



## **CONNECTED PARTIES IN CONVEYANCING AND FINANCE TRANSACTIONS**

### **Section 239 of the Companies Act, 2014 - Advising Irish Companies and their Counterparties on Loans, Guarantees, Security and Other Financial Transactions**

Practitioners often encounter companies in real estate finance transactions. What are the company law issues to be aware of in the case of financial transactions for which companies need special approval? Lenders seek certainty regarding the enforceability of loans, credit transactions, guarantees and security. In that context, how far can a legal adviser go in certifying the effectiveness of these transactions?

#### **Relevant law – Loans, Credit Transactions, Guarantees and Security**

Section 31 of the Companies Act 1990 (the “**1990 Act**”) imposed statutory restrictions on companies:

- making loans or quasi-loans,
- entering into certain credit transactions (as creditor), or
- entering into a guarantee or providing security in connection with such a transaction

in favour of a director or other connected person.

Prior to the introduction of section 31, it was not uncommon for directors to take advantage of their position and use company funds and assets for their own purposes. For example, directors often loaned monies from their companies which loans were commonly not repaid. It was also not unusual for companies to create long leases of company property in favour of its directors (or persons connected with them) at a below market or nominal rent. While the purpose of section 31 was to restrict the directors' ability to exploit their special position for their own benefit and thereby adversely affect the interests of the company's shareholders and creditors, the legislation was considered by many to be unworkable. Section 239 of the Companies Act 2014 (the “**2014 Act**”) re-enacts the restrictions set out in section 31 of the 1990 Act with the welcome reform that all of the prohibited transactions may now be validated by the Summary Approval Procedure (“**SAP**”). All references in the rest of this article to sections are to the 2014 Act unless otherwise specified.

Lenders are particularly concerned about compliance with section 239 as, if a company enters into a transaction or arrangement in contravention of section 239, then under section 246 the transaction is voidable at the instance of the company (which would include any liquidator). As legal advisers we may, therefore, be asked by lenders to confirm or certify certain matters relevant to section 239 which requires an analysis of the relevant provisions.

#### **Analysis of Section 239**

Question 1: Does the transaction include an Irish company?

The restrictions apply to companies incorporated under the Companies Acts. If the corporate is incorporated elsewhere, then section 239 does not apply. If the corporate is an Irish company but achieved incorporation in some other way, such as under other statutory provisions, then the restrictions are not relevant. For the rest of this article, “Irish Company” refers to a company incorporated under the Companies Acts.

All that an Irish solicitor can confirm in the circumstances of a foreign company is that section 239 does not apply. Any certification on matters of the laws of another jurisdiction should be provided by a lawyer qualified in that jurisdiction.

*Question 2: Has the Irish company made a loan or a quasi-loan?*

The word “loan” was considered self-explanatory by the Irish legislator and not specifically defined in the 2014 Act. It is, therefore, given its ordinary meaning, for example, an amount of money or assets given by one person to another for a period of time with a promise to pay it back at a future date.

A “quasi-loan” is a transaction in which an Irish company pays or agrees to pay money for a borrower, or reimburses expenditure incurred on behalf of a borrower (section 219). Examples would include a company paying a director’s overdraft or personal credit card bill.

*Question 3: Has the Irish company entered into a credit transaction?*

A “credit transaction” arises where an Irish company, in return for periodic payments or for deferred payment:

- supplies any goods or sells any land,
- enters into a hire purchase or conditional sale agreement,
- leases or licenses the use of land or hires goods, or
- supplies goods or services

to a director or connected person.

While this is a far-reaching definition, a credit transaction will only be caught by section 239 where the company *is the creditor*. An example of a credit transaction is a lease of land where the Irish company is the landlord. If the Irish company is the tenant, at first sight the legislation is irrelevant. However, one should ensure that the rent is no more than market rent as otherwise the transaction could be a disguised loan.

*Question 4: Has the Irish company given a guarantee or provided security in connection with any restricted transaction?*

The terms “guarantee” and “security” are also not defined in the 2014 Act and have their ordinary meaning. For the purpose of the Act a “guarantee” includes an “indemnity” (section 219). Frequently, security will involve both a guarantee and security but the restriction will apply where security is provided but no guarantee is given (for example, a surety mortgage over land).

