

Corporate law alert: Section 45 financial assistance - Unpacking the *Constantia Case*

Introduction

Section 45 of the Companies Act of 2008 (the “**Companies Act**”) is notoriously regarded as a problematic provision in the context of business transactions, given its effect of voiding business transactions which constitute the provision of financial assistance and which do not comply with the requirements of section 45. The ambiguity around the meaning of the term “financial assistance” has only served to underscore the infamy of the provision and created uncertainty in the application of section 45 to business transactions. Our courts have long recognised that the term “financial assistance” has not been comprehensively defined, which invariably gives rise to difficulty in determining whether the business transactions of a company constitute the giving of financial assistance. However, the recent Supreme Court of Appeal decision in *Constantia Insurance Company Limited v The Master of the High Court, Johannesburg and Others (512/2021) [2022 ZASCA 179]* (the “**Constantia Case**”) has reduced the uncertainty synonymous with section 45 by providing a more focused and clearer interpretation of the term “financial assistance” in section 45(1) of the Companies Act.

In this article, we consider how South African courts have defined financial assistance and unpack the meaning of section 45 financial assistance as determined in the *Constantia Case* whilst highlighting some of the practical implications of the decision.

Section 45 of the Companies Act

Section 45 imposes certain requirements on companies who provide direct or indirect financial assistance to directors, prescribed officers and certain related or inter-related parties to prevent the company from assuming onerous financial obligations in favour of these recipients without proper consideration and oversight. It is trite that section 45 seeks to prevent the misapplication or abuse of company resources by the company’s directors at the expense of the company and indirectly the company’s creditors and shareholders. Whilst the rationale underpinning the purpose of section 45 of the Companies Act is clear, the section offers limited guidance in defining the meaning of the term “financial assistance.” Section 45(1)(a) does not clearly define the term “financial assistance.” Rather, the provision broadly refers to financial assistance as, amongst other things, (i) lending money; (ii) guaranteeing a loan or other obligations; or (iii) securing a debt or obligation.

Section 45(1)(b) narrows the scope of section 45(1)(a) and the meaning of the term “financial assistance” by excluding the following transactions from the ambit of section 45: (i) lending money in the ordinary course of business by a company whose primary business is the lending of money; (ii) an accountable advance to meet legal expenses in relation to a matter concerning the company or anticipated expenses to be incurred by the person on behalf of the company; and (iii) an amount to defray the person’s expenses for removal at the company’s request.

Despite the exclusions contained in section 45(1)(b), section 45(1) of the Companies Act does not comprehensively define the business transactions which constitute financial assistance.

Financial assistance – what the courts have said

Due to ambiguity around the meaning of the term “financial assistance,” South African courts have previously developed tests such as the “impoverishment test” and the “direct object test” to determine whether business transactions constitute financial assistance. Our courts have also been cautious not to stigmatise ordinary business transactions dictated by prudent business considerations as “financial assistance.”

In *Trevo Capital Ltd and Others v Steinhoff International Holdings (Pty) Ltd and Others (2833/2021) [2021] ZAWCHC 123* the court commented that “*section 45 of the 2008 Act governs the provision of “financial assistance” and that the use of the word “includes” in section 45(1)(a) indicates that the types of transactions referred to are not an exhaustive list of what constitutes financial assistance.*”

This position was echoed in *Van Den Heever NO v Van Tonder [2021] JOL 51490 (GJ)*, wherein the court determined that section 45 financial assistance “*includes lending money, guaranteeing a loan or other obligation, and securing any debt or obligation. The use of the word ‘includes’ in section 45(1)(a) is wide-ranging and indicates that the types of transactions referred to are not an exhaustive list of what constitutes financial assistance. If the list was intended to be exhaustive, the legislature would have said so. Financial assistance therefore includes, but is not limited to, the lending of money, guaranteeing a loan or other obligation, and securing any debt or obligation*” (emphasis added). Some examples of transactions which have been categorised by South African courts as constituting financial assistance are:

- payment of a debt owed by a related company;
- the purchase of an asset from a related company at an inflated price;
- the provision of security for the debts of a related company;
- the provision of a guarantee to a related company in relation to the obligations of a convertible bond issued by that related company;
- a cross-guarantee in terms of which a company is bound as surety and co-principal debtor for the obligations of a related party; and
- more generally, where the direct purpose of the transaction is to assist another financially, in a manner to which the recipient was not previously entitled.

While the majority of these categories related to the 1973 Companies Act in respect of financial assistance relating to the acquisition of shares, these examples nevertheless provide useful context in respect of business transactions which may potentially constitute section 45 financial assistance.

The Constantia Case

In a landmark decision, the Supreme Court of Appeal in the *Constantia Case* departed from the long standing body of case law developed in relation to the meaning of “financial assistance” by defining the term “financial assistance” as comprising the matters mentioned in section 45(1)(a). The appeal court interrogated the proper meaning of section 45(1) and found that all the matters included by section 45(1)(a) (and excluded by section 45(1)(b)), fall within the primary meaning of “financial assistance.”

