Companies Act regulates the situation where a company provides remuneration and other benefits to its directors. In terms of section 161(1) the board may authorise the company to do the following:

- (a) to pay remuneration or provide other benefits to a director for services as a director or in any other capacity;<sup>156</sup>
- (b) to pay a director or former director compensation for loss of office;<sup>157</sup>
- (c) to make loans to a director;
- (d) to give guarantees for debts incurred by a director.

Furthermore, the board is allowed to authorise the company to enter into a contract in respect of the aforementioned transactions. Section 161(3) provides that the payment of remuneration or the provision of any other benefit to a director in accordance with a contract authorised under subsection (1) need not be authorised under that subsection.

## 3 *Definitions of terms and concepts*

The 1993 New Zealand Companies Act does not defined most of the terms and concepts contained in section 161. For instance, terms and concepts such as “remuneration” and “other benefits to directors” are not defined. The lack of definitions of terms and concepts may create uncertainty regarding the interpretation and application of the provisions contained in section 161. This problem also exists in South African company law. For instance, the 2008 Act does not define the term “financial assistance” and this may cause interpretative uncertainty.

Like the South African 2008 Act,<sup>158</sup> the 1993 New Zealand Companies Act contains the definition of the term “director”. In terms of section 126(1)(a) of the 1993 Act, “director”, in relation to a company, includes a person occupying the position of a director of the company

<sup>156</sup> Sections 66(8) and 30(4) and (6) of the South African 2008 Act deal with director’s remuneration. In terms of section 66(8), a company may pay remuneration to its directors for their service as directors. Section 30(4) and (6) deal with the disclosure of remuneration in the annual financial statements and the definition of remuneration.

<sup>157</sup> In South Africa, this position is regulated by section 71 of the 2008 Act which provides that a director who has been removed from the office is not deprived of right that he may have at common law or otherwise apply to a court for damages or other compensation loss of office or loss of any other office as a consequence of being removed as a director. Furthermore, section 30(4)(c) of 2008 Act requires a company which is required to be audited to include in its annual financial statements particulars showing the amount of any compensation paid in respect of loss office to current or past director.

<sup>158</sup> See s 1 of the 2008 Act.

by whatever name called. Furthermore, the 1993 New Zealand Companies Act refers to persons as directors if such persons effectively exercise the powers of directors, and influence a director.<sup>159</sup>

#### 4 *Requirements for payment of remuneration or the provision of other benefits*

##### 4.1 Constitution of the company

In terms of section 161(1) of the 1993 New Zealand Companies Act, the board should consider any restrictions contained in the constitution of the company when authorising the making of the payment of remuneration or the provision of the benefit or the making of the loan or the giving of the guarantee or the entering into of the contract. This entails that the company's constitution may prohibit or restrict the company to conclude the aforesaid transactions. As a result, the board should comply with any restrictions contained in the constitution of the company.

##### 4.2 Fairness

The 1993 New Zealand Companies Act requires that the board must be satisfied that the payment of remuneration or compensation for loss of office or the making of loans by a company to a director or the provision of guarantees by a company for debts incurred by a director is fair to the company.<sup>160</sup> However, like the 2008 Act of South Africa, the 1993 New Zealand Companies Act does not provide guidance as to the meaning of fairness. Perhaps, the board may consider the following to determine whether it is fair to the company to provide loans or guarantee:

- (i) whether the provision of a loan or guarantee is fair to the company when factoring in the interest rate, repayment terms security and other conditions.
- (ii) Whether the company is able to provide the loan or guarantee and still be able to explore other profitable opportunities.
- (iii) Whether the provision of the loan or guarantee will result in an adverse effect on the profits of the company.

---

<sup>159</sup> s 126 (1)(b), (c), and (d).

<sup>160</sup> s 161(1).

### 4.3 Interests register

In terms of section 189(1)(c) of the 1993 New Zealand Companies Act, every company must keep an interests register at its office. The company and every director will be held liable in instances where a company fails to keep the interests register. A director's personal interests in transactions relating to the company must be recorded in the interests register.

