

# Financial assistance: South African Supreme Court of Appeal interprets section 45 of the Companies Act to apply to an exhaustive list of transactions

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On 13 December 2022, the South African Supreme Court of Appeal ("SCA") delivered its judgment in *Constantia Insurance Company Limited v The Master of the High Court, Johannesburg and Others* (512/2021) [2022] ZASCA 179 ("**Constantia case**").

In this case, a group of companies (including Protech Khuthele Investment (Pty) Ltd ("**Protech Investment**")) requested Constantia Insurance Company Limited ("**Constantia**") to provide performance guarantees in respect of certain of the group's contractual obligations owed to third parties. Constantia agreed, on condition that each group company provided an indemnity in favour of Constantia to indemnify Constantia for any loss it suffered under the performance guarantees (the "**indemnity**").

Third parties subsequently claimed R182 million from Constantia under the performance guarantees. In turn, Constantia claimed from Protech Investment under the indemnity. Protech Investment was in liquidation at the time of the claim.

The liquidators of Protech Investment rejected the claim by Constantia on the basis that the indemnity constituted "financial assistance" by Protech Investments to Protech Khuthele within the meaning of section 45 of the Companies Act, 2008 (the "**Companies Act**"), and they were unable to find any resolutions authorising the "financial assistance". Therefore, the liquidators argued, the claim by Constantia against Protech Investment should be expunged, as the indemnity was void under section 45(6) of the Companies Act.

The court dealt with several issues which we will discuss below, but most notably it dealt with the meaning of "financial assistance" for purposes of section 45(1)(a) of the Companies Act.

## Section 45 prohibition against "financial assistance"

Section 45 of the Companies Act renders void any financial assistance given by a company to:

- a director or prescribed officer of the company or of a related or inter-related company; or

- a related or inter-related company or corporation; or
- a member (shareholder) of a related or inter-related corporation; or
- a person related to any such company, corporation, director, prescribed officer or member,

(each, a "**related person**") unless: (a) it is pursuant to a special resolution (adopted within the previous two years approving the financial assistance) or an employee share scheme; (b) the board is satisfied that the company would satisfy the solvency and liquidity test; (c) the board is satisfied that the terms under which the financial assistance is given is fair and reasonable to the company; and (d) if applicable, any requirements of the company's memorandum of incorporation are met. In addition, if the resolutions authorising the financial assistance or the agreements which are the subject of such financial assistance are void, the directors of the company may be subject to personal liability in terms of the Companies Act.

## **Interpretation of the definition of "financial assistance"**

Section 45(1) of the Companies Act does not on its face define "financial assistance" in all-inclusive terms. The definition provides for a number of inclusions and a number of exclusions. Paragraph (a) of the definition contains the inclusions and provides that "financial assistance" "includes lending money, guaranteeing a loan or other obligation, and securing any debt or obligation." Commentators on the definition have observed that the use of the word "includes" indicates that the types of transactions referred to are not an exhaustive list of what constitutes "financial assistance", noting that if the list was intended to be exhaustive it would have been expected that the word "means" would have been used in the definition instead of "includes". This has also been the general view in the South African legal market, and practitioners have generally considered the term "financial assistance" to be wide-ranging and have applied a conservative approach when advising on transactions potentially covered by section 45.

The South Gauteng High Court of South Africa in the court of first instance agreed with the prevailing commentary and had interpreted the word "includes" in the definition of "financial assistance" to denote a non-exhaustive list.

On appeal, the SCA discussed the use of the meaning of the word "includes" when used in a definition and noted that the word usually "denotes a term of extension". This would apply when the primary meaning of the term that is defined is well-known, and the word "includes" introduces a meaning or meanings that go beyond that primary meaning. In this case, the definition would encompass the primary well-known meaning as well as additional meanings which the definition declares it to include. The SCA said, however, that this "does not appear applicable" to the definition of "financial assistance" in section 45(1) of the Companies Act. The context in which it is used may, however, indicate that "includes" suggests that what follows after it comprises a complete or exhaustive definition of the relevant term. In other words, "includes" in certain contexts is equivalent to "means". The SCA said that all the matters included by paragraph (a) of the definition of "financial assistance" (and excluded by paragraph (b) of the definition) fall within the primary meaning of "financial assistance" and that this indicates an intention to determine the ambit of the term with certainty and that the listed matters are exhaustive of the term. The SCA therefore overturned the judgment of the court of first instance holding that "the matters mentioned in s 45(1)(a) are exhaustive of the meaning of 'financial assistance'".

In summary therefore, "financial assistance" under section 45 of the Companies Act can only apply to direct or indirect "financial assistance" which is:

- lending money to a related person;
- guaranteeing a loan or other obligation of a related person; and
- securing any debt or obligation of a related person.

The exhaustive list of instances of financial assistance in section 45(1)(a) must be read with section 45(2), which provides that the prohibition against "financial assistance" to related persons applies to direct and indirect "financial assistance".

