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Financial Assistance - the Case for Re-Examining Section 76 of the Companies Act

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FINANCIAL ASSISTANCE: THE CASE FOR RE-EXAMINING SECTION 76 OF THE COMPANIES ACT

Public Prosecutor v Lew Syn Pau
[2006] 4 SLR 210

Wu Yang Construction Group v Zhejiang Jinyi Group Co, Ltd
[2006] 4 SLR 451

Section 76 of the Companies Act prohibits the giving by a company of financial assistance for the purpose of or in connection with the acquisition of its own shares. This penal provision is highly controversial in view of its breadth and uncertainty in its application. In the recent criminal prosecution of *PP v Lew Syn Pau* and in the recent civil litigation of *Wu Yang Construction Group v Zhejiang Jinyi Group Co, Ltd*, the Singapore High Court had to determine the scope of the prohibition under s 76 of the Companies Act. This case comment examines the two Singapore decisions and suggests that there appears to be a divergence in the views on the underlying rationale behind the prohibition. The article also seeks to evaluate the possible impact of these decisions on certain issues that often arise in mergers and acquisitions transactions in Singapore.

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I. Introduction

1 Section 76 of the Companies Act,[1] which contains the prohibition on a Singapore company giving financial assistance for the purpose of or in connection with the acquisition of its own shares, is one of the most controversial provisions in the Companies Act. The scope of the prohibition is often uncertain and this is compounded by the fact that

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1 Cap 50, 2006 Rev Ed.

financial assistance issues often potentially arise in any corporate transaction involving an acquisition of shares of a Singapore company (including a reorganisation, refinancing, restructuring or structured finance transaction). The cases interpreting s 76 in Singapore and its statutory equivalent in overseas jurisdictions are often highly fact-specific and it is difficult to obtain guidance as to whether a particular assistance under consideration falls within the prohibition. Compliance with s 76 is taken very seriously as the contravention of s 76 would render the officers of the relevant company guilty of an offence,[2] and in addition each transaction or contract that contravenes s 76 may be void or voidable under s 76A.[3]

2 Reform proposals on s 76 had been considered by the Company Legislation and Regulatory Framework Committee ("CLRFC")[4] as recently as 2002. Despite acknowledging the criticism that the prohibition in s 76 is "fraught with uncertainty and amenable to reform",[5] the CLRFC declined to overhaul s 76 but instead recommended, *inter alia*, the amendment of the scope of the existing exceptions and the introduction of new exceptions, to s 76.[6] These recommendations were implemented via the Companies (Amendment) Act 2005. The introduction of new

2 A breach of s 76 carries with it serious consequences as the officers of the company that has provided unlawful financial assistance can be criminally liable on conviction to a fine not exceeding $20,000 and/or to imprisonment for a term not exceeding three years under s 76(5). Officers of the company may also be civilly liable for breach of s 76.

3 A transaction or contract is void if it is one that falls within s 76A(1), that is, a contract or transaction by which a company acquires or purports to acquire its own shares or units of its own shares, or shares or units of shares in its holding company and a contract or transaction by which a company lends money on the security of its own shares or units of its own shares, or on the security of shares or units of shares in its holding company. In all other instances, a contract or transaction made or entered into in contravention of s 76, or a contract or transaction related to such contract or transaction, is voidable at the option of the company, under s 76A(2).

4 The Company Legislation and Regulatory Framework Committee ("CLRFC") was appointed by the Ministry of Finance, the Attorney-General's Chambers, and the Monetary Authority of Singapore ("MAS") in December 1999. The terms of reference were "to undertake a comprehensive and coherent review of our company law and regulatory framework and recommend a modern company law and regulatory framework for Singapore which accords with global standards and which will promote a competitive economy". The members of the CLRFC comprised mainly persons who are in the private sector and with wide ranging experience and expertise.

5 See Company Legislation and Regulatory Framework Committee, *Report of the Company Legislation and Regulatory Framework Committee* (October 2002) ("*CLRFC Report*"), ch 2, para 3.4.1.

6 *CLRFC Report*, *ibid* at ch 2, para 3.4. The recommendations in relation to the financial assistance rules were introduced via the Companies (Amendment) Act 2005.

exceptions only mitigates but does not eliminate the thorny issue of determining whether there has been financial assistance rendered which is prohibited under s 76 in the first place. This is particularly important in situations where it may be impractical to rely on the exceptions in view of the lead time that is required[7] or the administrative burden that is involved.[8]

3 The scope of the prohibition on the provision of financial assistance is considered in the two recent decisions of the High Court in *PP v Lew Syn Pau*[9] ("*Lew Syn Pau*") and *Wu Yang Construction Group v Zhejiang Jinyi Group Co, Ltd*[10] ("*Wu Yang Construction*"). In *Lew Syn Pau*, Menon JC in the High Court considered the question of whether a Singapore parent company has provided indirect financial assistance, in contravention of s 76, where its foreign subsidiary has provided direct financial assistance for the acquisition of the shares of its parent company. The decision clarified a fundamental issue of when assistance rendered would be regarded as "financial" within the prohibition set out in s 76. In *Wu Yang Construction*, Andrew Phang Boon Leong J in the High Court addressed the issue of whether the assistance was for one of the proscribed purposes in s 76 and the relationship between ss 76(3) and 76(4) was subject to careful examination.