*Question 5: Is the Irish company carrying out a prohibited transaction for the benefit of either a director or a person connected with a director?*

A “director” means any person occupying the position of director by whatever name called, including shadow and de facto directors. Giving board members a title such as governors or trustees has no relevance in this context. A shadow director is a person in accordance with whose wishes the board generally acts (other than professional advisers).

A “connected person” is a broad category which includes family relationships (the director's spouse, civil partner, parent, brother, sister and child), the trustee of any trust where the principal beneficiaries are the director, spouse, civil partner or child; and anyone in partnership with the director. The term includes bodies corporate (not just Irish companies) controlled by that director or by another body corporate that is controlled by that director.

For the purposes of section 239, a body corporate is a connected person if the director in question, together with any other director or directors of the body corporate or any person or persons connected with any director or directors is interested in one half or more of the equity share capital of that body or controls or is entitled to control one half or more of the voting power at a general meeting of the company.

Question 6: Do any statutory exemptions apply?

Sections 240 to 245 set out the exceptions to the section 239 prohibitions.

**(a) Summary Approval Procedure or SAP**

The new SAP goes further and is more simplistic than its predecessor (section 34 of the 1990 Act) and now makes the whitewashing of transactions involving directors a more realistic possibility. Every transaction that is prohibited by section 239 can now be validated through compliance with the SAP. The procedure (set out in sections 202 and 203) does not contain any requirement for the problematic auditor's report (previously required under section 34 of the 1990 Act) and gives a finite period for the directors' declaration of solvency. The essential elements of this more streamlined approach to the approval of restricted activities are as follows:

- a declaration of the directors of the company setting out the prescribed information in respect of the restricted activity including:
  - (i) the circumstances in which the transaction was entered into;
  - (ii) the nature of the transaction or arrangement;
  - (iii) the persons to or for whom the transaction is to be made;
  - (iv) the purpose of the transaction;
  - (v) the nature of the benefit accruing to the company (whether directly or indirectly); and
  - (vi) a statement that the declarants have made full inquiry into the affairs of the company and that having done so have formed the opinion that the company, having entered into this transaction, will be in a position to meet its debts as they fall due for the next 12 months following the relevant activity,
- such declaration being delivered to the Companies Registration Office (the “CRO”) within 21 days of the restricted activity taking place, and
- a special resolution of the members of the company being passed not more than 12 months prior to the restricted activity, authorising the directors to carry out the activity. This too must be filed in the CRO.

**(b) Group Exemption**

Companies in the one group may enter into transactions which would otherwise be prohibited by section 239 (section 243). This exemption applies regardless of whether the subsidiary or holding company is an Irish incorporated company. Confirming that a group structure exists is essential in order to rely on this exception.

### **(c) Directors' Expenses**

An Irish company may reimburse a director for properly incurred and vouched expenditure (section 244). This exception appears to cover customary day to day banking and financial arrangements between a company and its directors. In order to avail of the exception such loans or advances to directors must be repaid to the company within 6 months from the date on which any liability was incurred (section 244(2)).

### **(d) Business Transaction**

Transactions which are in the ordinary course of business of an Irish company and on arm's length terms are exempt from the section 239 prohibition (section 245). The 2014 Act extended the scope of this exemption and section 245 now applies to all of the five prohibited transactions and not only loans, quasi-loans and credit transactions.

An Irish company may, therefore, provide finance to a director, but only on terms which are reasonable and ordinarily offered by the company to others. The fact that the company previously entered into a similar transaction is not enough unless it was also objectively reasonable for the company to have entered into that previous transaction.

As legal adviser to the company, you may provide guidance as to the objective meaning of "reasonably" and "ordinarily", however, assessing whether the terms offered by the company to the director (or connected person) are more favourable than those offered to others or unusual is a factual assessment and one to be carried out by the directors (often with assistance from its financial advisers).

