STEINHOFF CASE BY BAKER MCKENZIE

In brief

A recent case in South Africa highlights several important legal considerations that must be borne in mind by the board of directors of a company when approving financial assistance in terms of Section 45 of the Companies Act, 2008.

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Key takeaways

The recent Steinhoff case (detailed below) sheds important light on Section 45 of the Act, which must be considered by the board when contemplating the approval of financial assistance in terms of Section 45 thereof.

The key takeaways from the Steinhoff case, which are relevant in respect of Section 45 financial assistance, can be summarized as follows:

- A foreign company falls within the meaning of a "corporation" as set out in Section 45(2) of the Act.
- The solvency and liquidity test, set out in Section four of the Act, must be applied with reference to the documentation and information available to the board at the time that such financial assistance was approved, and not with the benefit of hindsight.
- The restatement of a debt on different terms and conditions, and involving at least one different party, is the creation of a fresh debt and will need to be specifically approved by the board in terms of Section 45 of the Act, even where the previous financial assistance was approved by the board.
- Failure to comply with the provisions of Section 45 of the Act will render the financial assistance void and may result in personal liability for the individual members of the board who authorized such financial assistance, in certain circumstances.

In depth

Financial assistance in terms of the Section 45 of the Companies Act

The Companies Act, 2008 regulates the provision of financial assistance by a company, either in respect of the subscription of securities as set out in Section 44, or in respect of the provision of direct or indirect financial assistance to, amongst others, a related or inter-related company or **corporation** as set out in Section 45.

Failure to comply with the provisions of Sections 44 or 45 renders such financial assistance void. Further, if the resolutions granting the financial assistance or the agreements, which are the subject of such financial assistance, are void, the directors of the company may be held personally liable in terms of the Act. This will be the case if a director was (i) present at the meeting when the board approved the resolution or agreement; and (ii) failed to vote against the resolution or agreement, despite knowing that the provision of financial assistance was inconsistent with the Act. As such, each member of the board must, when authorizing the granting of financial assistance, ensure full compliance with the Act so as to avoid any potential personal liability in terms thereof.

The recent High Court decision in *Trevo Capital Ltd and Others v Steinhoff International Holdings (Pty) Ltd and Others* (2833/2021) [2021] ZAWCHC 123 (2 July 2021) considers Section 45 of the Act and adopts a broad purposive approach to the wording contained therein. The Steinhoff case is of particular relevance to South African companies seeking to authorize the provision of financial assistance to, or for, the benefit of related or inter-related foreign corporations. Further, the Steinhoff case examines the circumstances in which financial assistance, previously approved by the board in terms of the Act, is considered "new" financial assistance requiring fresh board approval.

Background of the Steinhoff case

The Steinhoff case arose as a result of the "large scale and longstanding irregularities in the financial statements of the [Steinhoff] Group…" which resulted in a debt restructuring process within the group. Part of the debt restructuring process included "company voluntary arrangements" in terms of the UK Insolvency Act of 1986 (CVAs) being concluded in respect of certain Steinhoff companies. The CVAs included a "contingent payment undertaking" by Steinhoff International Holdings (Pty) Ltd (or SIHPL), a South African company, which resulted in a guarantee given by SIHPL in 2014 in respect of a bond issued by Steinhoff Finance Holding GMBH being replaced.

The applicants in the matter argued that both the 2014 guarantee, as well as the replacement thereof by way of the contingent payment undertaking, constituted the provision of financial assistance by SIHPL to a related or inter-related company, as contemplated in Section 45(2) of the Act. It was further alleged that the financial assistance granted by SIHPL under the 2014 guarantee, the resolution of the board of SIHPL authorizing the entering into of the 2014 guarantee, as well as the 2014 guarantee itself, were all void due to non-compliance at the time with the solvency, liquidity and fairness tests of Section 45(3) of the Act. The

applicants also argued that the resolution authorizing SIHPL's contingent payment undertaking, as well as the undertaking itself, were also void due to non-compliance with Section 45(3) of the Act.

According to the applicants, the effect of the CVA was that the debt which originally arose under the bonds that was guaranteed under the 2014 guarantee, was restated with revised terms and a new maturity date. Further, it was argued that because the terms of SIHPL's existing payment obligations under the 2014 guarantee were amended and deferred in terms of the contingent payment undertaking, the contingent payment undertaking constituted the provision of financial assistance to a related or inter-related company or corporation in terms of Sections 45(1) and (2) of the Act, requiring specific approvals.

Providing financial assistance to related or inter-related foreign corporations

The beneficiary of the financial assistance given by SIHPL was a "foreign company", related or inter-related to SIHPL. Although "foreign company" is defined in the Act, section 45(2) does not refer to a "foreign company." It does, however, refer to a "corporation", a term that is not defined in the Act. Accordingly, the Court had to determine whether Section 45(2), and specifically the reference to "corporation," includes within its ambit, foreign companies, as defined in the Act.