In the *Constantia* case, the SCA found that the indemnity by Protech Investments indirectly secured the obligations of Protech Khuthele and was therefore financial assistance within the meaning of paragraph (a) of the definition of "financial assistance". Put another way, the SCA found that the indemnity by Protech Investment in favour of Constantia secured the obligations owed by the Protech Khuthele to third parties and therefore constituted "financial assistance" indirectly for those obligations – the direct obligations under the indemnity being owed to Constantia.

## **Substantive nature of compliance with section 45 for the provision of financial assistance**

The *Constantia* case further confirmed the interpretation generally applied by the legal market that non-compliance with section 45 of the Companies Act voids the "financial assistance" in question. In the *Constantia* case, none of the group companies passed a section 45 resolution.

*Constantia* argued that the solvency and liquidity requirement was met as the audit and risk committee considered the liquidity of the Protech group members on a regular basis. The SCA countered that the **board** of a company must satisfy itself of the two matters set out in section 45(3)(b) of the Companies Act. The SCA said "[t]he board could only be satisfied of these matters if it applied its mind to them". As the board did not do so, the indemnity was held to be void for failure to satisfy the requirements of section 45(3). The SCA also pointed out that the board **must** adopt a resolution in order to authorise the providing of financial assistance to a related person and that the board could not do unless it was satisfied as to these matters.

*Constantia* also raised section 20(7) of the Companies Act in its defence. This section provides that a person dealing with a company in good faith is entitled to presume that the company has complied with all of the formal and procedural requirements in terms of the Companies Act unless in the circumstances the person knew or reasonably ought to have known of any failure by the company to comply with such requirements.

The SCA, however, held that the presumption by a third party that the company complied with all formal and procedural requirements is not a true presumption. The SCA said that where section 20(7) applies, it means that the company may not rely on its own non-compliance with these requirements. Further, the SCA said, since the requirements that the board of a company must pass a resolution to authorise financial assistance and that it must be satisfied of the matters mentioned in section 45(3)(b), are substantive requirements (and not merely formal or procedural requirements), section 20(7) cannot be used in defence of

non-compliance with the substantive requirements of section 45 since these are requirements for the validity of the resolution or agreement in question.

## **Notices under section 45(5)**

Section 45(5) of the Companies Act requires a company to provide a written notice of a resolution approving financial assistance (after the resolution is passed) to the company's shareholders and to trade unions representing its employees.

The legal market has generally accepted that non-compliance with section 45(5) does not void a financial assistance approval, however the position remained uncertain up to now. In the *Constantia* case, the SCA confirmed the generally accepted view that the failure to give the notices required by section 45(5) does not result in voidness of the financial assistance approval under section 45(6) of the Companies Act.

Although section 45(6) of the Companies Act determines that a resolution to approve financial assistance is void to the extent that the financial assistance does not comply with section 45 of the Companies Act, the SCA held that this section must be read as referring only to those provisions of section 45 that set substantive requirements for providing financial assistance. The notice requirement is not a substantive requirement.

## **Constitutionality of section 45(6) of the Companies Act**

Lastly, the SCA considered whether section 45(6) which declares void transactions entered into without compliance with the substantive requirements of section 45 permits arbitrary deprivation of property and therefore contravenes section 25(1) of the Constitution of the Republic of South Africa, 1996 ("**Constitution**"). Section 25(1) of the Constitution determines that no law may permit arbitrary deprivation of property.

As a non-binding comment, the SCA remarked that section 45(6) of the Companies Act may amount to a deprivation of property. An evaluation of the relationship between the deprivation and the purpose of section 45(6) is required. In addition, there must be an evaluation of the purpose of the deprivation, the person affected by the deprivation and the nature of the property under consideration. However, the appellant in the *Constantia* case did not make a sufficient case for the SCA to consider the constitutionality of section 45(6) on the facts before the court.

## **Conclusion**

The decision of the SCA in the *Constantia* case is significant in that it has substantially and, some might say, radically reduced the universe of transactions to which section 45 might otherwise apply and which practitioners have considered to fall within the ambit of section 45. The approach until the SCA's decision in the *Constantia* case would have been to conservatively treat every transaction with a related person with a financial element (e.g. a sale to a related person at a discounted price or a donation) as "financial assistance" for the purposes of section 45. The judgment removes a sizable burden from boards of directors having to consider whether transactions falling outside of those expressly mentioned in the definition of "financial assistance" would constitute "financial assistance". Boards should

more easily be able to determine whether the transaction in question involves lending money, guaranteeing a loan or other obligation or securing a debt or obligation. However, it must be noted that "securing" does not only mean so-called "hard" security (such as a mortgage bond, cession in security or share pledge), but any agreement or transaction which secures a debt or obligation (e.g. in the Constantia case, the indemnity was seen as a method of providing security). It is also important to take into account that if a transaction is designedly disguised so as to escape the provisions of section 45 but actually falls within those provisions, it is in fraudem legis and will be considered to be within the provisions of section 45.

In conclusion, the judgment in the Constantia case is noteworthy for the boards of directors of all South African companies. It provides clarity as to the definition of "financial assistance" under section 45 of the Companies Act. It also provides warning as to the risks of non-compliance with the substantive requirements of the section 45 and that care must be taken to ensure that all such requirements are met strictly when entering into a transaction to which section 45 applies.

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