HIGH COURT OF AUSTRALIA

KIEFEL CJ,
GAGELER, KEANE, GORDON AND EDELMAN JJ

CONNECTIVE SERVICES PTY LTD & ANOR APPELLANTS

AND

SLEA PTY LTD & ORS RESPONDENTS

Connective Services Pty Ltd v Slea Pty Ltd
[2019] HCA 33
9 October 2019
M203/2018

ORDER

1. *Appeal dismissed.*

2. *The appellants pay the costs of the first and second respondents.*

On appeal from the Supreme Court of Victoria

Representation

D F Jackson QC with D G Guidolin for the appellants (instructed by Quinn Emanuel Urquhart & Sullivan)

J T Gleeson SC with K E Foley and G C Kozminsky for the first and second respondents (instructed by Arnold Bloch Leibler)

Submitting appearances for the third and fourth respondents

Notice: This copy of the Court's Reasons for Judgment is subject to formal revision prior to publication in the Commonwealth Law Reports.

CATCHWORDS

Connective Services Pty Ltd v Slea Pty Ltd

Companies – Shares – Implied prohibition against financial assistance by company to acquire shares in company – Meaning of "financial assistance" – Where s 260A(1) of *Corporations Act 2001* (Cth) provides that company may financially assist a person to acquire shares in the company only if giving the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors – Where appellant companies' constitutions contained pre-emption clause which provided that, before a shareholder could transfer shares of a particular class, those shares must first be offered to existing shareholders of that class in proportion to the number of shares of that class already held by that shareholder – Where sole shareholder of one shareholder company entered into agreements for sale of shares – Where appellant companies claimed that agreements breached pre-emptive rights provisions – Where injunction sought under s 1324 of *Corporations Act* to restrain appellant companies from prosecuting proceedings in relation to pre-emptive rights on basis that proceedings contravened the prohibition against financial assistance in s 260A(1) – Whether funding by company of legal proceedings directed at compelling one shareholder to offer shares to other shareholders is financial assistance – Whether the companies should be enjoined from continuing legal proceedings at their expense to vindicate alleged breach of pre-emptive rights.

Words and phrases – "acquisition of shares", "creditors", "financial assistance", "implied prohibition against financial assistance", "injunction", "material prejudice", "power to enforce company constitution", "pre-emptive rights", "shareholders".

Corporations Act 2001 (Cth), ss 260A(1), 1324(1).

KIEFEL CJ, GAGELER, KEANE, GORDON AND EDELMAN JJ.

Introduction

1 In *Trevor v Whitworth*[1], Lord Macnaghten said that "[i]f shareholders think it worth while to spend money for the purpose of getting rid of a troublesome partner who is willing to sell, they may put their hands in their own pockets and buy him out, though they cannot draw on a fund in which others as well as themselves are interested". That concern with maintenance of corporate capital was extended by statutory provisions which provided protection for shareholders and creditors from a company giving financial assistance to acquire its shares. This appeal concerns the scope of the implied prohibition in s 260A(1) of the *Corporations Act 2001* (Cth) against financial assistance by a company to acquire shares in the company where the financial assistance is said to materially prejudice the interests of the company or its shareholders.

2 The question on this appeal is whether the appellant companies should be enjoined from continuing legal proceedings at their expense to vindicate alleged pre-emptive rights of their shareholders to be offered for purchase shares in the companies, which rights the companies allege have been breached. For the reasons below, the Court of Appeal of the Supreme Court of Victoria was correct to conclude that s 260A(1) was contravened and that an injunction must issue.

Background

3 In 2003, the two appellant companies (which can be described collectively as "the Connective companies") were incorporated to conduct a mortgage aggregation business. At all relevant times, the shareholders in the Connective companies have been: (i) the first respondent (Slea Pty Ltd, "Slea") with 33.33%; (ii) the third respondent (Millsave Holdings Pty Ltd, "Millsave") with 50%; and (iii) the fourth respondent ("Mr Haron") with 16.67%. Since 2011, the directors of the Connective companies have been Mr Haron, Mr Lees (who is associated with Millsave), and Mr Maloney.

4 The constitution of each Connective company contained an identical pre-emption clause ("the pre-emptive rights provisions"). In broad terms, the pre-emptive rights provisions required that before a shareholder could transfer shares of a particular class, those shares must first be offered to existing shareholders of

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1 (1887) 12 App Cas 409 at 436.

that class in proportion to the number of shares of that class already held by that shareholder.