Section 161(2) of the 1993 New Zealand Companies Act requires that the board must ensure that, subsequent to authorising the making of the payment of remuneration or the provision of the benefit or the making of the loan or the giving of the guarantee or the entering of the contract, particulars of the payment or benefit or loan or guarantee or the contract are entered in the interests register.

In South Africa, a director is also required to disclose his personal financial interests.<sup>161</sup> However, South African companies are not required to keep interest registers at their offices but must keep minutes of the meetings of the board, and any of its committees, and include in minutes any declaration given by notice or made by a director as required by section 75.<sup>162</sup> Section 75 of the 2008 Act, a director is required to make disclosure of his personal financial interest to the shareholders and directors of the company. Furthermore, such disclosure should be in a form of a delivery of a written notice or be disclosed in the meeting of the board.

### 4.4 Signing of a certificate

The directors who vote in favour of authorising a loan or guarantee are required to sign a certificate.<sup>163</sup> The directors must indicate in the certificate that, in their opinion, the making of the loan or the giving of the guarantee is fair to the company and the grounds for that opinion. The directors may state in the certificate that the grounds of their opinion is that the company will, after the making of a loan or the giving of a guarantee, satisfy the solvency test.

## 5 *Solvency and liquidity*

In contrast to section 45 of the South African 2008 Act, section 161 of the 1993 New Zealand Act does not expressly require the board to be satisfied that the company would meet the

---

<sup>161</sup> See s75 of the 2008 Act.

<sup>162</sup> See s 73(6)(a) of the 2008 Act.

<sup>163</sup> s 161(4) of the 1993 New Zealand Companies Act.

solvency and liquidity requirements subsequent to the making of the payment of remuneration or the provision of the benefit or the making of the loan or the giving of the guarantee or the entering of the contract.

In terms of section 107 of the 1993 New Zealand Companies Act, shareholders can make unanimous decisions in relation to certain types of corporate actions. Section 107(1)(f) provides that, subject to section 108 of the 1993 New Zealand Companies Act, if all entitled persons have agreed or concur, any of the matters referred to in section 161(1) may be authorised otherwise than in accordance with that section. This entails that entitled persons may authorise any matters referred to in section 161(1) without applying the provisions of that section.

In terms of section 2 of the 1993 New Zealand Companies Act, “entitled person” in relation to a company means a shareholder or a person upon whom the constitution confers any of the rights and powers of a shareholder.

A company’s shareholder is not allowed to authorise the making of the payment of remuneration or the provision of the benefit or the making of the loan or the giving of the guarantee or the entering of the contract in terms of section 161 read with section 107(1)(f) unless the board of company is satisfied on reasonable grounds that the company will, immediately after the authorisation, satisfy the solvency test.<sup>164</sup>

In terms of section 4(1) of the 1993 New Zealand Companies Act, a company satisfies the solvency test if the company is able to pay its debts as they become due in the normal course of business and the value of the company’s assets is greater than the value of its liabilities, including contingent liabilities.

The directors who vote in favour of the shareholder’s authorisation are required to sign a certificate which states that, in their opinion, the company will, after the authorisation, satisfy the solvency test.<sup>165</sup>

If the board ceases to be satisfied on reasonable grounds that the company will, immediately after the shareholder exercised power to authorise the making of a loan or the giving of a

---

<sup>164</sup> s 108(1) of the 1993 New Zealand Companies Act.

<sup>165</sup> s 108(2) of the 1993 New Zealand Companies Act.

guarantee, satisfy the solvency test, the shareholder's exercise of the power is deemed not to have been authorised.<sup>166</sup>

## 6 *Consequences for non-compliance*

In terms of section 161(5) of the 1993 New Zealand Companies Act, a director or former director to whom the payment is made or the benefit is provided, or in respect of whom the guarantee is given is personally liable to the company for any amount of the payment, or the monetary value of the benefit or any amount paid by the company under the guarantee, except to the extent to which he or she proves that the payment or benefit or guarantee was fair to the company at the time it was given. A director or former director is held personally liable where a payment or benefit or guarantee is either inconsistent with the provisions of section 161 of the 1993 New Zealand Companies Act or reasonable grounds did not exist for the opinion set out in certificate.<sup>167</sup>

Furthermore, section 161(6) of the 1993 New Zealand Companies Act provides that a loan made to a director which is either inconsistent with the provisions of section 161 of the 1993 New Zealand Companies Act or where reasonable grounds did not exist for the opinion set out in the certificate becomes immediately repayable to the company by the director, notwithstanding the terms of any agreement relating to the giving of the loan, except to the extent to which he or she proves that the loan was fair to the company at the time it was given.