In making such a determination, the Court considered the general purpose of the Act, noting that its provisions, including Section 45(2), must be interpreted and applied in a manner that gives effect to the purposes of the Act. The Court held that the purpose of the Act generally, as well as the financial assistance provisions specifically, are "served by broadening rather than narrowing the class of related [and inter-related] parties to which Section 45 applies…" To provide otherwise, the Court held, could allow a board to circumvent the provisions of Section 45 by making use of a foreign company "in a circuitous manner", which is not in line with the general purpose of the Act. Accordingly, the Court found that the reference to "corporation" in Section 45(2) must be read broadly enough to include the meaning of "foreign companies", as defined in the Act.

Responsibility of the board when applying the solvency and liquidity test in terms of the Companies Act

In terms of Section 45(3)(b), the board must be satisfied that, immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test as set out in Section four of the Act. The solvency and liquidity test requires that (i) the assets of the company, fairly valued, are equal to or exceed the liabilities of the company; and (ii) it appears that the company will be able to pay its debts in the ordinary course of business, as and when they fall due for a period of 12 months after the date on which the test is applied.

One of the applicants argued that, notwithstanding the resolution of the board in January 2014 approving the 2014 guarantee and the financial assistance constituted by that guarantee, the board nevertheless failed to comply with the provisions of Section 45 in that it is now known that, at the time that the resolution was passed, the company was "factually and materially insolvent" as a result of its liabilities exceeding its assets on a consolidated basis.

In other words, it was argued that the board, at the time, must have known that SIHPL did not satisfy the solvency and liquidity test, even though the financial information that was before the board when it made the decision did not show that to be the case. Further, it was argued, the financial information considered by the board when authorizing the issue of the 2014 guarantee could not have satisfied the requirements of the Act because the company's financial statements from 2009 to 2013 "were materially misleading as a consequence of fictitious transactions and accounting irregularities…" In applying the solvency and liquidity test in 2014, the board relied on, amongst other things, financial statements then available, and approved at the time by the company's auditors, which indicated that the company could indeed give the financial assistance in question without any risk to its solvency or liquidity, as well as a fairness and reasonableness opinion in respect of the granting of the financial assistance provided by another advisory firm and confirmatory legal opinions given by two law firms.

The applicant based its argument on a financial analysis of the company conducted in February 2021 (several years after the original financial assistance was approved), which identified certain irregularities and anomalies in the company's financial statements and financial affairs that existed at the relevant time the board approved the 2014 guarantee. Accordingly, so it was argued, the board, "acting reasonably" could not have satisfied itself that it would meet the solvency and liquidity test immediately after providing the 2014 guarantee, as required in terms of the Act.

The Court held that the solvency and liquidity test cannot be applied using an ex post facto analysis of the company's financial position "made with the benefit of hindsight" following the revelations of the accounting irregularities. Rather, compliance with the provisions of Section 45 as well as Section four has to be undertaken with reference to the documentation and information available to the board at the time that the financial assistance was approved. This is in line with the express wording of Section four of the Act, which provides that a company will satisfy the solvency and liquidity test "at a particular time" considering the financial circumstances of the company "**at that time**". It was also noted that even if two members of the 18 member board were aware of the financial irregularities at the time the financial assistance was approved, that cannot be sufficient proof of the entire board actually having been aware of such irregularities, thereby rendering such financial assistance void.

When will previously approved financial assistance be considered to be "new" financial assistance requiring new approval?

Pursuant to the debt restructuring undertaken by certain members of the Steinhoff group, the 2014 guarantee was replaced by the contingent payment undertaking, which effectively became a guarantee for the debt of another party, pursuant to different arrangements than those contemplated by the 2014 guarantee and bonds guaranteed thereby. SIHPL argued that the primary debt under the contingent payment undertaking was no more than a restatement of its debt under the 2014 guarantee, which had previously been approved by its board, and that no new approval was thus required for it to give financial assistance under the contingent payment undertaking. The Court did not uphold this argument, but rather found that the effect of the contingent payment undertaking, and related arrangements contemplated thereunder, replaced one debt with another (which debts had different terms) and introduced a new party into the arrangement, which party did not exist at the time the 2014 guarantee was approved.

To use the Court's words: the "restatement of a debt on different terms and conditions and involving at least one different party, is in terms of law the creation of a fresh debt". Notwithstanding the fact thus that the CVA and related contingent payment undertaking would not have existed but for the old debt previously approved by the board, the CVA and related contingent payment undertaking created a new obligation or debt for the company, even though the objective of the new debt was to replace the old (previously approved) debt.

It is clear therefore that financial assistance must be given to a "**specific party** or a **certain category of parties**, in **specific circumstances**, for specified purposes and which **authorization does not extend beyond a two-year period**". Accordingly, the Court found that in concluding the contingent payment undertaking, the company provided financial assistance to a new entity in breach of the provisions of Section 45 of the Act. Consequently, the SIHPL board resolution authorizing the financial assistance (being the contingent payment undertaking), as well as the contingent payment undertaking itself, were both found to be void for non-compliance with Section 45(3) of the Act, in terms of Section 45(6) thereof.

Based on the above, where there is a restatement of a debt which had previously been authorized in terms of Section 45, on different terms and conditions and involving at least one different party, such will be considered "new" financial assistances to which the board of the company must pass a new financial assistance resolution approving that specific financial assistance.

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