5 In May 2009, the sole director and sole shareholder of Slea, Mr Tsialtas, entered an agreement with the second respondent (Minerva Financial Group Pty Ltd, "Minerva") for the sale of Mr Tsialtas' shares in Slea ("the 2009 Agreement"). Shortly afterwards, Mr Tsialtas disclosed the existence of the 2009 Agreement to the Connective companies. There is a dispute about whether the 2009 Agreement has been terminated by Mr Tsialtas, as Slea and Minerva claim.

6 In August 2010, Slea, Minerva and Mr Tsialtas entered a second agreement, entitled "Accommodation Agreement". In December 2011, in Slea's amended defence to a separate proceeding brought by Mr Haron, the existence of the Accommodation Agreement was disclosed to Mr Haron, the Connective companies, and Millsave. Slea also disclosed the Accommodation Agreement in an oppression proceeding against Mr Haron, the Connective companies, and Millsave.

7 On 11 August 2016, the Connective companies instituted proceedings against Slea and Minerva, also joining Millsave and Mr Haron as defendants ("the pre-emptive rights proceeding"). In the pre-emptive rights proceeding the Connective companies claimed that the 2009 Agreement and the Accommodation Agreement breached the pre-emptive rights provisions, and alleged that Slea intended, and still intends, to transfer its shares in the Connective companies to Minerva without complying with the pre-emptive rights provisions. The relief sought by the Connective companies included an order to compel Slea to offer its shares in the Connective companies to Millsave and Mr Haron in accordance with the pre-emptive rights provisions.

8 On 4 October 2016, Slea and Minerva applied by summons to have the pre-emptive rights proceeding dismissed or stayed. One form of relief sought by Slea and Minerva was an injunction under s 1324 of the *Corporations Act* to restrain the Connective companies from prosecuting the pre-emptive rights proceeding on the basis that by doing so they were in contravention of the implied prohibition against financial assistance in s 260A(1) of the *Corporations Act*. It is that application that is the subject of this appeal.

The prohibition against financial assistance

The background to s 260A(1) of the Corporations Act

9 The statutory prohibition against financial assistance was introduced in the United Kingdom in 1929 following a recommendation from the Company Law Amendment Committee, headed by Lord Greene[2]. The Greene Committee expressed concern about a practice, which it described as "highly improper"[3], by which a company provided money for the purchase of its own shares. The Greene Committee recommended that "companies should be prohibited from directly or indirectly providing any financial assistance in connection with a purchase (made or to be made) of their own shares by third persons, whether such assistance takes the form of loan, guarantee, provision of security, or otherwise"[4]. This recommendation was adopted in the United Kingdom in the *Companies Act 1929* (UK)[5].

10 The statutory prohibition went further than the rule, reiterated in the decision of the House of Lords in *Trevor v Whitworth*[6], that a corporation cannot "traffic" in its own shares. The rule in *Trevor v Whitworth* was concerned with capital maintenance but the rationale for the statutory prohibition came to be understood as operating on a wider basis of protecting against abuse of the rights of the company's creditors and shareholders, particularly minority shareholders[7].

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2 Great Britain, *Report of the Company Law Amendment Committee* (1926) Cmd 2657 ("the Greene Committee") at 14 [31].

3 Great Britain, *Report of the Company Law Amendment Committee* (1926) Cmd 2657 at 14 [30]. See also *In re V G M Holdings Ltd* [1942] Ch 235 at 239.

4 Great Britain, *Report of the Company Law Amendment Committee* (1926) Cmd 2657 at 14 [31].

5 *Companies Act 1929* (UK), s 45(1).

6 (1887) 12 App Cas 409 at 416-417, 423-424, 433, 436.

7 Great Britain, Board of Trade, *Report of the Company Law Committee* (1962) Cmnd 1749 ("the Jenkins Committee") at 62 [173]; *Dempster v National Companies and Securities Commission* (1993) 9 WAR 215 at 267. See also Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th ed (2018) at 1813 [24.670].

11 From 1931, when the United Kingdom provisions were first adopted in State legislation in Australia[8], until the form of the present prohibition was introduced into the *Corporations Law* in 1998[9], the prohibition underwent a process of refinement, including in response to the Jenkins Committee in the United Kingdom and judicial decisions[10]. The immediate predecessor provision to s 260A of the *Corporations Law* (which became s 260A of the *Corporations Act*) was s 205(1) of the *Corporations Law*[11]. In broad terms, and with exceptions, that provision prohibited a company from "directly or indirectly" giving financial assistance "for the purpose of, or in connection with ... the acquisition by any person", or the "proposed acquisition by any person", of shares or units of shares in the company.