It is clear from the aforementioned that the New Zealand's position regarding the consequences for non-compliance is different to that of South Africa. In South Africa, the liability of a director arises if a resolution by the board of a company to provide financial assistance or an agreement with respect to the provision of any such assistance is declared void.<sup>168</sup> A resolution by the board or an agreement in respect of such assistance is declared void to the extent that the provision of financial assistance would be inconsistent with section 45 or a prohibition, condition or requirement in the memorandum.<sup>169</sup> As can be seen from above, the 1993 New Zealand Companies Act does not declare void the decision of the board and subsequently imposes liability on a director.

---

<sup>166</sup> s 108(3) of the 1993 New Zealand Companies Act.

<sup>167</sup> s 161 of the 1993 New Zealand Companies Act.

<sup>168</sup> s 45(6) and (7) of 2008 Act.

<sup>169</sup> See s 45(6) of the 2008 Act

In South Africa, the liability of a director is joint and several with any other person who is or may be held liable for the same act. In terms of the 1993 New Zealand Companies Act, a director is held personally liable to the company for payment or benefit received and in some instances a director may be required to immediately repay the loan made.

Furthermore, another sharp contrast between New Zealand and South Africa is that in South Africa, a company or a director who has been, or may be, held liable may apply to a court for an order setting aside the decision of the board to provide financial assistance contrary to section 45.<sup>170</sup> The court may make an order setting aside the decision in whole or in part, absolutely or conditionally. The court may also make 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.<sup>171</sup> In New Zealand, the court is not empowered to make any order in respect of a decision taken contrary to section 161 of the 1993 New Zealand Act.

#### 7 Transactions involving self-interest and section 161 of the 1993 Act

A director of a company is interested in a transaction to which the company is a party if, and only if, the director is, *inter alia*,

- (i) a party to, or will or may, derive a material financial benefit from the transaction; or
- (ii) has a material financial interest in another party to the transaction, or is a director, officer or trustee of another party or is related to or person who will or may derive a material financial benefit from the transaction; or
- (iii) is the parent, child, spouse civil union partner or de facto partner of another party to or person who will or may derive a material financial benefit from the transaction or is otherwise directly or indirectly materially interested in the transaction.<sup>172</sup>

A director of a company is required to, after becoming aware of the fact that he or she is interested in a transaction with the company, cause to be entered in the interests register and if the company has more than one director, disclose to the board of the company-

---

<sup>170</sup> s 77(5) of the 2008 Act.

<sup>171</sup> s 77(5)(b).

<sup>172</sup> s 139(1) of the 1993 New Zealand Companies Act.



- (i) If the monetary value of the director's interest is able to be quantified, the nature and monetary value of that interest; or
- (ii) if the monetary value of the director's interest cannot be quantified, the nature and extent of that interest.<sup>173</sup>

However, a director must not comply with aforesaid if the transaction or proposed transaction is between the director and the company and the transaction or proposed transaction is or is to be entered into in the ordinary course of the company's business and on usual terms and conditions.<sup>174</sup>

In terms of section 143 of the 1993 New Zealand Companies Act, the provisions of section 140 do not apply in relation to remuneration or any other benefit given to a director in accordance with section 161 of the 1993 New Zealand Act. Therefore, a director of a company is not required to disclose his/her interests in accordance with section 140.

Contrary to the 1993 New Zealand Act, the South African 2008 Act requires a director to disclose any personal financial interest that he has in respect of the matter to be considered at a meeting of the board of directors.<sup>175</sup> This is aimed at ensuring that the integrity of board decisions is not compromised by a director's personal financial interests.