### **(e) Minor Transactions**

Another exemption that applies to all five of the prohibited transactions is the *de minimis* exemption. If the value of the transaction is less than 10% of the value of the Irish company's relevant assets, the transaction is not prohibited. However, the exception is of limited interest to funders, as the test is reset just when the matter becomes relevant to funders and, therefore, the exception may cease to apply before the funder has its money back!

How does one make the calculation? One must ascertain both the value of the arrangement and the value of the company's relevant assets. If there is more than one transaction, then the calculation aggregates the transaction values.

The value of the transaction is:

- in the case of a loan, the value is the principal of the loan;
- in the case of a quasi-loan, it is the amount or maximum amount which the person to whom the quasi-loan is made is liable to reimburse the credits;
- in the case of a credit transaction, its value is the price which it is reasonable to expect to obtain for the goods, land or services to which the transaction relates if they had been supplied in the ordinary course of business on the same terms; and
- in the case of a guarantee or security, the value is the amount guaranteed or secured.

In the past, transactions often fell through the net on grounds that they were incapable of being expressed as a specific sum. Section 219 (6) provides that where the value of a transaction or arrangement is not capable of being expressed as a specific sum because the amount of the liability arising under the transaction is unsecured or for any other reason, it is

deemed to exceed €65,000 which is the value considered to justify invocation of the prohibition.

The relevant assets of the Irish company are (section 238 (2)) either:

- the value of its net assets as determined by reference to its last annual financial statements (see section 290 and section 341 for the detailed requirements); or
- its called-up share capital, if it has no such financial statements.

If the value of the transaction goes above the 10% threshold, then the directors must amend the terms of the arrangements within 2 months, so that the value falls below 10% (section 241). If not, then the arrangements are voidable at the instance of the company. This situation could arise where the value of assets falls due to property values dropping or the company experiencing trading difficulties.

### **Practicalities**

Much of the above is based on the particular facts of a case. Matters of fact are best confirmed by the parties, be they the company or the directors and corporate certificates are already used as a matter of course in confirming for example that the SAP was properly authorised and documented.

- (a) Certifying that transaction was approved by the Summary Approval Procedure or SAP

It is common for lenders to seek evidence that a transaction relying on the SAP exemption was properly approved and documented. In this instance, the company involved should provide a corporate certificate certifying that the transaction was authorised by the summary approval procedure and annexing a copy of (i) the declaration of all directors of the company made pursuant to the procedure and (ii) the unanimous special resolution of the company passed by all shareholders of the company entitled to attend and vote at general meetings pursuant to such procedure.

A legal opinion, opining on the validity of the transaction by reason of the summary approval procedure, could also be provided where the legal adviser can rely on the (i) directors' declaration, (ii) the special resolution and (iii) the board minutes of the company approving the transaction and these documents should be annexed to the legal opinion.

If one is drafting the SAP documents, care should be taken to ensure that the SAP documents are accurately drafted. The directors' declaration must be filed with the CRO no later than 21 days after the commencement of the transaction or arrangement.

- (b) Certifying that the group company exemption applies – corporate certificate or legal opinion?

Where a company is availing of the group company exemption, a lender may request a corporate certificate confirming that the companies are, in fact, in the same group. In order to be in a position to advise in relation to such certificate, one should review a group structure chart (where available) and the register of members of the relevant companies to satisfy oneself that the companies are part of the same group of companies. As legal adviser, you can then guide the company (and the directors) through the corporate certificate process. A certified copy of the certificate of incorporation of the companies and the register of members of the companies and a copy of the group structure chart should be annexed to the corporate certificate.

A legal opinion may also be requested by a lender. If one is providing a legal opinion, it is important to rely on the corporate certificate for this purpose and that the appropriate qualification and assumptions are included in the legal opinion.

- (c) Certifying that the minor transaction exemption applies – corporate certificate or legal opinion?

Section 240 provides that if the value of the transaction is less than €65,000 or 10% of the company’s relevant assets, the transaction is not prohibited by section 239. A corporate certificate certifying that the value of the transaction is less than €65,000 or 10% of the company’s relevant assets of companies should suffice for lenders. A copy certificate of incorporation, a copy of the financial statements prepared under section 290 and laid before the company in general meeting in accordance with section 341 in respect of the last preceding financial year (or where no financial statements have been prepared the amount of its called-up share capital) should all be annexed to the corporate certificate.