4 These two decisions are important in illustrating the judicial attitudes towards the scope of the prohibition on financial assistance. While both decisions emphasise the importance of taking a commercial view in determining whether a transaction falls within the prohibition, there appears to be a divergence of views on what should be the rationale underlying s 76. *Lew Syn Pau* affirms the traditional view that the prohibition on financial assistance is a rule relating to the capital maintenance of a company but in *Wu Yang Construction*, there appears to be a shift towards viewing the prohibition as rules supplementing directors' fiduciary duties. This note discusses the two decisions and seeks to evaluate their possible impact on certain issues that often arise in mergers and acquisitions transactions, particularly the provision of

7 *Eg*, a "whitewash" resolution under s 76(10) requires the approval of the shareholders by way of a special resolution and there is a minimum 21–day waiting period commencing from the date of the publication of the notice (setting out the terms of the resolution) during which, *inter alia*, shareholders and creditors may apply to the court opposing the giving of the financial assistance.

8 *Eg*, the exception under s 76(9A) requires a notice to be sent to all the shareholders of the company within 10 business days of providing the financial assistance.

9 [2006] 4 SLR 210.

10 [2006] 4 SLR 451.

representations, warranties and indemnities by target companies and the payment of dividend at the conclusion of take-over transactions.

II. The judgments in *Lew Syn Pau* and *Wu Yang Construction*

A. Lew Syn Pau – *the facts in summary and decision*

5 The facts in *Lew Syn Pau* were largely not disputed. The first accused, L, was a friend and business associate of the second accused, W. W was a director and the single largest shareholder of Broadway Industrial Group Ltd ("BIGL"), a Singapore company listed on Singapore Exchange. BIGL is the direct parent company of Compart Holdings (S) Pte Ltd ("Compart Holdings"), which is in turn a direct parent company of Compart Asia Pte Ltd ("Compart Singapore"). Both Compart Holdings and Compart Singapore are Singapore companies. Compart Singapore held all the shares of Compart Asia Pacific Limited ("Compart Mauritius"), a Mauritius company. W and L each held directorships of Compart Holdings, Compart Singapore and Compart Mauritius. L was not a director of BIGL.

6 BIGL had entered into a share placement agreement with Silver Touch Holding Pte Ltd ("Silver Touch") pursuant to which Silver Touch would subscribe for 33 million new ordinary shares of BIGL in two tranches. Upon the completion of the share placement, Silver Touch and W would hold 22% and 14.63% of BIGL respectively and Silver Touch would replace W as the single largest shareholder of BIGL. Prior to the scheduled date of completion of the placement, it appeared that Silver Touch was unable to complete the placement due to lack of funds. W was concerned because if the placement did not take place, there were adverse financial consequences to BIGL. In order to put Silver Touch in funds, it was agreed that Compart Mauritius (which had the funds) would give a temporary loan to L who would in turn loan the amount (and at an interest rate of 1% per month) to T, who controlled Silver Touch. Silver Touch would then complete the placement in respect of the first tranche. Under Mauritius law, there was no prohibition against a Mauritius company (such as Compart Mauritius) extending a loan to its director so long as the board of directors authorised such a loan. It was not disputed that W and L knew that the moneys belonging to Compart Mauritius were used to enable Silver Touch to acquire the shares in BIGL.

7 W and L were each charged under s 76(1)(*a*)(i)(A) of the Companies Act; W was charged with knowingly and wilfully authorising BIGL to indirectly give financial assistance to T by authorising a loan

from Compart Mauritius to L for the latter to use the money as a loan to T, for the purpose of enabling Silver Touch to acquire the shares of BIGL. L was charged with abetting, by intentionally aiding, W to knowingly and wilfully authorising BIGL to indirectly give financial assistance to T. The crucial issue in the case was whether any financial assistance was provided to T by BIGL and whether such assistance was prohibited under s 76. The Prosecution had conceded that the funds advanced to L belonged to Compart Mauritius (and did not originate from BIGL). Instead, the Prosecution had argued that the funds used to provide financial assistance to T were funds belonging to the "BIGL group".

8 At the end of the Prosecution's case, counsel for W and L submitted that there was no case to answer on the basis that with the facts presented by the Prosecution, W and L had not committed the offences as charged. The court held that the Prosecution failed to make out the case that there was financial assistance given by BIGL in contravention of s 76(1)(a)(i)(A) and W and L were acquitted. The Prosecution has not appealed against the decision.[11]

(1) Financial assistance

9 Menon JC in *Lew Syn Pau* held that the scheme of the Companies Act was that assistance by a company in order to facilitate the acquisition of its shares was not prohibited generally; what was prohibited was the giving of assistance that was "financial" in nature. For assistance to be "financial" in nature, there must have been diminution or depletion of the company's assets; actual depletion was not required so long as "the assets have been placed at risk and there is a potential for future depletion to take place by virtue of an undertaking or obligation entered into by the company at the time of and in connection with the acquisition of its shares."[12] The test is viewed from the company's perspective and not from the perspective of the intending purchaser.

10 The court reached the conclusion based on the following: (a) the Australian cases, starting from *Burton v Palmer*,[13] have held that a company had provided financial assistance for an acquisition only if its assets were either being used or were at risk of being depleted in connection with that acquisition and this was being done otherwise than in the ordinary course of business, (b) the legislative purpose of s 76 was

11 "No appeal against acquittal of Lew Syn Pau", *Business Times* (31 August 2006).
12 *Supra*, n 9 at [99].
13 [1980] 2 NSWLR 878.

to preserve the company's capital and to prevent the use of its assets in connection with an intended acquisition of its shares, and (c) the test relating to the depletion of assets was applied in the Malaysian High Court decision in *Simmah Timber Industries Sdn Bhd v David Low See Keat*[14] and the South African Supreme Court decision in *Lipschitz No v UDC Bank*.[15]

11 Based on the test relating to the depletion of assets set out above, the court held that BIGL did not provide any financial assistance in respect of the acquisition of shares, whether directly or indirectly. At no time was BIGL's assets being used or put at risk of actual depletion. What is significant is that the court drew a distinction between direct and indirect financial assistance. Direct assistance refers to putting the company's assets directly in the hands of the intended purchaser of the company's shares. Indirect financial assistance refers to the relevant company making its assets available to the intended purchaser of the company's shares by routing such assets through another vehicle, such as the foreign subsidiary of such company. As the Prosecution's case was that the funds for subscription of the shares of BIGL came from Compart Mauritius (and not BIGL) and BIGL's assets were not put at risk of depletion, there was no financial assistance by BIGL.