12 In *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd*[12], Hoffmann J considered the terms of the offence in s 54 of the *Companies Act 1948* (UK), which was in relevantly similar terms to s 205(1) of the *Corporations Law*. Hoffmann J explained that there were "two elements"[13] to that offence: (i) the giving of financial assistance, and (ii) "that it should have been given 'for the purposes of or in connection with' ... a purchase of shares". The focus of Hoffmann J was only upon the first element, financial assistance, because, as he explained, without financial assistance the second element of "the purpose and

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8 *Companies Act 1931* (Qld), s 57(1). See also *Companies Act 1934* (SA), s 62(1); *Companies Act 1936* (NSW), s 148(1); *Companies Act 1938* (Vic), s 45(1); *Companies Act 1943* (WA), s 59(2); *Companies Act 1959* (Tas), s 55(1), (2).

9 *Company Law Review Act 1998* (Cth), Sch 1.

10 See Fletcher, "Financial Assistance around the Pacific Rim" (2006) 6 *Oxford University Commonwealth Law Journal* 157 at 162.

11 *Corporations Law*, s 205(1), set out in *Corporations Act 1989* (Cth), s 82. Applied by *Corporations (New South Wales) Act 1990* (NSW), s 7; *Corporations (Victoria) Act 1990* (Vic), s 7; *Corporations (South Australia) Act 1990* (SA), s 7; *Corporations (Queensland) Act 1990* (Qld), s 7; *Corporations (Western Australia) Act 1990* (WA), s 7; *Corporations (Tasmania) Act 1990* (Tas), s 7.

12 [1986] BCLC 1.

13 [1986] BCLC 1 at 10. See also *British and Commonwealth Holdings Plc v Barclays Bank Plc* [1996] 1 WLR 1 at 14-15; [1996] 1 All ER 381 at 395-396; *Chaston v SWP Group Plc* [2003] 1 BCLC 675 at 682 [17].

the connection would not be important"[14]. The element of purpose or connection did not need to be considered because the defendant, which had sought to resist an action for specific performance on the basis that the agreement contravened s 54, failed to discharge the burden of proving that the transaction involved financial assistance.

13 In focusing upon the meaning of the first element, of "financial assistance", Hoffmann J echoed earlier remarks of Mahoney JA (with whom Samuels JA agreed) in the Court of Appeal of the Supreme Court of New South Wales that the words "financial assistance" are "words of a commercial rather than a conveyancing kind"[15]. Hoffmann J said that those words "have no technical meaning and their frame of reference is ... the language of ordinary commerce"[16]. He then added[17]:

> "One must examine the commercial realities of the transaction and decide whether it can properly be described as the giving of financial assistance by the company, bearing in mind that the section is a penal one and should not be strained to cover transactions which are not fairly within it."

14 The approach taken by Hoffmann J to financial assistance was relied upon in numerous cases in Australia under s 205(1) of the *Corporations Law* and its predecessors[18]. However, the flexible focus upon "commercial realities" did not

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14 [1986] BCLC 1 at 10, quoting *Gradwell (Pty) Ltd v Rostra Printers Ltd* 1959 (4) SA 419 at 425.

15 *Burton v Palmer* [1980] 2 NSWLR 878 at 890.

16 [1986] BCLC 1 at 10. See also *Chaston v SWP Group Plc* [2003] 1 BCLC 675 at 687 [32]; *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311 at 332 [50], quoting *British and Commonwealth Holdings Plc v Barclays Bank Plc* [1996] 1 WLR 1 at 14; [1996] 1 All ER 381 at 395: "The words 'financial assistance' are not words which have any recognised legal significance".

17 [1986] BCLC 1 at 10. See also *Chaston v SWP Group Plc* [2003] 1 BCLC 675 at 682-683 [17], 688 [38]; *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* [2008] 1 BCLC 185 at 191 [27].

18 See, eg, *Dempster v National Companies and Securities Commission* (1993) 9 WAR 215 at 274-275; *Milburn v Pivot Ltd* (1997) 78 FCR 472 at 501; *Tallglen Pty Ltd v Optus Communications Pty Ltd* (1998) 146 FLR 380 at 385; *Wambo*

(Footnote continues on next page)

resolve the conflict in the Australian authorities concerning whether a company's conduct must cause a diminution of the assets of the company before it can amount to financial assistance[19]. On one view, it was said that such an implication would "ignore the plain language of the Act"[20]. On another view, it was thought that without an implied restriction, in that form or some related form, the literal terms of the prohibition could extend beyond "the policy reasons [for] the prohibition"[21] to ordinary or "innocuous"[22] commercial conduct by the company, not falling within an exemption[23], that causes no material prejudice to the company, its shareholders, or its creditors.