#### 8 *Disclosure of remuneration and the value of other benefits in the annual report.*

In terms of section 211(1)(f) of the 1993 New Zealand Companies Act, the annual report of a company must be in writing and be dated, and must state, in respect of each director or former director of the company, the total remuneration and the value of other benefits received by that director or former director from the company during the accounting period. Similarly, South Africa companies which are required to be audited are also required to include in their annual financial statements particulars showing, *inter alia*, the remuneration and benefits received by each director and the amount of any compensation paid in respect of loss office to current or past director.<sup>176</sup> The only noticeable difference between these jurisdictions is that companies in New Zealand need to comply with the provisions of section 211(1)(f) if shareholders who together hold at least 95% of the voting shares agree that the

---

<sup>173</sup> s 140(1) of the 1993 New Zealand Companies Act.

<sup>174</sup> s 140(1A) of the 1993 New Zealand Companies Act.

<sup>175</sup> s 75 of the 2008 Act. This is discussed in detail under chapter 3 of this dissertation.

<sup>176</sup> See s 30(4) of the 2008 Act.

companies' annual reports need not to state the details of the remuneration and other benefits.<sup>177</sup>



---

<sup>177</sup> See s 211(3) of the 1993 New Zealand Companies Act.

## CHAPTER 5

### CONCLUSIONS AND RECOMMENDATIONS

#### 1 *Conclusions*

The legislature must be commended for replacing the 1973 Act with the 2008 Act. Companies are no longer prohibited from providing financial assistance to their directors or to the directors of a related or inter-related company. Although the prohibition was aimed at preventing potential abuse of company assets by directors and management, to the detriment of a company and its shareholders, there was a need for more effective ways of protecting the interests of the company and its shareholders.

Section 45 of the 2008 Act replaces sections 226 and 37 of the 1973 Act. Section 226 prohibited the making by a company of loans to the directors of a company, its holding company and co-subsiidiaries, as well as to companies controlled by such directors. The prohibition was subject to certain exceptions. Section 37 governed the loans made and security provided by a subsidiary to its holding company. Unlike section 226, section 37 did not prohibit a company from making a loan or providing security to its holding company or a subsidiary of its holding company. It, however, required a company to disclose the particulars of such loan or security in its annual financial statements.

The purpose of sections 226 and 37 was to prevent directors and holding companies from abusing their control over the company's financial resources otherwise than for its own benefit. However, the provisions of these sections, in particular the prohibition of loans, were no longer useful and, in the modern environment, unnecessary. Furthermore, it was generally accepted that these provisions were not adequate to protect the interests of the creditors and shareholders and consequently, needed to be amended.<sup>178</sup>

Section 45 of 2008 Act allows a company to provide financial assistance to its directors or to the directors of its related or inter-related company subject to certain requirements and conditions. Through section 45, the solvency and liquidity test was adopted, in order to ensure that company assets are not depleted by the provision of financial assistance for the benefit of creditors and shareholders. The provisions of the 1973 Act did not contain this

---

<sup>178</sup> See Jooste (n 7) 289 and McLennan (n 16) 246.

requirement. Consequently, I am of the view that the solvency and liquidity test provide better protection for creditors and shareholders than what was previously afforded under the provisions of the 1973 Act.

However, the application of the solvency and liquidity test is very confusing. In terms of section 4 of the 2008 Act the test is objective whereas the test in terms of section 45 is subjective. The question arises as to why the legislature did not provide a single test that will be applicable across all provisions of the 2008 Act.

Section 45(3)(b)(ii) provides that the board of directors may not authorise any financial assistance unless it is satisfied that “the terms under which the assistance is proposed to be given are fair and reasonable to the company”. However, neither the 2008 Act nor the section defines what is meant by “fair and reasonable” for such purpose. The lack of clarity on this requirement may, therefore, create uncertainty.

Other measures introduced by section 45 to protect creditors and shareholders are the conditions that restrictions and/or conditions in the memorandum of incorporation have to be complied with and the inclusion of the adoption of a special resolution<sup>179</sup>.

Furthermore, section 45 requires that, after the adoption of any resolution of the board to provide financial assistance, the company must provide written notice thereof to all its shareholders and to any trade union representing its employees. However, it is not clear from either the 2008 Act or the section why the information has to be provided to the trade union, as the trade union does not appear to be empowered by the 2008 Act to do anything particular with that information.