(2) Lifting of the corporate veil

12 The Prosecution's alternative submission was that the corporate veil between BIGL and Compart Mauritius should be lifted and the acts of Compart Mauritius should be treated as the acts of its holding company. On this argument, the acts of Compart Mauritius which provided financial assistance to Silver Touch in connection with the shares of BIGL were to be regarded as the acts of BIGL. The court rejected the Prosecution's argument and held that BIGL and Compart Mauritius were separate legal entities; the acts of one company would not generally be regarded as the acts of the other under the rule in *Salomon v Salomon*.[16] The doctrine of separate legal personality was not displaced merely because the companies were organised as a single economic unit or that BIGL controlled Compart Mauritius.

14 [1999] 5 MLJ 421 (M'sia).
15 [1979] 1 SA 789.
16 [1897] AC 22.

B. Wu Yang Construction – *the facts in summary and decision*

13 *Wu Yang Construction* arose from the sale and purchase agreement in respect of the shares of VGO Corporation Ltd ("VGO"). Unlike *Lew Syn Pau*, *Wu Yang Construction* was not a criminal prosecution but the issues of financial assistance were raised in a commercial dispute. Simplifying the facts somewhat, VGO and Kingsea Ltd ("Kingsea") entered into an agreement ("Agreement") pursuant to which VGO would purchase all the shares of Spring Wave Ltd (Spring Wave" together with certain loans advanced by Kingsea to Spring Wave (collectively, the "relevant assets") for an aggregate consideration of RMB 55m, based on the net asset value ("NAV") of Spring Wave and its subsidiaries ("Spring Wave group"). Subsequently the purchase consideration was adjusted to RMB 50.596m. The purchase consideration was to be satisfied by the issuance of new shares in VGO. Completion of the Agreement took place and the new VGO shares were issued in favour of, *inter alia*, Kingsea. Out of these new VGO shares issued in favour of Kingsea, a large proportion of such new VGO shares ("escrow shares") was retained by VGO with a power of sale reserved to the directors of VGO in the event of a breach by Kingsea of certain warranties. These escrow shares continued to be registered in the name of Kingsea. Kingsea defaulted on the warranties and VGO exercised its power of sale and the escrow shares were sold to M. In the meantime, the plaintiff entered into certain agreements with the second defendant (who was the owner and controller of Kingsea) pursuant to which the second defendant, *inter alia*, agreed to pledge the VGO shares (which included the escrow shares) that were registered in Kingsea's name to the plaintiff. At the hearing, the issue was one of priority of the transactions *vis-a-vis* the escrow shares and it was found that VGO and M were clearly entitled to succeed. Counsel for the plaintiff argued, however, *inter alia*, that there was financial assistance by VGO in aiding the purchase of its shares on the ground of the difference in amount between the actual and the agreed NAV of Spring Wave group and such difference resulted in new VGO shares being issued.[17]

17 It was not clear how the argument on financial assistance would have helped the plaintiff because even if the Agreement amounted to financial assistance, it would have been rendered voidable under s 76A and it would have been for the company (VGO) to determine whether the Agreement should be avoided. If the Agreement was not in fact avoided, it was not clear how it would affect the priority of security interests that VGO had.

14 The High Court had no hesitation in rejecting the plaintiff's argument that the Agreement contravened s 76 on the following grounds: (a) there was no *financial* assistance because the issuance of new shares as purchase consideration for the relevant assets did not deplete the capital of VGO; (b) VGO issued new shares in order to pay for the relevant assets, which was a very different proposition from assisting the acquiror to *purchase* its shares; (c) the Agreement was a genuine agreement entered into *bona fide* by VGO and the court would not inquire into the quantum of consideration of the Agreement; (d) the Agreement was entered into *bona fide* in the commercial interest of the company and "section 76 was never intended to 'capture' transactions which were entered into *bona fide* in the commercial interests of the company itself (as opposed to providing, in substance if not form, financial assistance for the purchase of the company's own shares)";[18] and (e) the phrase "in connection with" in s 76(1)(a) did not broaden the scope of the prohibition under s 76 and such phrase should be read restrictively so as to be consistent with the phrase "for the purpose of" in the same provision.

15 The court observed that the exception in s 76(8)(c), that is, the discharge by a company of its liability that was incurred in good faith as a result of a transaction entered into on ordinary commercial terms, could possibly apply on the facts. This may indicate that the scope of s 76(8)(c) is more liberal than what is previously assumed to be the position. Prior to *Wu Yang Construction*, cautious advisers would have argued that the exception did not apply where the liability in question arose from the same transaction which amounted to the giving of financial assistance.[19]

III. Financial assistance and corporate acquisitions

A. Elements of financial assistance

16 An analysis of whether a transaction entered into by the company contravenes s 76 necessarily involves a consideration of the following three issues: (a) whether there is an acquisition or proposed acquisition of shares of a company or units of shares in the holding company of the

18 *Supra*, n 10, at [35].

