LEGAL UPDATE

LEGISLATION UPDATE

17 October 2014

AMENDMENTS TO THE COMPANIES ACT – IMPACT ON CORPORATE TRANSACTIONS

This article is part of a series of legal updates relating to the amendments to the Singapore Companies Act proposed to be effected by the Companies (Amendment) Bill No. 25 of 2014 passed by the Singapore Parliament on 8 October 2014.

INTRODUCTION

The Companies (Amendment) Bill No. 25 of 2014 ("**Amendment Bill**") was passed by the Singapore Parliament on 8 October 2014. The Amendment Bill sets out a wide range of amendments to the Singapore Companies Act ("**Companies Act**"), and marks a significant change to certain aspects of companies' legislation in Singapore.

The amendments in the Amendment Bill (the "**Amendments**") are to come into operation on a date to be appointed by notification in the Government Gazette but many of the Amendments are expected to come into force by the end of 2014.

This update aims to highlight certain amendments affecting the following key categories of corporate transactions and the potential issues that may be faced by stakeholders in practice:

(a) the provision of loans and quasi-loans to, and entry into credit transactions with, directors or entities connected with directors;

(b) the provision of financial assistance by a company for the acquisition of its own shares; and

(c) the compulsory acquisition of shares.

LOANS, QUASI-LOANS & CREDIT TRANSACTION INVOLVING DIRECTORS AND ENTITIES CONNECTED WITH DIRECTORS

Background – current prohibitions under sections 162 and 163 of the Companies Act

Presently, section 162 of the Companies Act prohibits a company[1] from making a loan to any of its directors or giving a security or guarantee for such a loan (the "**Direct Prohibition**"), subject to certain exceptions[2].

Section 163 of the Companies Act also prohibits a company[3] from making a loan to another company where the director(s) of the first company are interested in 20% or more of the shares of the second company, subject to certain exceptions[4] (the "**Indirect Prohibition**").

Existing prohibition relating to loans to directors/entities linked to directors extended to cover quasi-loans and credit transactions

The Amendments will extend the Direct Prohibition and the Indirect Prohibition (which currently only covers loans and guarantees), to also cover quasi-loans and credit transactions.

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[1] which is not an exempt private company (*ie* a private limited company whose shares are not held by any corporate body and has no more than 20 shareholders who are all natural persons)

[2] *eg* where a loan is provided to a director engaged in full time employment with the company to acquire a home

[3] which is not an exempt private company

[4] *eg* section 163 will not apply to loans by a company to its subsidiaries

The terms "quasi-loans" and "credit transactions" are widely defined. Quasi-loans will include transactions under which a party (the "**creditor**") agrees to pay a sum for another party (the "**borrower**") on terms the borrower repays the creditor (for example, when a company pays the bills of one of its director on the understanding that the director will repay the company later).

Credit transactions are transactions under which a party:

(a) supplies goods or disposes of immovable property under a hire purchase agreement or a conditional sale agreement[5];

(b) leases or hires any immovable property or goods in return for periodic payments; and/or

(c) otherwise disposes of immovable property or supplies goods or services on the understanding that payment (whether in a lump sum or instalments or by way of periodic payment or otherwise) is to be deferred.

The Indirect Prohibition will also be expanded to cover transactions between a company (acting as the creditor or supplier) and a limited liability partnership in which the company's director(s) have a 20% or more interest.

Given the enlarged scope of these prohibitions, it would be prudent for a company to exercise greater care when proposing to enter into a transaction which may benefit a director[6], and consider if such transaction may be regarded as a "quasi-loan" or "credit transaction" with the company acting as the creditor or supplier.

Directors who authorise transactions that breach these prohibitions may be guilty of an offence which can attract a fine of up to $20,000 or a prison term of up to 2 years.

Accordingly, if there is a risk that a proposed transaction is a "quasi-loan" or a "credit transaction", it will be necessary to consider if there are any exceptions that may permit the company to enter into the transaction.

New shareholder approval exception to be made available to permit transaction with entities connected with directors

The current exceptions to the Direct Prohibition and the Indirect Prohibition are fairly limited. In particular, there is currently no process by which the shareholders of a company may approve a transaction that may run afoul of the Indirect Prohibition even if the shareholders wish to do so[7].

The Amendments will introduce an exception to the Indirect Prohibition to allow a transaction if prior shareholders' approval in a general meeting is obtained. However, directors (and their family members) who are interested in the transaction must abstain from voting. They need not abstain if all the shareholders of the company vote to approve the transaction. This addresses concerns that shareholders of family owned companies might otherwise all have to abstain.

This new exception does not provide for post transaction ratification by shareholders. It would therefore still be important for a company to exercise care and consider if a proposed transaction could run afoul of the prohibitions prior to entering into the transaction.

It should also be noted that this new exception applies only with respect to the Indirect Prohibition and not the Direct Prohibition (*ie* transactions entered into directly with a director as opposed to an entity in that the director has an interest).