The power to authorise the financial assistance vests with the board. In terms of section 45 of the 2008 Act, the directors of the company will be held jointly and severally liable if a director was present at the meeting, or participated in the making of a decision in terms of section 74, and failed to vote against the provision of financial assistance, despite knowing that the provision of such assistance was inconsistent with section 45 or the memorandum of incorporation. Such director is liable to the extent set out in 77(3)(v) of the 2008 Act.

The liability of directors is limited to the loss, damage, or costs sustained by the company as a result of the directors’ failure to vote against the resolution or agreement. Furthermore, the

---

<sup>179</sup> See Yeats and Jooste (n 104) 580.

proceedings to recover any such loss, damage or costs may not be commenced more than three years after the act or omission that gave rise to the liability.

However, the 2008 Act is too lenient in respect of the directors' liabilities. For instance, a director may escape liability by simply not attending the meeting at which the provision of financial assistance was voted for. This entails that a director who is not certain whether section 45 would be complied or not may not attend the meeting or participate in the making of a decision at all. A director may also not prefer to vote against a particular resolution for political reasons.<sup>180</sup> I am of the view that failure to vote, in certain instances, may be influenced by the presence of the receipt director in the meeting. This may be curbed by applying the provisions of section 75 of the 2008 which requires that a director who has a personal financial interest to recuse himself from certain meetings.

Furthermore, it does not make sense that a director may apply to a court for an order setting aside the decision of the board to provide financial assistance contrary to section 45 in order to escape liability. The court may make an order setting aside the decision in whole or in part, absolutely or conditionally.

The court may also make any order that is just and equitable in the circumstances, including an order to rectify the decision, reverse any transaction or restore any consideration received by any person in terms of the decision of the board. It is commended that a director may be ordered to, *inter alia*, pay back any money received from the company based on the board's decision taken inconsistent with the provisions of section 45.

Furthermore, the court may make an order requiring the company to indemnify the director for possible liability including indemnification for costs of the proceedings. I agree with Jooste that the rationale for this order of the court is difficult to comprehend.<sup>181</sup> It baffles me why should a director be indemnified when he knew at the time of voting on the resolution providing financial assistance that such assistance was inconsistent with section 45 or the company's memorandum of incorporation? A further question arises as to why such director failed to vote against the resolution. This is one of the flaws presented by the 2008 Act and directors may take advantage of this.

---

<sup>180</sup> Jooste (n 28) 183.

<sup>181</sup> Jooste (n 28) 181.

A closer analysis of section 45 has further revealed that its interpretation and application will be marred by several problems and uncertainties. Section 45 contains several terms and concepts that are not clearly defined or not defined at all. Terms and concepts such as “financial assistance” are not comprehensively defined. This will create interpretative problems for the company and its board. I believe that even courts will find it difficult to interpret some of these terms and concepts. Therefore, the interpretation and application of the section does not prove to be easy.

The scope of section 45 is extremely wide and imposes onerous task on a company that intends to provide financial assistance to its directors or to the directors of a related or inter-related company. A company is required to embark on an extensive enquiry to determine its relationship with other companies and directors of such companies prior to providing financial assistance. This is practically unnecessary and will cause undue administrative burden for such company. A company will also have to spend a lot of money in order to conduct such enquiry.

I have also discussed the rules of financial assistance to a director under the 1993 New Zealand Companies Act. Like in South Africa, companies in New Zealand are allowed to provide financial assistance to its directors. Such financial assistance includes, *inter alia*, payment of remuneration or the making of loans to a director or the provision of guarantees for debts incurred by a director.

Like in South Africa, the power to authorise the aforementioned transactions vests with the board of directors. The board may authorise such transactions subject to certain requirements. The board may authorise subject to the restrictions contained in the constitution of the company. The constitution of a company may restrict the board from authorising the making of the payment of remuneration or the making of the loan or the giving of the guarantee.

Furthermore, the board is required to be satisfied that the payment of remuneration or the making of loans by a company to a director or the provision of guarantees by a company for debts incurred by a director is fair to the company. Like the 2008 Act, the 1993 New Zealand Companies Act does not provide guidance as to the meaning of fairness.