19 *Fitzsimmons v R* (1997) 23 ACSR 355 (SC, WA). An example where the exception could apply is the situation where the shares are acquired as a result of the compromise of a debt due by the company which was incurred in good faith. See *Dempster v National Companies and Securities Commission* (1993) 10 ACSR 297 (SC, WA) at 345.

company; (b) whether the company has, directly or indirectly, rendered any assistance that was "financial" in nature; and (c) whether the assistance is for one of the proscribed purposes set out in s 76, that is, whether it is "for the purpose of" or "in connection with" the acquisition by any person, whether before or at the same time as the giving of financial assistance, of shares or units of shares in the company.

B. Legislative purpose behind section 76

17 The statutory predecessor of s 76 was based on s 54 the UK Companies Act 1948. By way of background, in 1926, the *Report of the Company Law Amendment Committee* chaired by Lord Greene ("Greene Committee")[20] had considered the widespread practice that existed in 1920s where syndicates would agree to purchase a controlling stake in a company, the purchase money was provided by the bank, the syndicate's nominees were appointed to the board and proceeded to lend to the syndicate, out of the company's funds, the money required to pay off the loan from the bank.[21] Such a practice offended the rule on capital maintenance, as derived from *Trevor v Whitworth*,[22] which prohibited a limited company from returning capital to its shareholders other than in respect of the distribution of profits, reduction of capital or distribution of surplus assets on a winding up, as these former shareholders were cashed out at the expense of the creditors. The recommendations of the Greene Committee resulted in the enactment of s 45 of the Companies Act 1929, which was subsequently followed by s 54 of the Companies Act 1948.[23]

18 In Singapore, when the Companies Act[24] was enacted in 1967, the prohibition on financial assistance contained therein was based on s 54 of the UK Companies Act 1948. Since 1967, the provision has been amended several times.[25] The first significant amendment occurred in 1987 when

20 Report of the Company Law Amendment Committee, Cmd 2657 (1926), chaired by Lord Greene.

21 *Ibid* at para 30.

22 (1887) 12 App Cas 409.

23 The imperfections in the drafting of s 54 of the UK Companies Act 1948 were criticised in the *Report of the Company Law Committee* chaired by Lord Jenkins. See *Report of the Company Law Committee*, Cmnd 1749 (1962). For a historical discussion of the prohibition on financial assistance in the UK, see C Roberts, *Financial Assistance for the Acquisition of Shares* (Oxford University Press, 2005), c 2 at 7–17.

24 Act 42 of 1967.

25 Prior to 1987, the legislation amending the provision included the Companies (Amendment) Act 1974 and the Companies (Amendment) Act 1984.

s 76 was repealed and re-enacted by the Companies (Amendment) Act 1987. The amended s 76 (as it then was) was based on s 129 of the Australian Companies Act 1981. The changes included having a controlling prohibition on financial assistance that was more complex than that which existed previously and such prohibition was also supplemented by a more extensive list of exempted transactions and an exception which authorised the provision of financial assistance where the "white-washing" procedure was carried out. Sections 76(3) and 76(4) were inserted to define the circumstances in which the company was taken to have provided financial assistance "for the purpose of" and "in connection with" the acquisition. As mentioned above, s 76 was subsequently amended again via the Companies (Amendment) Act 2005.

19 In *Lew Syn Pau,* the court affirmed the traditional view that the objective of s 76 was one of capital maintenance and the protection of creditors.[26] However, it is submitted that the rule in s 76, as it currently stands, is wider than that required for capital maintenance or for creditor protection. First, the basic prohibition in s 76 applies to any assistance that depletes the assets of the company or places the assets at risk, regardless of whether the company has profits from which it can declare dividends. Dividends which are paid in circumstances other than in the ordinary course of commercial dealing may fall within the prohibition.[27] Second, s 76 prohibits loans which do not necessarily deplete the assets at all. Loans may also not place the assets at risk if the debtor is objectively credit-worthy and no provision against the likelihood of default has been made. Similarly, the granting of a security does not diminish the value of the company's assets and may not place the value of such assets at risk in circumstances where it is unlikely that the security will be enforced.

20 In *Wu Yang Construction*, the court held that a useful and practical approach was to inquire into the substance of the transaction pursuant to which the shares of the company changed hands. If the substance of the transaction was to enable the company to furnish, whether directly or indirectly, financial assistance for the purchase of its shares, then s 76 would have been clearly contravened.[28] In determining the substance of the transaction, the court drew a distinction between a transaction that was entered into *bona fide* in the commercial interests of

26 *Supra,* n 9 at [126].

27 The exception on payment of dividends under s 76(8)(*a*) does not apply if the special dividend is not paid in the ordinary course of commercial dealing: *Milburn v Pivot Ltd* (1997) 149 ALR 439 at 469.