- (d) Other certifications

Although the above certifications and legal opinions are relatively straightforward, recently there have been reports of lender requests for particularly onerous and far-reaching legal opinions, such as opinions that the company has complied with the 2014 Act in its entirety. While it is impossible for a legal adviser to provide such a broad legal opinion, advisers are being put under pressure to provide these.

Where one is being pressured into providing such an opinion, one should instead suggest that a corporate certificate such as those discussed above be provided. The type of certification required by the lender should also be discussed at the outset. Where the request is excessive or impossible for the legal adviser to provide then the matter should be discussed with the lender as early as possible to agree what comfort can be provided to the lender.

### CHECKLIST

<b>Corporate certificate</b>	<b>Assessment</b>	<b>Documents to be annexed to the certificate or legal opinion (where provided)</b>
<p>Certifying that section 239 does not apply as the arrangement is not for the benefit of a director of the company or a person connected with a director.</p>	<p>When advising the company in relation to the provision of a corporate certificate, you should review the company’s group structure chart and its statutory registers. You should also take your client through the assessment of who is a “connected person” for the purpose of section 239.</p>	<p>The following documents should be annexed to the corporate certificate:</p> <ul style="list-style-type: none"> <li>• a copy certificate of incorporation;</li> <li>• a group structure chart;</li> <li>• an up-to-date list of directors; and</li> <li>• a certified copy register of members.</li> </ul> <p>If you are providing a legal opinion, it is important to rely on the corporate certificate for this purpose and that the appropriate qualifications and assumptions are included in the legal opinion.</p>

<p>Certifying that the group company exemption applies.</p>	<p>When advising the companies in relation to the provision of corporate certificates, you must guide the client through their assessment of whether the companies are, in fact, group companies. You therefore need to review a group structure chart and registers of members in order to be so satisfied.</p>	<p>With regard to each of the companies involved, the following documents should be annexed to the corporate certificates:</p> <ul style="list-style-type: none"> <li>• a copy certificate of incorporation;</li> <li>• a group structure chart; and</li> <li>• a certified copy register of members.</li> </ul> <p>If you are providing a legal opinion, it is important to rely on the corporate certificate for this purpose and that the appropriate qualifications and assumptions are included in the legal opinion.</p>
<p>Certifying that the minor transaction exemption applies.</p>	<p>Two figures are fundamental when determining whether or not the de minimis exception applies (i) the value of the arrangement and (ii) the value of the company's relevant assets.</p>	<p>With regard to the company:</p> <ul style="list-style-type: none"> <li>• a copy certificate of incorporation;</li> <li>• a copy of the financial statements prepared under section 290 and laid in accordance with section 341 in respect of the last preceding financial year (where available).</li> </ul> <p>If you are providing a legal opinion, it is important to rely on the corporate certificate for this purpose and that the appropriate qualifications and assumptions are included in the legal opinion.</p>
<p>Certifying that the transaction was approved by the Summary Approval Procedure</p>	<p>We need to review the summary approval procedure documents to be sure that such documents were properly drafted. You also need to ensure that the directors' declaration is filed with the Companies Registration Office no later than 21 days after the commencement of the transaction or arrangement.</p>	<p>The company involved should provide a corporate certificate certifying that the transaction was authorised by the Summary Approval Procedure and annexing a copy of the following documents:</p> <ul style="list-style-type: none"> <li>• the declaration of all directors of the company made pursuant to the SAP; and</li> <li>• the unanimous special resolution of the</li> </ul>

		<p>company passed by all shareholders of the company entitled to attend and vote at general meetings pursuant to such procedure.</p> <p>A legal opinion, opining on the validity of the transaction by reason of the Summary Approval Procedure, could also be provided where the legal adviser can rely on the (i) directors' declaration, (ii) the special resolution and (iii) the board minutes of the company approving the transaction.</p>
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**CONVEYANCING COMMITTEE**

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