



## What is financial assistance?

### Common law prohibition against providing financial assistance

Part 2J.3 of the *Corporations Act 2001* (Cth) (**Act**) had its roots in United Kingdom legislation passed as a result of a recommendation of the Green Committee in 1926. The legislation attempted to ensure that people who acquire shares in a company do so from their own resources and without financial assistance from the company itself see: *Darvall v North Sydney Brick and Tile Co Ltd* (1989)<sup>16</sup> NSWLR 260.

The Greene Committee said:

*'A syndicate agrees to purchase from the existing shareholders sufficient shares to control a company, the purchase money is provided by a temporary loan from a bank for a day or two, the syndicate's nominees are appointed directors in place of the old board and immediately proceed to lend to the syndicate out of the company's funds (often without security) the money required to pay off the bank. Thus in effect the company provides money for the purchase of its own shares. This is a typical example although there are, of course, many variations. Such an arrangement appears to us to offend against the spirit if not the letter of the law which prohibits a company trafficking in its own shares and the practice is open to the gravest of abuses.'*

A company is generally seen as giving financial assistance if it gives something needed to carry out a transaction or something in the nature of aid or help. Common examples of giving financial assistance include:

- (a) issuing a debenture;
- (b) giving security over the company's assets; and
- (c) giving a guarantee or indemnity in respect of another person's liability.

The thing or help given does not need to be given directly to assist with the acquisition of the shares to constitute financial assistance. Examples of indirect financial assistance may include:

- (a) the giving of security by the target company to the vendors in support of existing unsecured debts of the target company;
- (b) the refinancing of secured debt with one lender with secured debt from another lender (even though the debt is not used to directly assist in the acquisition); and
- (c) a target company giving some collateral benefit to the vendor of its shares (for example, a preferential supply agreement).

*Section 260 of the Corporations Act 2001 (Cth) provides a mechanism to usurp the common law prohibition against providing financial assistance.*

where in each case, the action is a condition precedent to the acquisition going ahead.

#### **What is a financial assistance whitewash?**

A financial assistance whitewash is a procedure that involves obtaining shareholder approval of the financial assistance, the subsequent notices and ASIC lodgements as described in the Act at sections 260A to E

The current provisions in the Act regarding a company financially assisting a person to acquire shares in itself or its holding company are significantly different from those which applied prior to the commencement of the *Company Law Review Act* in 1998. The Explanatory Memorandum relating to that Act said that the previous prohibition on the giving of financial assistance was useful in deterring a range of undesirable transactions but it also inhibited many normal transactions that could be implemented if approved by shareholders.

To overcome this barrier, financial assistance is now permitted, provided that the transaction does not "materially prejudice" the interests of the shareholders or the company itself, or affects the ability of the company to pay its creditors.

Under the Act, financial assistance may be provided where the company satisfies one of three criteria; namely,

- (a) that the no material prejudice test referred to above is satisfied;
- (b) shareholder approval is obtained;
- (c) or where the assistance falls within one of the exemptions specified in sec 260C.

The providing of financial assistance in contravention of sec 260A does not affect the validity of the financial assistance or of any contract or transaction connected with it. However, any person who is involved in a company's contravention of section 260A contravenes section 260D.

Where shareholder approval is to be obtained via a financial assistance whitewash, in addition to it being obtained from the company's shareholders, in some circumstances it will also need to be obtained from the shareholders of the parent company.

The Australian Securities and Investments Commission (ASIC) must be given 14 days notice before the financial assistance is given and shareholder approval is required.

#### **What are the exceptions to providing financial assistance?**

The specified exemptions in sec 260C include a general exemption based on assistance given in the ordinary course of commercial dealing such as liens on partly paid shares and agreements for the payment of shares by instalments. Special exemptions exist for financial institutions, subsidiaries of borrowing corporations and approved employee share schemes. Also exempted are capital reductions, share buy-backs, court ordered assistance and the discharge of a liability on ordinary commercial terms.

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