28 *Supra,* n 10, at [53].

the company and a transaction that amounted to the provision of financial assistance. The court held that s 76 was "never intended to 'capture' transactions by a company which were entered into *bona fide* in the commercial interests of the company itself (as opposed to providing, in substance if not form, financial assistance for the purchase of the company's own shares)".[29] The mischief that was sought to be avoided in relation to s 76(1)(a) was held not to include transactions, the "sole or primary purpose of which is to give effect to the *bona fide* commercial interests of the company *other than* in the giving of financial assistance in order to assist in the purchase of the company's shares".[30]

21 This expression, "*bona fide* commercial interests of the company", is similar to the common law test in relation to the validity of the conduct of directors.[31] In drawing a distinction between a transaction which is entered into *bona fide* in the commercial interests of the company and a transaction whose sole or primary purpose amounts to financial assistance, it appears that the court has viewed the prohibition as a rule supplementing directors' fiduciary duties, particularly their duties to act *bona fide* and in the commercial interests of the company. In particular, the court emphasised that the commercial realities of the transaction should be given effect to and s 76 was not intended to impede genuine commercial transactions.[32] On this view, the use of the resources of a company to financially assist a purchaser solely or primarily to make the acquisition of shares will be an instance that is not a proper exercise of directors' duties. Hence, it appears that there is a shift away from the view that the prohibition is a rule on maintenance of capital. The test of whether a transaction is *bona fide* in the commercial interests of the company was also imposed in the earlier Court of Appeal decision in *Intraco v Multi-Pak Singapore*[33] ("*Intraco*"). In that case, it was held that the transactions in question were entered into *bona fide* in the commercial interest of the company and were not prohibited under s 76 (as it then was).[34]

29 *Supra,* n 10, at [35].
30 *Supra,* n 10, at [71].
31 *Eg*, *Re Smith v Fawcett Ltd* [1942] 1 Ch 304 at 308; *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363 at 379.
32 *Supra,* n 10, at [28], [35], [50] and [53]. The commercial realities of the transaction approach were discussed in *Chaston v SWP Group plc*, *infra*, n 35 and in *MT Realisations Ltd (in liquidation) v Digital Equipment Co Ltd* [2003] 2 BCLC 117.
33 [1995] 1 SLR 313.
34 *Id*, at 323.

22 However, it is respectfully submitted that the distinction drawn between a *bona fide* transaction in the commercial interests of the company and a transaction which is for the primary purpose of providing financial assistance is not always so clear-cut. In cases not involving sham transactions, it is not inconceivable that the directors may *bona fide* believe that the relevant transaction in question is in the commercial interest of the company but one of the purposes of such a transaction is to financially assist in the company's own shares. In such a case, how should one determine what is the primary or substantial purpose of the acquisition? An example illustrating the point can be found in the context of *Chaston v SWP Group plc*.[35] In that case, the issue was whether the payment of certain invoices to a firm of accountants by a subsidiary of a target company was regarded as unlawful financial assistance within s 151 of the UK Companies Act 1985 (which contains the prohibition on financial assistance); these invoices were incurred in relation to the preparation of information used by the acquiror for the purposes of its own due diligence in order to conclude its negotiations in the purchase of the target company. The trial judge, at first instance, found that the liability to the accountants was incurred *bona fide* in what the directors believed in good faith was in the best interest of such subsidiary; the advancement of negotiations and co-operation with the acquiror were regarded as being beneficial to the target company and its subsidiaries. The Court of Appeal, in allowing the appeal, held that such payment of fees by the subsidiary was financial in nature and was given for the purpose of facilitating the purchase of the target company. Arden LJ in *Chaston v SWP Group plc,* in response to the trial judge's finding that the directors acted *bona fide* in the best interests of the subsidiary, held that due performance of fiduciary duties is not of itself enough to avoid a breach of s 151 of the UK Companies Act 1985 and "if it were, financial assistance by way of a loan by a target to a bidder on commercial terms might be outside s 151. That result would drive a coach and horses through these provisions".[36] *Chaston v SWP* is an example of a case where the directors believed that the payment of the fees was for the benefit of the company but s 151 was held to have been contravened because one of the purposes of the payment of such fees was to facilitate the acquisition of shares. If the facts arise under the Companies Act, and the directors have a *bona fide* belief that they are acting in the interests of the company by authorising the payment of fees, it is not clear after *Wu Yang Construction* on which side of the line between acting in the commercial

35 [2002] EWCA Civ 1999; [2003] 1 BCLC 675.
36 *Ibid*, [2002] EWCA Civ 1999 at [46].

interests of the company (which seems to be permissible) and acting with the purpose of facilitating the acquisition of the shares (which is not permissible) their conduct falls. Arguably, such fees should be prohibited (in the absence of an exception) because the substantial purpose for the payment of such fees is to facilitate the acquisition of the company's shares.

23 One further point to note is that even though the phrase "the commercial interests of the company" and its variants are used in relation to directors' duties and in the exceptions to financial assistance under ss 76(9A)(*c*)(ii) and 76(9B)(*a*)(ii),[37] they have never been comprehensively defined. If the rule is seen as one of capital maintenance, the focus is whether the transaction results in a transfer of capital from the company to its shareholders (in their capacity as shareholders), thereby prejudicing or potentially prejudicing the interests of the creditors of the company. However if the basis of the rule is one of directors' duties, the relevant interests that should arguably be taken into account would be the interests of the company and its stakeholders (including the employees, creditors and shareholders).[38] In the context of the "white-wash" resolution approving the grant of financial assistance under s 76(10), regard is being made to the interests of creditors and members as the directors must take into account whether the financial assistance prejudices materially the interests of the creditors or members of the company.

C. Assistance must be financial

24 In *Lew Syn Pau*, the court had to consider whether there was provision of assistance that was "financial" in nature by BIGL and held that there must be an actual depletion, or a risk of depletion, of the relevant company's assets.[39] The court held that there was no financial assistance if the assets of the relevant company were not depleted or put at risk of depletion.