The decision turned on the word “includes” in section 45(1)(a) of the Companies Act. The court held that the word “includes” does not introduce a meaning or meanings that go beyond the primary meaning of the term “financial assistance” which indicates that the ambit of the term should be determined with certainty and that the matters listed in section 45(1)(a) are exhaustive of the term “financial assistance”. The court further held that the excluded matters in terms of section 45(1)(b) also fall within the primary meaning of the term “financial assistance,” which informed the legislature’s intention to provide a precise definition of the term and limit the meaning of section 45 financial assistance to the matters listed in section 45(1)(a).

Following the *Constantia Case* decision, the term “financial assistance” in section 45(1), is limited to the following three types of business transactions:

- lending money;
- guaranteeing a loan or other obligation; and
- securing any debt or obligation.



Key Considerations

Section 45 financial assistance: a closed list of business transactions

The interpretation of section 45 financial assistance in terms of the decision in the *Constantia Case* has the effect of limiting the types of business transactions to which section 45 applies to a finite, closed list. A business transaction not listed in section 45(1)(a) (i.e. a transaction which is not money lending, guaranteeing a loan or other obligation, or securing any debt or obligation), or which is excluded from the meaning of "financial assistance" in terms of section 45(1)(b), will not be subjected to the substantive and procedural requirements of section 45 of the Companies Act, nor will the business transaction be rendered void in terms of section 45(6) of the Companies Act for failing to comply with the section 45 requirements.

Although the *Constantia Case* seems to have provided clarity on the legal interpretation of the term "financial assistance" as applied in section 45, there is still a need to consider what the meaning and ambit is of each of the words in section 45(1)(a). In this regard, consideration must be given to whether the following business transaction will be regulated by section 45(1):

- subordination of a shareholder loan to a subsidiary;
- deferment of a payment date of a shareholder loan;
- payment of a debt owed by a subsidiary; and
- the conclusion of related party agreements on terms which are not objectively at arm's length, such as the purchase of an asset or business from a subsidiary at an inflated price or at a price which is below market value.

The company's memorandum of incorporation

Whilst section 45 financial assistance is limited to the matters referred to in section 45(1)(a), business transactions not regulated by section 45 but which still have the effect of providing financial assistance may be subject to additional restrictions in the company's memorandum of incorporation ("MOI"). A company must consider whether there are any provisions in its MOI which impact or restrict its ability to enter into business transactions which have the effect of providing financial assistance, but are not regulated by section 45 of the Companies Act.

Financial assistance for the issue or purchase of shares

Section 45 is not the only section dealing with financial assistance in the Companies Act. There is also section 44 which regulates financial assistance in respect of the issue and purchase of shares. The exhaustive meaning of the term "financial assistance" in terms of the *Constantia Case* decision is predicated on the wording of section 45(1) and in particular the word "includes" in section 45(1)(a), which does not appear in section 44(2) of the Companies Act which defines financial assistance advanced by a company for the issue or purchase of shares in the company or a related or inter-related company.

The meaning of section 44 financial assistance will therefore follow the broader definition of "financial assistance" informed by the rich body of case law on the matter.

It appears that an unintended consequence of the *Constantia Case* decision is the creation of two different meanings attributed to "financial assistance" in terms of sections 44 and 45 respectively.

Conclusion

Section 45 deals with financial assistance granted to a variety of persons including directors and related or inter-related companies. The *Constantia Case* is a clear watershed moment in relation to the meaning of financial assistance in South African company law. In terms thereof, section 45 financial assistance has been exhaustively defined as:

- lending money;
- guaranteeing a loan or other obligation; and
- securing any debt or obligation.

We welcome the appeal court's guidance in providing an absolute and exhaustive interpretation of the definition of section 45 financial assistance which, until the decision in the *Constantia Case*, has been notoriously ambiguous. Having said this, consideration should still be given as to what the meaning of the transactions listed in section 45(1)(a) is. In other words, we still need to properly interpret each of the words in section 45(1)(a). A starting point will be to consider how broadly these three categories may potentially apply.

A second, and salient consideration is the question of voidness. The failure to comply with section 45 will render any financial assistance granted as void. The benefit of a narrower interpretation is that a number of business transactions will no longer be at risk of being voided.

However, such business transactions may nevertheless be subject to requirements and/or restrictions contained in the MOI of the company which is a party to such transaction. Consideration must therefore be given to whether these business transactions are regulated in terms of section 44, section 45 and/or the restrictions (if any) contained in the MOI of the company, and companies are cautioned to avoid treating the matters listed in section 45(1)(a) as a checklist to determine whether these business transactions amount to financial assistance for all purposes.

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