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## **Australia**

Financial Assistance

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## INTRODUCTION

This guide provides an overview of the law in relation to the concept of financial assistance for private and public companies in Australia, as currently regulated by the *Corporations Act 2001* (Cth) (the Corporations Act).

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## GENERAL OVERVIEW

### Origins of financial assistance in Australian law

Australian companies have generally been prohibited from providing financial assistance. The origins of this prohibition stem from the United Kingdom, which sought to ensure that persons who acquire shares in a company do so from their own resources and not with the financial assistance of the company itself.

Over time, this prohibition has been substantially relaxed to reflect the principle that financial assistance may be given by a company if it does not materially prejudice the interests of the company, its shareholders and creditors.<sup>1</sup>

### The Corporations Act

The Corporations Act contains a general prohibition on providing financial assistance unless the company adheres to the exemptions outlined in section 260A of the Act. The purpose of the prohibition against financial assistance is to protect a company's resources and prevent them from being diminished, or diminished in value, thus protecting the interests of creditors and shareholders.

Under section 260A of the Corporations Act, a company can only give financial assistance to a person to acquire shares (or units of shares) in itself if:

- giving the assistance does not materially prejudice the interests of the company, its shareholders or the company's ability to pay its creditors;
- the assistance is approved by shareholders under section 260B of the Corporations Act; or
- the assistance is exempted under section 260C of the Corporations Act.

### What constitutes financial assistance under Australian law?

In Australia, financial assistance occurs when a company financially assists a person to acquire its shares. Financial assistance may include the company providing a loan to that person, or providing a guarantee or other security to support that person borrowing from a financial institution to buy the shares.

The term 'financial assistance' is not defined under the Corporations Act. Australian courts have instead examined the commercial realities of the transaction to determine whether it can properly be described as the provision of financial assistance by a company. They have typically allowed a broad interpretation of what can constitute financial assistance, as evidenced in the High Court of Australia's decision in *Connective Services Pty Ltd v Sleat Pty Ltd* [2019] HCA 33 (*Connective Services*). In *Connective Services*, the High Court confirmed that 'financial assistance' should be given a broad commercial meaning; any action by the company can be financial assistance if it eases the financial burden that would be involved in the process of an acquisition, or if it improves the person's 'net balance of financial advantage' in relation to the acquisition.

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<sup>1</sup> RP Austin and IM Ramsay, 'Restrictions on a company financially assisting a person to acquire its shares' [24.670.3], *Ford's Principles of Corporations Law* (online at 19 May 2022).

In *Connective Services*, the High Court determined that Connective Services Pty Ltd had provided financial assistance when it commenced and funded legal proceedings to enforce the pre-emptive rights obligations under its constitution against a shareholder for the benefit of other shareholders. If Connective Services Pty Ltd wanted to fund and bring legal proceedings to enforce the pre-emptive rights under its constitution, then the company was prohibited from doing so unless the assistance was approved under section 260B of the Corporations Act.

Company shareholders and directors should be aware of what constitutes financial assistance, and the processes that must be followed to comply with the Corporations Act.

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## KEY CONCEPTS

### Private and public companies

Both private companies and public companies are subject to the same restrictions on providing financial assistance.

### The general rule

The provision by a company of financial assistance to a person to acquire shares in the company is generally prohibited unless the company providing financial assistance complies with section 260A of the Corporations Act, which outlines the exceptions to the general prohibition.

### Exceptions to the general rule

Section 260A of the Corporations Act provides the following three exceptions to the general rule of prohibition on financial assistance:

#### *No material prejudice*

Financial assistance may be provided by a company if the directors resolve that the financial assistance will not materially prejudice the interests of the company, its shareholders or its ability to pay its creditors. Whether the granting of financial assistance will be materially prejudicial is ultimately a question of fact.

Case law does not provide a simple path or working definition to determine whether there has or will be material prejudice. Generally, a court will assess whether the grant of financial assistance will be materially prejudicial 'by reference to the transaction with its interlocking elements giving rise to the financial assistance, taking into account its financial consequences for the interests of the company or its shareholders' (*ASIC v Adler* [2002] NSWSC 171). This requires a comparison between the position before and after the giving of financial assistance to determine whether the company, its shareholders or its ability to pay creditors is in a worse position (*Connective Services*).

In adopting this commercial approach, the courts have supported the need to consider all elements of a commercial transaction as a whole, and to determine where the net balance of financial advantage lies.

Ultimately, this will be a matter for the directors to decide, taking a view on the basis of their knowledge of the current and projected future financial and operating condition of the company.

#### *Shareholder approval*

Financial assistance is permitted if it is approved by shareholders in accordance with section 260B of the Corporations Act. Shareholder approval must be given by:

- the shareholders of each individual company providing the financial assistance (section 260B(1) of the Corporations Act);

- the shareholders of any listed holding company if the company will be a subsidiary of a listed domestic corporation immediately after the acquisition (section 260B(2) of the Corporations Act); and
- the shareholders of an ultimate Australian holding company if, immediately after the acquisition, the company will have a holding company which is an unlisted domestic corporation and which is itself a subsidiary of a domestic corporation (section 260B(3) of the Corporations Act).

Section 260B(4) of the Corporations Act provides that a notice of a meeting in relation to sections 260B(1), (2) or (3) must be accompanied by a statement to shareholders 'setting out all the information known to the company or body that is material to the decision on how to vote on the resolution'. Typically, such statements contain the following information:

- a brief summary of the financial assistance provisions contained in the Corporations Act;
- a summary of the relevant transaction; and
- a summary of the financial assistance that the company is proposing to provide, and the key benefits and risks of the proposed financial assistance for the relevant company and its shareholders.

Under section 260B(5) of the Corporations Act, copies of the statement described above and notice of the meeting of shareholders are required to be lodged with the Australian Securities & Investments Commission (ASIC) prior to their dispatch to the shareholders of the relevant company and the ultimate Australian holding company (if applicable).

In accordance with section 260B(6) and (7) of the Corporations Act, notice stating that the financial assistance has been approved must be lodged with ASIC in the prescribed form by each company and the ultimate Australian holding company. This must be lodged within 14 days of the approval of the financial assistance by the relevant shareholders, and 14 days before the financial assistance can be given.

#### *Exemptions under section 260C*

Section 260C of the Corporations Act also permits financial assistance in the following situations:

- it is given in the ordinary course of commercial dealings and is a lien on partly paid shares or a share instalment agreement;
- where the company is a financial institution, and the assistance is given in the ordinary course of that business and on ordinary commercial terms;
- the company is a subsidiary of a debenture issuer, and the financial assistance is a guarantee or other security given in the ordinary course of its commercial dealing for the debenture issuer's obligations;
- it is given under an employee share scheme and meets certain other requirements (see section 260C(4) of the Corporations Act);
- it is a reduction of share capital or a share buyback in accordance with Part 2J.1 of the Corporations Act;
- it is given under a court order; or
- it is a discharge, on ordinary commercial terms, of a liability the company incurred as a result of a transaction entered into on ordinary commercial terms.

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## **CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE**

### **What are the consequences of providing financial assistance?**

If a company provides financial assistance in contravention of section 260A of the Corporations Act, the company will not be guilty of an offence. The contravention will not affect the validity of the financial assistance, nor any contract or transaction connected with it.

However, a contravention of section 260A of the Corporations Act carries civil penalties for those persons knowingly involved in the transaction.

This would normally include the directors of the company, as 'involved' is defined broadly in section 79 of the Corporations Act. It includes being 'in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention', which would normally capture the directors of the company.