25 There are two difficulties with the test formulated in relation to the test of depletion of assets or risk of depletion of assets. First, if it is

37 Sections 76(9A)(*c*)(ii) and 76(9B)(*a*)(ii) refer to the "best interests of the company".

38 See *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363 at 379 where the Court of Appeal held that the "duties owed by the directors are to the company and the company is more than just the sum total of its members"; see also *Brady v Brady* [1989] AC 755 at 778.

39 *Supra*, n 9, at [189].

accepted that the Singapore parent company may have assisted in the acquisition of its shares by procuring that the foreign subsidiary put an intended purchaser in funds in order to acquire such shares, it could be argued that there was in fact a risk of depletion of the assets of the *Singapore parent company*. The reason was that there was a risk that the overall NAV of the Singapore parent company (as shown on the balance sheet of the Singapore parent company) would be reduced. Given that BIGL controlled Compart Mauritius, the financial statements of Compart Mauritius were consolidated into the BIGL group.[40] Shareholders and creditors of BIGL would surely assess the performance of BIGL by the accounts of the BIGL group on a consolidated basis. If the intended purchaser was not credit-worthy and the loan to the intended purchaser was not in fact repaid, such a loan would have been written off. It should follow that the NAV of BIGL would be reduced by an impairment of its investment in Compart Mauritius if the loan was not recoverable. Arguably, such reduction in the NAV would amount to a depletion of the assets of BIGL.

26 Second, the court held that the giving of financial assistance by a subsidiary did not *ipso facto* also constitute the giving of such assistance by the parent company, relying on *Arab Bank v Mercantile Holdings Ltd*[41] where Millet J held that the prohibition was directed at the assisting company and not at its parent company. The court rejected the Prosecution's arguments that the acts of W should be attributed to the acts of BIGL as the Prosecution's case was that W was acting as a director of Compart Mauritius in authorising the loan from Compart Mauritius and it was Compart Mauritius that had authorised the loan. It is suggested that further consideration could have been given to the issue as to whether the acts of W in procuring the transfer of the funds of BIGL's subsidiary, could be construed as the acts of BIGL. W exercised substantial influence and was a dominant figure on the board of Compart Mauritius[42] and as the single largest shareholder and executive chairman (and director) of BIGL, he could have exercised significant influence over BIGL. The view that only the acts of the board of directors can be attributed to the company has been rejected in *Meridian Global Funds Management Asia v Securities Commission*[43] and the issue as to whether the act of an individual can be attributed to the company is one of

40 *Supra*, n 9, at [13].
41 [1994] Ch 71.
42 *Supra*, n 9, at [41(g)].
43 [1995] 2 AC 500. See also *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685.

construction in each case of the particular rule in question. It could be argued that in the context of s 76, the acts and knowledge of W, the single largest shareholder and executive chairman of BIGL, could be attributed to BIGL. On this argument, W's actions, by procuring that Compart Mauritius put the intended purchaser in funds for the acquisition of shares of BIGL, could be attributed to BIGL's acts. Such an inquiry is not the same as lifting the corporate veil nor is it an inquiry into whether there can be recourse to the shareholders of a limited liability company decided under *Salomon v Salomon*; it is not proposed that the Singapore parent company be made liable for the debts of its foreign subsidiary. The issue is whether the Singapore parent company has provided financial assistance in breach of the prohibition, which is a criminal offence.

D. Financial assistance for the purpose of, or in connection with, the acquisition

27 Section 76 requires that the financial assistance must be "for the purpose of" or "in connection with" the acquisition. As set out above, ss 76(3) and (4), which purport to define these expressions, were included as a result of the Companies (Amendment) Act 1987. On a literal reading of ss 76(3) and (4), it would appear that "in connection with" is broader than "for the purpose of" and even where the company knows that the transaction would financially assist the acquisition of the shares but it is not the main purpose for such acquisition, it would not fall within s 76(3) but would fall within s 76(4). Prior to the Companies (Amendment) Act 1987 coming into force, "for the purpose of" and "in connection with" were not defined. The Court of Appeal in *Intraco* did not consider whether there was a difference between the two expressions but held there was no financial assistance in breach of s 76 when looking at the transactions in their proper commercial context; they were not entered into "solely or mainly" for the purpose of enabling the acquisitions of the shares at no costs to themselves[44] but were transactions entered into *bona fide* in the commercial interests of the company.

28 The impact of ss 76(3) and 76(4) on the prohibition on financial assistance was not considered in *Intraco* simply because the relevant transactions that were sought to be impugned in that case took place in 1984, and were decided on the basis of s 76 of the Companies Act that was in force prior to the commencement of the Companies (Amendment) Act 1987, which was *in pari materia* with s 54 of the UK

44 *Supra*, n 33 at 324.

Companies Act 1948.[45] This issue was finally considered in *Wu Yang Construction*. The court was of the view that while ss 76(3) and (4) are not exhaustive, the phrase "in connection with" in s 76(1) should be read narrowly so as to be consistent with the phrase "for the purpose of", even though such an interpretation would render the phrase "in connection with" otiose. Such a construction was regarded as being consistent with taking a commercially practical approach.

29 In reaching the conclusion, the court relied on the fact that s 76(4) refers, as an illustration of the phrase "in connection with", to situations where the company was aware that its acts of financial assistance would assist the acquisition of its shares and this excluded a situation involving *bona fide* commercial transaction and where those acting for the company never even applied their minds to the potential effects that the transaction could have of financially assisting an acquisition of its shares.[46] The result must have come as a surprise to many. Prior to the decision, one would have thought that ss 76(3) and 76(4) should not be read in exactly the same way or one of the two sub-ss would be redundant. It also does not appear that for the assistance to be made in connection with the acquisition, it is essential for the company to be aware as envisaged by s 76(4). The Australian case law interpreting the Australian equivalent of the provision has held that it does not provide exhaustively the circumstances in which financial assistance is given in connection with an acquisition.[47]

30 The result of the narrow interpretation of the phrase "in connection with" in s 76(1) may now mean that the focus of any inquiry will be on the objective of the company in providing the assistance. One consequence is that it may now be possible to argue that an inducement

45 In *Intraco*, the Court of Appeal had to interpret s 76(1), as it then was, which provided that:

> (1) Except as is otherwise expressly provided by this Act, no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase, deal in or lend money on its own shares.