Section 260A of the Corporations Act

15 Section 205 of the *Corporations Law* was replaced in 1998[24] by s 260A, which reflected the recommendations of the Corporations Law Simplification

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Mining Corp Pty Ltd v Wall Street (Holding) Pty Ltd (1998) 28 ACSR 654 at 667-668; *Sterileair Pty Ltd v Papallo* (1998) 29 ACSR 461 at 465.

19 *Burton v Palmer* [1980] 2 NSWLR 878 at 881; *Re Myer Retail Investments Pty Ltd and the Companies Act 1981* (1983) 48 ACTR 41 at 49; *Darvall v North Sydney Brick & Tile Co Ltd* (1987) 16 NSWLR 212 at 246; *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260 at 297; *Re National Mutual Royal Bank Ltd* [1992] 1 Qd R 533 at 540; *ZBB (Australia) Ltd v Allen* (1991) 4 ACSR 495 at 503-504; *R v Roget* (1992) 7 WAR 356 at 368; *Dempster v National Companies and Securities Commission* (1993) 9 WAR 215 at 273-275; *Milburn v Pivot Ltd* (1997) 78 FCR 472 at 502-503; *Tallglen Pty Ltd v Optus Communications Pty Ltd* (1998) 146 FLR 380 at 387-388.

20 *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260 at 291.

21 *Dempster v National Companies and Securities Commission* (1993) 9 WAR 215 at 267.

22 *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* [2008] 1 BCLC 185 at 191 [26].

23 Compare *Companies (Western Australia) Code*, s 129(8)(c) with *Companies Act 1961* (NSW), s 67(2), discussed in *Dempster v National Companies and Securities Commission* (1993) 9 WAR 215 at 266-267 and *Burton v Palmer* [1980] 2 NSWLR 878 at 881.

24 *Company Law Review Act 1998* (Cth), Sch 1.

Task Force[25]. Section 260A of the *Corporations Act*, which is materially identical to s 260A of the *Corporations Law*, relevantly provides as follows:

> "**Financial assistance by a company for acquiring shares in the company or a holding company**
>
> (1) A company may financially assist a person to acquire shares (or units of shares) in the company or a holding company of the company only if:
>
> (a) giving the assistance does not materially prejudice:
>
> (i) the interests of the company or its shareholders; or
>
> (ii) the company's ability to pay its creditors; or
>
> (b) the assistance is approved by shareholders under section 260B (that section also requires advance notice to ASIC); or
>
> (c) the assistance is exempted under section 260C.
>
> Note: For the criminal liability of a person dishonestly involved in a contravention of this section, see subsection 260D(3). Section 79 defines ***involved***."

16 The general purpose of the amendments introduced in s 260A of the *Corporations Law* was to "improve the substance and the drafting of the current rules, eliminating unnecessary or redundant regulation and making the Law more readily understandable"[26]. The re-drafted s 260A, like the capital reduction provisions in ss 256B and 257A, was expressed in permissive terms although it contained an implied prohibition. The simplification of s 260A omitted the express references contained in the predecessor provision to a "proposed

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25 See Fletcher, "F A, after 75 years" (2005) 17 *Australian Journal of Corporate Law* 323 at 329; Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th ed (2018) at 1812 [24.670].

26 Australia, House of Representatives, *Company Law Review Bill 1997*, Explanatory Memorandum at 1 [1.2]. See also Australia, House of Representatives, *Parliamentary Debates* (Hansard), 3 December 1997 at 11930-11931.

acquisition" and to giving financial assistance "directly or indirectly". But the concept of financial assistance remained a commercial notion and, as explained below, despite the omissions the implied prohibition could not have been intended to permit indirect financial assistance or financial assistance for proposed acquisitions.

17 However, important substantive changes were introduced in s 260A, including (i) the introduction of an express requirement that the assistance cause material prejudice to the interests of the company or its shareholders or to the company's ability to pay its creditors, and (ii) an exception for financial assistance that is approved by the shareholders of the company following the procedure in s 260B. The reason for these changes was described in the Explanatory Memorandum as follows[27]:

> "This approach is intended to minimise the difficulties the rule currently causes for ordinary commercial transactions. In particular, for transactions which do not involve material prejudice, the new rules will make it unnecessary to decide whether the transaction involves the giving of financial assistance. The new rules will bring the requirements for financial assistance more closely into line with those proposed for capital reductions."

18 Again mirroring the capital reduction provisions in ss 256B and 257A, a focus of the new s 260A was therefore directed towards material prejudice. That express requirement of material prejudice, together with complete exemptions for various conduct in the ordinary course of commercial dealing, thus removed the need for, and controversy surrounding, various implied restrictions to similar effect within the element of "financial assistance".