[5] Under section 2 of the Hire-Purchase Act, a conditional sale agreement refers to an agreement for the sale of goods under which the purchase price or part of it is payable by instalments, and the property in the goods is to remain in the owner (notwithstanding that the hirer is to be in possession of the goods) until such conditions as to the payment of instalments or otherwise as may be specified in that agreement are fulfilled

[6] or an entity in which its director(s) hold 20% or more of the voting power

[7] for example because the terms of the transaction are on an arm's length basis and the shareholders feel that the transaction will still benefit the company notwithstanding it is being entered into with another entity in which a director may have an interest in

ABOLITION OF FINANCIAL ASSISTANCE PROHIBITION FOR PRIVATE COMPANIES

What is prohibited financial assistance?

Section 76 of the Companies Act currently prohibits any company incorporated under the Act from providing financial assistance for the acquisition of its own shares, or the shares of its holding company. The primary rationale for the prohibition is to protect creditors and to preserve the capital of a company.

However the scope of the existing rule under section 76 is very wide, and in practice can cover certain innocuous transactions that arguably do not fall within the mischief sought to be addressed by the prohibition. While there are certain "whitewash" procedures set out in the Companies Act[8] that can be undertaken so that a company can enter into a transaction that may otherwise be prohibited, these procedures can delay or impede certain transactions such as leveraged buy-outs of companies incorporated in Singapore.

Restricted to public companies and their subsidiaries

The Amendments will amend section 76 to limit the financial assistance prohibition such that it will apply only to public companies and their subsidiaries.

The prohibition is therefore no longer applicable to private companies whose holding or ultimate holding company is not a public company and such companies will be able to enter into transactions involving financial assistance without having to undertake the "whitewash" procedures set out in the Companies Act. For example, following the amendments to section 76, an acquisition of the shares of a private company[9] financed with loans secured on the company's assets will no longer require a "whitewash".

New "no material prejudice" exception

The Amendments will introduce a new "no material prejudice" exception to this prohibition via a new section 76(9BA) of the Companies Act.

In brief, the "no material prejudice" exception provides that a company to which the prohibition applies may provide financial assistance in connection with the acquisition of its shares if the giving of the assistance does not materially prejudice:

(a) the interests of the company or its shareholders; or

(b) the company's ability to pay its creditors.

The board of directors will need to pass a resolution that:

(a) the company should give the assistance; and

(b) the terms and conditions of the assistance are fair and reasonable to the company.

The resolution will also need to set out the full grounds of the directors' conclusions. There is however no requirement for directors to make a solvency statement in relation to the giving of financial assistance under this new exception (unlike the present "whitewash" regime under sections 76(9A) and 76(9B) of the Companies Act).

If this exception is to be relied on, the directors will need to determine whether there is material prejudice to the interests of the company, and also whether the terms and conditions of the proposed financial assistance are fair and reasonable. In this regard, Australian case law[10] suggests that there will be material prejudice to the interests of the company or its shareholders, or to the ability of the company to pay its creditors, if there has been a material diminution of the company's assets.

[8] these are set out in sections 76(9A), 76(9B), 76(9C) and 76(10) of the Companies Act

[9] which is not a subsidiary of a public company

[10] regarding section 260A of the Australian Corporations Act which is similar to the new section 76(9BA)

The Amendments will also make it clear that the following transactions are excluded from the financial assistance prohibition:

(a) a distribution in the course of a company's winding up;

(b) an allotment of bonus shares;

(c) a redemption of redeemable shares of a company in accordance with the company's constitution; and

(d) the payment of costs by a company listed on a securities exchange associated with a scheme, an arrangement or a plan under which any shareholder of the company may purchase or sell shares for the sole purpose of rounding off any odd-lots which he owns.

COMPULSORY ACQUISITION

Section 215 compulsory acquisition regime extended - now applicable to individual offerors, joint offers and units of shares

In gist section 215 of the Companies Act sets out a mechanism pursuant to which a company (the "**Transferee**") which has acquired very nearly all of the shares of another company[11], may acquire the shares of the dissenting minority of shareholders who have yet to sell their shares to the Transferee. Section 215 essentially provides for a compulsory acquisition mechanism and is often used in take-overs of public listed companies in Singapore where the offeror intends to acquire all the shares in a company and thereby cause such company to become its wholly owned subsidiary.

The Amendments will amend section 215 to cover certain scenarios and situations which the current section does not cover. In particular section 215 will be amended such that:

(a) a Transferee can be an individual (currently the section only applies where the Transferee is a company or a corporation); and

(b) the compulsory acquisition mechanism set out in the section can be used to acquire options and other interests in shares (currently it only covers acquisition of shares).

Other amendments to section 215 include amendments to implement mechanisms to deal with joint offers (*ie* where 2 or more persons are jointly making an offer for shares) and where dual consideration (*eg* money and some other consideration) is being offered for the shares.

CONCLUSION

Some of the Amendments mentioned in this update, such as the removal of the financial assistance prohibition for private companies, and the expansion of the compulsory acquisition mechanism under section 215, are facilitative. On the other hand, companies will need to remain circumspect and exercise more thought, care and planning when proposing to enter into transactions that may have a financing/credit element, if the parties to such transactions include directors or entities in which directors have an interest.

If you have any questions or comments on this article, please contact:

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[11] generally speaking the applicable threshold here is 90% of all the shares of the company (excluding treasury shares and shares already held by the Transferee when it makes its offer)

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