

The High Court's first decision on the financial assistance prohibition in section 260A of the Corporations Act 2001 (Cth) (Corporations Act) adopts a conservative approach to the prohibition.

In a unanimous judgment, the High Court held that the taking of legal proceedings by a company, at its own expense and risk, to enforce a pre-emptive rights provision for the benefit of majority shareholders qualified as financial assistance for the acquisition of shares in the company.

(Note: The full text of the decision is available on the [High Court's website](#).)

Case Background

Slea Pty Ltd (Slea) held a 33.3% interest in Connective Services Pty Ltd (Connective), along with two other shareholders, Millsave Holdings Pty Ltd (Millsave) and Mr Haron. Connective conducted a mortgage aggregation business. Connective's constitution included a pre-emption clause requiring the company's shareholders to offer their shares to their fellow shareholders before the shares could be transferred to any other party.

Slea entered into an agreement to transfer its shares to a third party, Minerva Financial Group (Minerva), without complying with this pre-emptive rights provision in the constitution. To prevent this, Connective instituted proceedings against Slea and Minerva, also joining Millsave and Mr Haron as defendants claiming that this arrangement breached the pre-emptive rights provision.

Slea and Minerva applied to have these proceedings dismissed or stayed, and sought, among other forms of relief, an injunction under section 1324 of the Corporations Act to restrain Connective from prosecuting the proceedings on the basis that they were in contravention of the implied prohibition in section 260A(1) of the Corporations Act against financial assistance.

The High Court held that the legal proceedings brought by Connective, against Slea and Minerva to enforce a pre-emptive rights provision for the benefit of other Connective shareholders at Connective's expense, constituted financial assistance and issued the injunction.

What Is Financial Assistance?

Section 260A(1) of the Corporations Act relevantly provides that a company may only financially assist a person to acquire shares (or units of shares) in the company if:

- Giving the financial assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors
- Giving the assistance is prior approved by a special resolution of shareholders under section 260B
- An exemption applies under section 260C

Breadth of Financial Assistance

The High Court confirmed that financial assistance should be given a broad commercial meaning. It was held that financial assistance need not involve any diminution or depletion of assets, but rather is a commercial or financial question.

The financial assistance need not involve a monetary payment by the company to the person acquiring the shares. "Any action by the company can be financial assistance if it eases the financial burden that would be involved in the process of acquisition or if it improves the person's 'net balance of financial advantage' in relation to the acquisition."

The financial assistance in this case was the commencement and funding of legal proceedings against one shareholder to enforce a pre-emptive rights provision for the benefit, in effect, of the other shareholders. The commencement of these proceedings by Connective, at its expense, constituted the giving of financial assistance, as this eased the financial burden in the process of any acquisition of shares by those other shareholders, who were relieved of having to take the proceedings themselves.

If those proceedings had been commenced by Millsave and Mr Haron, and funded by Connective, this would have plainly constituted financial assistance. Instead, the proceedings were commenced at the expense of Connective, in which Millsave and Mr Haron hold 66.67% of the shareholding, thereby having a similar effect.

The Meaning of “to Acquire”

Section 260A does not require that an acquisition actually take place. The words “to acquire” in section 260A extend to “all conduct in connection with the process of acquiring the shares or units of shares. The acquisition can be by issue, transfer or any other means.”

Materially Prejudice

The High Court held that “the issue of material prejudice to the interests of the company or its shareholders or creditors requires an assessment of and comparison between the position before the giving of the financial assistance and the position after it to see whether the company or its shareholders or its ability to pay its creditors is in a worse position.”

Connective eased the financial burden in the process of any acquisition of shares by Millsave and Mr Haron. The High Court ruled that if a pre-emptive rights proceeding was to take place, it would incur costs of approximately AU\$525,000 to AU\$755,000, in addition to potential adverse costs orders. The proceeding could have been brought by Millsave and Mr Haron in their own right. The High Court found that Connective had not shown there was no material prejudice.

Key Takeaways

- Companies should be aware of adopting too narrow an interpretation of financial assistance. The term “financial assistance” has a broad meaning and can extend to a company relieving shareholders of the financial burden of taking legal proceedings to enforce a provision in their constitution in connection with an acquisition of shares in the company.
- The necessary connection between the financial assistance and an acquisition or proposed acquisition can be indirect and contingent.
- The High Court held that if a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders, but at the company’s expense, the company is liable to be enjoined from doing so unless the assistance is approved by the shareholders under section 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders, or the company’s ability to pay its creditors.
- A conservative approach should always be adopted when considering whether there has been a contravention of section 260A(1)(a), and the performing of a “whitewash” procedure by obtaining shareholder approval under section 260B remains an effective way to avoid the consequences of the financial assistance prohibition.

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