19 As was the case in relation to its predecessor provisions[28], although s 260A(1) is directed at the company, a concern of the statutory prohibition, in

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27 Australia, House of Representatives, *Company Law Review Bill 1997*, Explanatory Memorandum at 73 [12.76]. See also Australia, House of Representatives, *Parliamentary Debates* (Hansard), 3 December 1997 at 11932.

28 *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260 at 292-293; *Dempster v National Companies and Securities Commission* (1993) 9 WAR 215 at 264.

common with duties including those of directors and other officers[29], is to establish liability of those officers who are sufficiently involved in the contravention. Hence, although a contravention of s 260A by a company does not affect the validity of any contract or transaction connected with the financial assistance[30], and does not make the company liable for an offence[31], the consequences of a contravention of s 260A may be serious for a person who is "involved"[32] in that contravention. Such a person commits a separate contravention[33] and is exposed to civil penalties[34], including pecuniary penalty orders[35] and compensation orders[36]. If the person's involvement in the breach is dishonest, then that person commits an offence under s 260D(3), with a maximum penalty of 2,000 penalty units or imprisonment for five years or both[37]. However, although the potential penal consequences are part of the context within which s 260A(1) falls to be interpreted and applied, this context should not distract the court from "its primary task of extracting the intention of the legislature from the fair meaning of words by which it has expressed that intention", particularly where that intention is to afford protection to a person or entity[38].

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29 See *Corporations Act 2001* (Cth), s 260E; Wellington, "Regulating financial assistance: An obsolete regime" (2008) 26 *Company and Securities Law Journal* 7 at 27-33; Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th ed (2018) at 1813 [24.670].

30 *Corporations Act 2001* (Cth), s 260D(1)(a).

31 *Corporations Act 2001* (Cth), s 260D(1)(b).

32 *Corporations Act 2001* (Cth), s 79.

33 *Corporations Act 2001* (Cth), s 260D(2).

34 *Corporations Act 2001* (Cth), s 1317E(1), table item 4.

35 *Corporations Act 2001* (Cth), s 1317G.

36 *Corporations Act 2001* (Cth), s 1317H.

37 *Corporations Act 2001* (Cth), Sch 3, item 90.

38 *Waugh v Kippen* (1986) 160 CLR 156 at 164; [1986] HCA 12, after quoting from *Beckwith v The Queen* (1976) 135 CLR 569 at 576; [1976] HCA 55.

20 The three elements necessary to establish a contravention of s 260A(1) that are relevant to this appeal are: (i) financial assistance given by the company; (ii) to acquire shares or units of shares in the company; and (iii) which materially prejudices the interests of the company or its shareholders or its ability to pay its creditors. The Connective companies deny the existence of each of these elements in their ground of appeal in this Court.

Financial assistance

21 As explained above, the re-drafted s 260A(1) was intended to resolve the uncertainty surrounding the application of the element of "financial assistance" by removing any issue concerning diminution or depletion of assets to a separate element of material prejudice in s 260A(1)(a)[39]. That element is considered separately below. It suffices to observe the breadth of the element of financial assistance in s 260A.

22 The financial assistance need not involve a money 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"[40] in relation to the acquisition. For instance, the assistance might involve the company paying a dividend by means other than by payment of cash[41], issuing a debenture[42], granting security[43], or agreeing to pay consultancy fees[44]. The breadth of the notion of financial assistance is particularly evident by s 260C, which creates exemptions for matters that would otherwise involve financial assistance. The exemptions include: (i) in the ordinary course of

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39 See also Ooi, "The Financial Assistance Prohibition: Changing Legislative and Judicial Landscape" (2009) *Singapore Journal of Legal Studies* 135 at 148-149; Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th ed (2018) at 1816-1817 [24.710].

40 *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd* [1986] BCLC 1 at 11.

41 *Corporations Act 2001* (Cth), s 260A(2)(b); see also s 254U(1).

42 *Victor Battery Co Ltd v Curry's Ltd* [1946] Ch 242.

43 *Firmin v Gray & Co Pty Ltd* [1985] 1 Qd R 160.

44 *Independent Steels Pty Ltd v Ryan* [1990] VR 247.

commercial dealing creating a lien on partly paid shares in the company for amounts payable to the company on the shares[45]; (ii) in the ordinary course of commercial dealing entering into an agreement to permit the person to make payments to the company on shares by instalments[46]; (iii) a discharge on ordinary commercial terms of a liability that the company incurred as a result of a transaction entered into on ordinary commercial terms[47]; and (iv) "assistance given under a court order"[48].