The expressions "for the purpose of" and "in connection with" were not defined. The Companies (Amendment) Act 1987 provided expressly that transactions entered into before the commencement of the Companies (Amendment) Act 1987 would be grandfathered. See s 76(17) of the Companies Act.

46 *Supra,* n 10, at [70].

47 *Darvall v North Sydney Brick & Tile Co Ltd* (1987) 16 NSWLR 212 at 248.

and incentive given by a company for the counter-party to enter into a transaction involving the acquisition of the company's shares is not financial assistance given for the purpose of an acquisition; this distinction between inducements and incentives on the one hand and financial assistance on the other was drawn in *British & Commonwealth v Barclays Bank plc*[48] ("*British & Commonwealth*").

E. Corporate acquisitions

(1) The giving of representations, warranties and indemnities in corporate acquisitions

31 In a merger or take-over transaction involving the acquisition of the shares, the target company may agree to make certain representations and warranties (to the acquiror) in a recommended offer. Subject to the agreement between the parties, the representations and warranties could relate to a state of affairs or conduct of the target company that exists on the date of agreement and up to the date when the acquisition is completed. Indemnities may also be requested to be given by the target company to hold harmless against losses by the acquiror in connection with the breach of the representations and warranties.

32 Prior to *Lew Syn Pau* and *Wu Yang Construction*, notwithstanding the fact that it is not unusual for Singapore publicly listed target companies to give representations, warranties and indemnities to the acquiror in a merger or recommended offer, there is some doubt on whether such a practice contravened s 76. An argument could be made that if any of such representations and warranties is breached, the target company is liable to a claim in damages. Hence, according to this view, the provision of representations, warranties and covenants financially assists in the acquisition of the relevant shares. The provision of such representations and warranties is usually given to facilitate the acquisition of the shares of the Singapore company by the acquiror, which would satisfy the purpose requirement of such assistance. Certainly, prior to the amendment to s 76 creating an exception for a company giving representations, warranties and indemnities in relation to an initial public offering,[49] it was recognised that such a company in an initial public

48 [1996] 1 WLR 1. *Cf Robert Chaston v SWP Group*.

49 Section 76(8)(*ga*), introduced by the Companies (Amendment) Act 2005, provided that it was an exception to the prohibition in respect of the provision of representations, warranties or indemnities in good faith and in the ordinary course of commercial dealing but only in relation to an offer to the public or an invitation

offering that involves vendor shares may be prohibited from giving representations, warranties and/or indemnities to investors (including underwriters) on the ground of financial assistance.[50] Such representations, warranties or indemnities are given mainly for the benefit of the investors in the initial public offering, rather than that of the company.

33 In *Lew Syn Pau*, Menon JC, citing Mahoney JA's judgment in *Burton v Palmer*,[51] held that to constitute assistance that is "financial" in nature, there must have been provision of a representation, warranty, indemnity with the "intention that the company will be called upon to pay damages and to provide funds in connection with the transfer of its shares",[52] and the mere fact that the company has undertaken an obligation, absolute or contingent, in connection with the proposal for the transfer of its shares does not amount to financial assistance. Accordingly, it is submitted that if the target company provides the representations and warranties believing that such representations are true and that the warranties will be complied with, the provision of such representations or warranties should not amount to assistance that is "financial" in nature. Alternatively, based on *Intraco* and *Wu Yang Construction*, it could be argued the commercial reality is that the provision of representations, warranties and indemnities is not given for the purpose of assisting the intended purchaser to acquire the shares but to reassure such intended purchaser, and any assistance that is rendered is only incidental. In this regard, *British & Commonwealth* is instructive. In that case, British & Commonwealth ("B&C") had given certain covenants as to B&C's ongoing financial position *inter alia* to a company Caledonia, which had subscribed for preference shares in B&C, and to a company called Tindalk which had entered into an option agreement pursuant to which it would be required to purchase the preference shares from Caledonia. The covenants were breached and Tindalk sued B&C for the breach. B&C argued that the option constituted unlawful financial assistance. The Court of Appeal held that the purpose of the covenants in the option was to reassure Caledonia (as an investor) and were *bona fide* covenants the performance of which did not involve the giving of any "financial assistance". This aspect of the decision in *British & Commonwealth* was affirmed in *Robert Chaston v SWP Group plc*.

to the public to subscribe for or purchase shares or units of shares in that company. It would not apply to a corporate acquisition.

50 *CLRFC Report*, ch 2 para 3.4.7.

51 *Supra,* n 9, at [168].

52 *Supra,* n 13, at 890.

34 Taking into account *Lew Syn Pau, Wu Yang Construction* and *British & Commonwealth*, it is reasonable to conclude that the representations, warranties and indemnities given by a target company in a transaction involving the sale of its shares to an acquiror would not constitute prohibited financial assistance under s 76.