The 1993 New Zealand Companies Act also requires the board to ensure that, subsequent to authorising the making of the payment of remuneration or the making of the loan or the giving of the guarantee, particulars are entered in the interests register. Conversely, although

a director must disclose his personal financial interests, the 2008 Act does not require South African companies to keep interest registers.

The directors who vote in favour of authorising the making of the payment of remuneration or the making of the loan or the giving of the guarantee are required to sign a certificate indicating that, in their opinion, the aforementioned transactions are fair to the company and the grounds for that opinion.

Of importance, I have noted that, unlike section 45 of the 2008 Act, section 161 of the 1993 New Zealand Companies Act does not expressly require the board to be satisfied that the company would meet the solvency and liquidity requirements subsequent to the making of the payment of remuneration or the making of the loan or the giving of the guarantee. However, the only time the board must be satisfied on reasonable grounds that the company would, immediately after the authorisation, satisfy the solvency and liquidity test, is when the aforementioned transactions are authorised by the shareholders. I could not find the rationale for this requirement, perhaps this is to prevent the shareholders from abusing the financial resources of the company.

In New Zealand, a director or former director whom the payment of remuneration is made or in respect of whom the guarantee is given is personally liable to the company for any amount of the payment, or the monetary value of the benefit any amount paid by the company under guarantee except to the extent that the payment or benefit or guarantee was fair to the company or consistent with section 161 or reasonable grounds existed for the opinion set out in certificate at the time was given. Furthermore a loan made inconsistent with section 161 or where reasonable grounds did not exist for the opinion set out in certificate is immediately repayable to the company by the director, except to the extent to which such director proves that the loan was fair to the company at the time it was given.

It is clear from the aforesaid that liabilities provisions of both Acts are in sharp contrast. As discussed above, in South Africa, a director is liable if a resolution to provide financial assistance or an agreement with respect to the provision of such assistance is declared void. Furthermore, a director may be held jointly or severally liable for any loss, damages or costs sustained by the company. A company or a director who has been, or maybe, held liable may apply to a court for an order to, *inter alia*, set aside the decision of the board to provide financial assistance contrary to section 45. This may be costly.

Furthermore, in South Africa, a director is not required to immediately repay the financial assistance provided inconsistent with section 45 of the 2008 Act as the proceedings to recover loss, damage or costs may be commenced any time within three years after the act omission that gave rise to the liability.

The 1993 New Zealand Companies Act, expressly, does not require a director of a company to disclose any personal financial interests that has been acquired in terms of section 161. However, in South Africa, a director is required to disclose any personal financial interest that he has in respect of the matter to be considered at a meeting of the board of directors.

## *2 Recommendations*

Based on the above conclusions I recommend the following:

It is clear from the aforesaid that the interpretation and application of section 45 of 2008 Act does not prove to be simple and clarity is needed in certain regards. The legislature should provide comprehensive definitions in respect of old and new terms and concepts discussed in this dissertation. Terms and concepts such as “financial assistance” and “fair and reasonable terms” need comprehensive definitions to avoid interpretative uncertainties. Therefore, I recommend that the legislature, in future amendments to the 2008 Act, should include definitions of the aforesaid terms and concepts.

The legislature must also maintain a single solvency and liquidity test or scrap the test regards the provision of financial assistance to directors as discussed in this dissertation. Financial assistance to a director should be treated as a form of incentive like a salary/remuneration. The test does not apply when a salary of a director is determined. Why should it not apply when financial assistance is provided to a director?

I recommend that the provisions of section 75 of the 2008 Act should be linked to the provisions of section 45 to further strengthen the protection of the creditors and shareholders. The 2008 Act does not expressly provide that the provisions of section 75 should be applicable to section 45. Therefore, it is left to the company or the board to decide whether or not to apply such provisions to section 45.

Furthermore, the South African legislature could learn a thing or two from the 1993 New Zealand Companies Act which is widely praised for its simple language which renders it accessible and functional for its users. In New Zealand, the board of directors applies the



solvency and liquidity test in instances where the shareholders authorise financial assistance. Therefore, South Africa could adopt this approach by scrapping the test in instances where the board of directors authorises the provision of financial assistance or shareholders must be given powers to authorise financial assistance to directors and apply the test.