To acquire shares or units of shares

23 The words "to acquire" require a sufficient link between the financial assistance and the acquisition of the shares or units of shares. Section 260A(1) does not require that an acquisition actually take place, since the provision can be contravened[49] and injunctions can be ordered[50] before any acquisition actually takes place. In this sense, "to acquire", like the express words of s 205(1) of the *Corporations Law*, includes conduct that is in connection with the process of an acquisition of the shares or units of shares and not limited to conduct for the purpose of acquisition. Acquisition also has broad connotations. It does not require a transaction or transfer. It includes acquisitions by issue or transfer or any other means[51].

24 The Connective companies referred to a number of examples which might be brought outside the operation of s 260A by a strict test for connection. The examples given by the Connective companies all concerned conduct by a company to enforce pre-emption requirements that might be contained in its constitution. The Connective companies submitted that provisions in the *Corporations Act* that recognise that conduct do not sit well with a "broad

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45 *Corporations Act 2001* (Cth), s 260C(1)(a).

46 *Corporations Act 2001* (Cth), s 260C(1)(b).

47 *Corporations Act 2001* (Cth), s 260C(5)(d).

48 *Corporations Act 2001* (Cth), s 260C(5)(c).

49 *Corporations Act 2001* (Cth), s 260A(2)(a).

50 *Corporations Act 2001* (Cth), s 1324(1).

51 *Corporations Act 2001* (Cth), s 260A(3).

interpretation" of s 260A. The examples were of acts by a company in exercising a power[52] to refuse to register a share transfer to any of the following: (i) the personal representative of a deceased shareholder[53]; (ii) a person[54] or trustee in bankruptcy[55] entitled to shares upon the bankruptcy of the shareholder; and (iii) a person entitled to shares on mental incapacity of a shareholder[56]. When the requirement of connection is properly applied none of these examples is automatically exempted from the operation of s 260A. It may be that in many such cases a company's conduct in enforcing its constitution by refusal of registration will occasion no material prejudice. However, if the company's conduct causes material prejudice to the interests of the company or its shareholders or the company's ability to pay its creditors, such as if the company's conduct includes incurring the cost of commencing and maintaining associated legal proceedings that would often be brought by others, there is no textual basis, nor any reason of principle, why s 260A must be incapable of extending to such conduct arising from any of these examples.

Material prejudice

25 The potential breadth of s 260A is constrained by the requirement of the implied prohibition that, by s 260A(1)(a), the financial assistance to acquire shares be materially prejudicial to the interests of the company or its shareholders or its ability to pay its creditors. Consistently with the protective purpose of s 260A(1), and its concern with minority shareholders, the reference to its "shareholders" must mean both the shareholders collectively and each shareholder individually.

26 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. It does not assist to gloss the concept of material prejudice by

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52 *Corporations Act 2001* (Cth), s 1072G.

53 *Corporations Act 2001* (Cth), s 1072A.

54 *Corporations Act 2001* (Cth), s 1072B.

55 *Corporations Act 2001* (Cth), s 1072C.

56 *Corporations Act 2001* (Cth), s 1072D.

the introduction of further concepts, which themselves require further explanation, such as whether there has been a diminution of the assets of the company, whether there has been a transaction, or whether there was a net transfer of value to the person acquiring the shares. For instance, the introduction of a requirement not present in the text of s 260A(1) of a transaction with, or a net transfer of value to, the person acquiring the shares could lead to further issues such as whether the interposition of intermediaries is included within those concepts.

27 As the Explanatory Memorandum to the 1998 amendments said, the question of material prejudice is fact-intensive and "it will not be possible to determine whether the transaction involves material prejudice merely by reference to arbitrary rules, such as the percentage impact the transaction will have on the company's profit"[57]. To borrow an example from Hutley JA in *Burton v Palmer*[58], a company might compromise a claim in relation to the transfer of shares in the interests of the company as a whole, but in some cases it "may be a nice question" whether the compromise materially prejudices the interests of the company or its shareholders or its ability to pay its creditors.

The onus of proof

28 It has been said that a company disputing the application of s 260A(1) bears the substantive onus of proof to negate material prejudice in all cases[59]. That issue did not arise in this appeal and was not the subject of any submissions in this Court. Relevantly to this appeal, s 1324(1B) provides that in an application for an injunction based upon an alleged contravention of s 260A(1)(a), the court "must assume that the conduct constitutes, or would constitute, a contravention of [s 260A(1)(a)] unless the company or person proves otherwise". In relation to s 1324(1B), the Court of Appeal correctly concluded that, in proceedings for an injunction under s 1324(1) to restrain a contravention of s 260A(1)(a), s 1324(1B) required the Connective companies to

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57 Australia, House of Representatives, *Company Law Review Bill 1997*, Explanatory Memorandum at 73 [12.77].