(2) Payment of dividends

35 One frequent problem that arises is whether it is financial assistance by a target company to pay a special cash dividend, which is over and above the dividend that is customarily paid to shareholders, upon a change of control of such target company. The exception in s 76(8)(a) is not applicable as the special cash dividend cannot be regarded as being paid in the ordinary course of commercial dealing. The payment of the special cash dividend clearly amounts to assistance that is "financial" in nature. Prior to *Wu Yang Construction*, it could be argued that such payment breaches s 76 as the dividend may be used by the shareholders to repay their acquisition financing and there is a close enough relationship between the giving of assistance and the acquisition of shares in order for the assistance to be given "in connection with" the acquisition. In Singapore, there has been at least one instance where the publicly listed target company undertakes the "white-washing" procedure under s 76(10) in order to pay such cash dividend.[53]

36 It is submitted that it is certainly arguable, in light of *Wu Yang Construction*, as to whether the cautious view was justified. It could be argued that where the directors of the company have properly determined that the payment of a special dividend is *bona fide* and is in the commercial interest of the company (that is, the general body of its shareholders), such payment should not amount to financial assistance.[54]

37 However, if the purpose behind the prohibition is the maintenance of capital, the payment of the special dividend is not very different from the original justification for the prohibition, which is to prevent the target company's assets from being used by the controlling shareholders after the conclusion of a take-over to repay their acquisition

53 NatSteel Ltd, *Circular to Shareholders*, 4 July 2003, para 3.3.

54 Directors are not expected to act only on the basis of the economic advantage of the company as a separate legal entity and ignore the interests of the shareholders. See, for example, L C B Gower, *Gower's Principles of Modern Company Law*, (Steven & Sons, 4th Ed, 1979) at 577.

financing. On this view, it could be argued that such dividend is payable only if it falls within one of the exceptions to s 76.

38 In *Wu Yang Construction*, the court suggested that the inquiry in relation to the second issue (whether the assistance rendered was "financial" in nature) and the third issue (whether the assistance is for the purpose of or in connection with the acquisition), raised in Section III(A) above, should be "read and applied holistically – as an integrated whole".[55] It is respectfully submitted that these are two separate and distinct issues and should not be conflated. The example raised here in relation to the payment of dividend shows that the conclusion that the assistance that is financial in nature may not necessarily lead to a definitive conclusion that such assistance is for the purpose of the acquisition of shares.

IV. Concluding remarks

39 In this regard, there has been a development in the UK and in the Commonwealth countries towards liberalising the legislation governing financial assistance. The UK has enacted legislation to abolish the ban on financial assistance for private companies, following the recommendations of the Company Law Review Steering Group ("CLR").[56] Financial assistance rules continue to apply to public companies in view of the Second Company Law Directive,[57] which has been recently amended by Directive 2006/68/EC but which has not yet been implemented.[58] Australia has retained the ban on financial assistance

55 *Supra,* n 10, at [71].

56 Sections 677–683 of the Companies Act 2006 (c 46) ("the Companies Act 2006"); the Companies Act 2006 was granted Royal Assent on 8 November 2006 and the provisions regarding financial assistance are expected to come into force in October 2008 (see the Written Statement dated 28 February 2007 by the Minister of State and Industry and the Regions). For the recommendations of the CLR, see *Modern Company Law for a Competitive Economy: Completing the Structure* URN 00/1335 (DTI, 2000), ch 7; *Modern Company Law for a Competitive Economy: Final Report* URN 01/942 vol 1 (DTI, July 2001) at 218.

57 The prohibition against financial assistance will remain in place for public companies: see ss 678 and 679 of the Compannies Act 2006. The Second Council Directive 77/91/EEC provides the basis of the prohibition on rendering financial assistance by public companies limited by shares in the UK.

58 Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alternation of the capital, [2006] OJ L 264/32. The Directive came into force on 26 September 2006, and it provides that Member States may relax the prohibition on public companies giving financial assistance to third parties for the acquisition of their own shares, provided *inter alia* that the level of assistance does not exceed distributable reserves and the

but has substantially widened the circumstances in which financial assistance may be provided, including permitting financial assistance where this "does not materially prejudice" the interests of the company or its shareholders or the company's ability to pay its creditors.[59] New Zealand has also liberalised the circumstances in which financial assistance may be granted.[60]

40 *Lew Syn Pau* and *Wu Yang Construction* highlight the fact that the debate on the prohibition on financial assistance is far from over. The decisions go to some extent in clarifying the scope of the prohibition. However, in view of the fact that there is a huge range of practical situations in which the possibility of financial assistance can arise and there is some uncertainty on the proper rationale underlying the prohibition, it is submitted that s 76 should be reviewed beyond the matters that were discussed in the *CLRFC Report*. For a start, the first inquiry should be whether the s 76 is still necessary today, bearing in mind that the rules on financial assistance could be controlled through other means (*eg*, common law rules on directors' fiduciary duties). Other justifications which are not based on capital maintenance have been offered in respect of the ban on financial assistance,[61] such as the prevention of bidders or target companies from engaging in price support schemes for their shares.[62] These can be controlled by rules relating to market manipulation under the Securities and Futures Act.[63]

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transaction meets certain specific requirements which protect the other shareholders and creditors.

59 Corporations Act 2001 (cth), s 260A.

60 New Zealand Companies Act 1993, ss 76 to 80.

61 E Ferran, *Company Law and Corporate Finance* (Oxford University Press, 1999), at 372–373.

62 *Eg*, the bidder which is offering shares in itself as consideration for the offer for the target shares indemnities purchasers of its (the bidder's) shares. Similarly, the target company purchases its own shares in order to influence the outcome of the bid.

63 Cap 289, 2006 Rev Ed, ss 197 and 198.