The liability that arises as a result of non-compliance with the provisions of section 45 should no longer be referred to the court for the indemnity of directors. The 1993 New Zealand Companies Act does not involve courts in determining the liability of directors as a director who benefitted from the transaction should repay. Furthermore, it is recommended that the directors should no longer be held liable jointly for the contravention of section 45. The legislature should emulate New Zealand by holding liable only the director who benefitted from the financial assistance.



## BIBLIOGRAPHY

Blackman MS, Jooste R, Everingham GK, Larkin M, Rademeyer CH and Yeats YL *Commentary on Companies Act* Lansdowne Juta and Co Ltd (2002)

Cassim FHI, Cassim MF, Cassim R, Jooste R, Shev J and Yeats J *Contemporary Company law* Juta (2012)

Cilliers HS, Benade ML, Henning B, Du Plessis JJ and Pretorius JT *Corporate Law* LexisNexis Butterworths Durban (1992)

Delport P *The Commentary of Henochsberg on Companies Act 71 of 2008* LexisNexis Butterworths Durban (2014)

Delport P *The New Companies Act Manual* LexisNexis (2011)

Du Plessis JJ “Nominee directors versus puppet, dummy and stooge directors: reflections on these directors and their nominators or appointors” 1995 *TSAR* 310.

Du Plessis JJ “Some subtle distinctions in the term “director”” 1995 *TSAR* 153.

Havenga M “Directors’ exploitation of corporate opportunities and the Companies Act 71 of 2008” 2013 *TSAR* 257

Hickey E *Guide to Companies Act 1993* the Law Book Company Limited (1994)

Idensohn K “The meaning of ‘prescribed officers’ under the Companies Act 71 of 2008” 2012 *SALJ* 717

Idensohn K “The regulation of shadow directors” 2010 *SA Merc LJ* 326.

Jooste R “Financial assistance to directors- The Companies Act 71 of 2008” 2010 *Acta Juridica* 165

Jooste R “Issues relating to the regulation of distribution by the 2008 Companies Act” 2009 *SALJ* 627

Jooste R “Loans to directors-An analysis of section 226 of the Companies Act” 2000 *SALJ* 269

Locke N “Shadow directors: lessons from abroad” 2002 *SA Merc LJ* 420

McLennan JS “Loans by subsidiaries to holding companies” 1978 *SALJ* 240

Meskin PM, Galgut B, Kunst J, Delpont P and Vorster Q *Henochsberg on Companies Act* LexisNexis Butterworths Durban (2011)

Morrison *Company and Securities Law: Companies Commentary, precedents*, Butterworths Wellington (2001)

Ross M *Directors' liability and Company Solvency-the new Companies Act* CCH New Zealand Limited (1994)

Sutherland P “The state of company law in South Africa” 2012 *Stell LR* 157

Tomasic R *Company law in East Asia* (1999)

Van der Linde K “The solvency and liquidity approach in the Companies Act 2008” 2009 *TSAR* 224

Wainer H E “The new Companies Act: peculiarities and anomalies” 2009 *SALJ* 806

Williams G *Corporations and Partnerships in New Zealand* Kluwer Law International BV the Netherlands (2011)

Yeats JL and Jooste R “Financial assistance-A new approach” 2009 *SALJ* 566

### ***Table of statutes***

#### **South Africa**

Companies Act 61 of 1973

Companies Act 71 of 2008

**New Zealand**

Companies Act 63 of 1955

Companies Act 105 of 1993

***Table of cases*****South Africa**

*Gardner and another v Margo* 2006 (6) SA 33 (SCA)

*Gradwell (Pty) Ltd v Rostra Printers Ltd* 1959 (4) SA 419 (A)

*Lipschitz v UDC Bank Ltd* 1979 (1) SA 789 (A)

*Olley v Maasdorp and Another* 1948 (4) SA 657 (A) 665

*S v Pouroulis* 1993 (4) SA 575 (W)

*Standard Bank of SA Ltd v Neugarten & Others* 1988 (1) SA 652 (W)

**England**

*Anglo petroleum Ltd v TFB (Mortgages) Ltd* 2008 1 BCLC 185 (CA)