58 [1980] 2 NSWLR 878 at 880.

59 *Adler v Australian Securities and Investments Commission* (2003) 179 FLR 1 at 88 [410]-[411]. See also Austin and Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th ed (2018) at 1820 [24.710].

disprove that their conduct constituted a contravention of s 260A(1)(a)[60]. The Connective companies were therefore required in the application for an injunction to disprove each element of "the conduct" that "would constitute" a contravention of s 260A(1)(a), including those in the prefatory words.

The decisions of the primary judge and the Court of Appeal

29 Before the primary judge, Almond J, Slea and Minerva sought a dismissal or stay of the pre-emptive rights proceeding on a number of bases[61]. One basis was that since the Accommodation Agreement had been obtained in discovery as part of other litigation, the pre-emptive rights proceeding had been commenced in breach of the Connective companies' legal obligation, historically described as an implied undertaking, not to use the Accommodation Agreement for any purpose other than that litigation[62]. The primary judge granted a stay on that ground[63]. However, the Connective companies subsequently applied for, and were given, leave nunc pro tunc to use the Accommodation Agreement for the purpose of commencing the pre-emptive rights proceeding[64].

30 An alternative form of relief sought by Slea and Minerva before the primary judge is the subject of this appeal. They sought an injunction under s 1324(1) of the *Corporations Act* to restrain the Connective companies from prosecuting the pre-emptive rights proceeding on the basis that by doing so they were in violation of the implied prohibition against financial assistance in s 260A(1) of the *Corporations Act*.

31 The primary judge held that the Connective companies had not contravened s 260A[65]. Central to his Honour's reasoning was the absence of a transaction between the Connective companies and Millsave or Mr Haron. The search for a transaction, which is not a requirement of s 260A, led his Honour to

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60 *Slea Pty Ltd v Connective Services Pty Ltd* (2018) 359 ALR 159 at 173 [75].

61 *Connective Services Pty Ltd v Slea Pty Ltd* (2017) 53 VR 130 at 135 [10].

62 See *Hearne v Street* (2008) 235 CLR 125 at 157-160 [105]-[108]; [2008] HCA 36.

63 *Connective Services Pty Ltd v Slea Pty Ltd* (2017) 53 VR 130 at 159-160 [116].

64 *Slea Pty Ltd v Connective Services Pty Ltd* (2017) 53 VR 161 at 179 [73].

65 *Connective Services Pty Ltd v Slea Pty Ltd* (2017) 53 VR 130 at 159 [115].

the conclusion that the commercial realities of the pursuit of the pre-emptive rights proceeding by the Connective companies were that the Connective companies had "simply brought the proceeding in order to ensure that their constitutions are followed according to their terms"[66]. The primary judge also said that there was no benefit conferred on Millsave or Mr Haron, accepting the submission by the Connective companies that the rights of Millsave and Mr Haron to be offered the shares existed prior to any proceeding, and also drawing a distinction between the acquisition of shares and the offer of shares pursuant to a pre-emptive right[67].

32 The Court of Appeal (Ferguson CJ, Whelan and McLeish JJA) allowed the appeal by Slea and Minerva. Although the Court of Appeal, adopting the common submissions of the parties, added an unnecessary element to s 260A(1) of a "net transfer of value"[68], the Court of Appeal nevertheless concluded that s 260A(1) had been contravened[69]. The Court of Appeal held that the "commercial consequence" was that since Slea would not make the pre-emptive offer without a court order, some action was required to be taken to enforce the existing right. As the pre-emptive rights proceeding sought to procure that outcome, it assisted Millsave and Mr Haron to acquire shares in the Connective companies if they decided to accept the offer[70]. By bringing the pre-emptive rights proceeding, the Connective companies had financially assisted Millsave and Mr Haron since there was no evidence that Millsave and Mr Haron had incurred any costs or taken on any potential cost liability[71].

The Connective companies contravened s 260A(1)

33 The broad concept of financial assistance, described above, extends beyond direct contributions to the share price. Examples of financial assistance

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66 *Connective Services Pty Ltd v Slea Pty Ltd* (2017) 53 VR 130 at 156-157 [97].

67 *Connective Services Pty Ltd v Slea Pty Ltd* (2017) 53 VR 130 at 157 [98].

68 *Slea Pty Ltd v Connective Services Pty Ltd* (2018) 359 ALR 159 at 170 [60], 174 [77].

69 *Slea Pty Ltd v Connective Services Pty Ltd* (2018) 359 ALR 159 at 174 [78].

70 *Slea Pty Ltd v Connective Services Pty Ltd* (2018) 359 ALR 159 at 173 [77].

71 *Slea Pty Ltd v Connective Services Pty Ltd* (2018) 359 ALR 159 at 173 [77].

by a company include the reduction of the financial burden of acquisition by payment of the costs of stamp duty, valuation costs, or, as has been held in the context of a differently worded provision in England, incurring due diligence costs which "smoothed the path to the acquisition of shares"[72].

34 Bringing legal proceedings against Slea was a necessary step for the vindication of any pre-emptive rights of Millsave and Mr Haron. Those legal proceedings could have been commenced by Millsave and Mr Haron[73]. If they had been so commenced, then it would plainly have been financial assistance for the Connective companies to provide the funds for Millsave and Mr Haron's proceedings just as it would have been financial assistance to provide funds for stamp duty, valuation costs, or due diligence costs. Instead, the proceedings were commenced at the expense of the Connective companies, in which Millsave and Mr Haron hold 66.67% of the shares. The Connective companies eased a financial burden in the process of any acquisition of shares by Millsave and Mr Haron. The commencement of the pre-emptive rights proceeding by the Connective companies, at their expense, was financial assistance to Millsave and Mr Haron.

35 The Connective companies submitted that any financial assistance by the companies was not to acquire shares in the companies. Although Slea would not make the pre-emptive offer without a court order, and hence a court order was a necessary step towards an acquisition of shares, the Connective companies submitted that the pre-emptive rights proceeding would not "create any new rights" and that, in any event, the pre-emptive rights were only to be offered shares for purchase. The pre-emptive rights would not necessarily give rise to an acquisition. This narrow approach to the requirement that the financial assistance be to acquire shares or units of shares is not consistent with the breadth of application of the words "to acquire" as extending to all conduct in connection with the process of acquiring the shares or units of shares. For instance, as the Connective companies rightly accepted, even the final act in that process, namely registration of shares, can be in connection with an acquisition if one party has refused to transfer shares in which the other has an equitable interest. Further, the process of acquisition does not exclude any court recognition of pre-emptive rights merely because the rights, if exercised, would not result in the

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72 *Chaston v SWP Group Plc* [2003] 1 BCLC 675 at 688 [38].

73 See, eg, *Grant v John Grant & Sons Pty Ltd* (1950) 82 CLR 1 at 3, 18, 29; [1950] HCA 54.

acquisition of shares. Indeed, s 260A(1) includes the acquisition of "units of shares" and a "unit" of shares is defined in s 9 of the *Corporations Act* in terms that include "an option to acquire such a right or interest in the share". The Connective companies thus financially assisted Millsave and Mr Haron to acquire shares, or units of shares, in the companies.

36 The Connective companies then submitted that any financial assistance they gave would not materially prejudice the interests of the companies or their shareholders or the ability of the companies to pay their creditors. As explained above, the Connective companies properly accepted in this Court that they bore the onus of negating this element before the primary judge.

37 The Connective companies will incur costs in conducting the pre-emptive rights proceeding which, even if they succeed, will not be entirely recovered. Before the primary judge, Slea led evidence that the estimated cost of the pre-emptive rights proceeding was $525,000 to $755,000 in addition to any potential adverse costs orders[74]. As a shareholder, Slea's equity may be reduced by these costs of the pre-emptive rights proceeding, which is a step towards compelling Slea to offer its shares for transfer to Millsave and Mr Haron. The pre-emptive rights proceeding could, and commonly would, have been brought by Millsave and Mr Haron in their own right. Yet the Connective companies led no evidence to explain whether they had even sought funding or indemnity from costs liability from Millsave and Mr Haron. The Connective companies did not discharge their onus of proving that there was no material prejudice to them or their shareholders by giving the financial assistance to Millsave and Mr Haron.

Conclusion

38 The Connective companies submitted that if the Court of Appeal's decision were to stand then a company would have no practical ability to enforce pre-emptive rights provisions in its constitution. That submission is not correct. Section 140(1) of the *Corporations Act* provides that a company's constitution has effect as a contract "between the company and each member" and "between a member and each other member". However, s 140(1) of the *Corporations Act* cannot be read divorced from other provisions of the *Corporations Act* with which it may intersect.

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74 *Connective Services Pty Ltd v Slea Pty Ltd* (2017) 53 VR 130 at 154 [82].

Kiefel CJ
Gageler J
Keane J
Gordon J
Edelman J

39 Section 260A(1) does not abrogate the power of a company to enforce its constitution. However, together with s 1324(1B), it has the effect 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, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s 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. The Connective companies failed to discharge this onus.

40 The appeal should be dismissed. As the third and fourth respondents entered submitting appearances, the appellants should pay the costs of the first and second respondents.