Financial Assistance around the Pacific Rim: the persistence of dysfunctional provisions

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The giving of financial assistance by a company for the acquisition of shares in it or its holding company by a third party is, in the absence of legislative intervention, strictly a matter to be determined by directors charged with the management of a company. The decision to grant such assistance is an unusual exercise of discretion but not necessarily improper. In consequence some commentators have called for the repeal of existing regulatory provisions whereas others have expressed strong reservations about the validity of the practice.

Financial assistance is a problem because it does not fit neatly into established regulatory categories. An exercise of discretion is ordinarily sufficiently regulated by the concept of fiduciary obligation and related penalties for misuse of powers. However a wrongful or misguided exercise of the power to grant financial assistance by the directors may deprive existing creditors of the company, who had dealt with it upon a particular assessment of the company’s financial strength, of the right to levy execution over the company’s former assets. Nevertheless a decision to grant financial assistance, unlike the decision to return company capital to shareholders,

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1 Hereinafter ‘financial assistance.’
2 The Supreme Court of Canada recognised in Hughes v Northern Electric and Manufacturing Co (1915) 21 DLR 358 at 363-4 that, while giving financial assistance was not an ordinary power of a company, it was not prohibited. In that case, a company gave vendors of its shares a security over its assets to secure both its indebtedness to them and for unpaid purchase moneys. This decision is supported by dicta in Durack v West Australian Trustee Executor & Agency Co Ltd (1944) 72 CLR 189, per Rich J at 202 and Williams J at 218-20.
5 For example, Corporations Act 2001 (Cth), ss 181-183 (civil penalty provisions) and s 184 (criminal liability for reckless or intentionally dishonest exercise of powers); Companies Act 1993 (NZ), ss 131, 133 and 137 - 8.
6 Exemplified by Trevor v Whitworth (1887) 12 App Cas 409, which determined that the unrestricted return of capital to shareholders was “contrary to the plain intention of the Act…and inconsistent with the conditions upon which…parliament has granted the right of trading in corporate form with limited liability” at 433 per Lord Macnaghten, adopting the view expressed by Jessel MR in Re Exchange Banking Co (Flitcroft’s case) (1882) 21 ChD 519, at 533-4.
with which it is sometimes compared, does not necessarily result in any diminution of company assets. Arguably the practice, if it is to be regulated, ought, therefore, to be regarded as a less risky activity than a share buyback and the prime role of regulation should be to ensure that creditors receive due notice of the company’s intention to undertake a financial assistance transaction and opportunity to oppose the dealing, if it could significantly affect the solvency of the company. Nevertheless, in many jurisdictions, the barriers to a grant of financial assistance are higher than for a return of capital.

The Recognised Problem

Financial assistance emerged as a problem in the United Kingdom after the First World War. The Greene Committee, established to review the shareholders who alleged that their shareholdings had been purchased by persons using company money or money borrowed on the security of company assets to effect the purchase. The Committee was satisfied that this practice should not be permitted. In their Report, they gave an example of the type of transaction to which their recommendation was directed:

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 the 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. The Committee considered that “[s]uch 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 abuses”. The Greene Committee did not elaborate upon this assertion but the later Jenkins Committee explained that,

[J]If people who cannot provide the funds necessary to acquire control of a company from their own resources, or by borrowing on their own

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7 Lipton P & Herzberg A, Understanding Company Law, 12th ed, 2004 at 192 contrast Dugan R, Company Law – a transactional approach, 1994 at 185 who suggests that “[t]he better view is that the rule is designed to prevent the risks associated with a transfer of control being shifted onto the firm’s unsecured creditors.” This is true but supported by the (United Kingdom) Board of Trade, Report of the Company Law Committee (Lord Jenkins chair), HMSO, London, Cmnd 1749, 1962 at [173], rather than the authority cited.

8 The following historical material draws heavily on an earlier exploration of financial assistance issues in Fletcher K, “Re-baiting the financial assistance trap” (2000) 11 Australian Journal of Corporate Law 119 at 121-127.

9 So called, after its chair, Wilfrid Greene, later Lord Greene MR but, more formally, the (United Kingdom) Company Law Amendment Committee. Established 1924; report published as Command Paper 2657 of 1926.

10 Above n 9 at [30], reproduced in Ford, above n 4 at [24.670]. A more sophisticated form of this transaction occurred where the syndicate made a takeover offer, on delayed payment terms, and, after taking control of the company, loaned themselves the money to pay the former shareholders out of company funds. In this situation, the syndicate members avoided the necessity of borrowing money from a bank or other lender to finance the transaction.

11 Ibid.
credit, gain control of a company with large assets on the understanding that they will use the funds of the company to pay for their shares it seems to us all too likely that in many cases the company will be made to part with its funds either on inadequate security or for an illusory consideration. If the speculation succeeds, the company and therefore its creditors and minority shareholders may suffer no loss, although their interests will have been subjected to an illegitimate risk; if it fails, it may be little consolation for creditors and minority shareholders to know that the directors are liable for misfeasance.  

The Response: Prohibition

The Greene Committee’s recommendation that the practice be prohibited was adopted by the United Kingdom Parliament in Companies Act 1929 (UK), s 45. The provision made it unlawful for a company to “give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase … of…any shares in the company…”

The section had a limited purpose. In re VGM Holdings Ltd13, Lord Greene MR, delivering the judgment of the Court of Appeal, accepted that use of the word “purchase” was deliberate. The section applied only to purchases of shares and did not prohibit giving financial assistance to subscribe for shares in the company. Even the validity of that limited purpose was challenged in Victor Battery Co Ltd v Curry’s Ltd.14 Curry’s Ltd had lent moneys to the purchaser of the share capital of Victor Battery Co Ltd and been issued with a debenture, charging the battery company’s assets, as security for the amount advanced. Roxburgh J recognised that the debenture had been issued by Victor Battery Co Ltd in connection with the purchase of its shares but did not rule the debenture void or invalid because, “[t]he section provides, not that it shall not be lawful for a company to provide a security in order to give financial assistance, but that it shall not be lawful for a company by means of the provision of security to give any financial assistance.”15

Apart from interpretative difficulties, the section suffered from the more fundamental flaw that, in many cases, it failed to protect a vulnerable company’s assets from being dissipated in the course of prohibited transactions. Prohibiting a company from giving financial assistance and supporting that prohibition by imposing criminal penalties upon the company and its officers rendered contracts for financial assistance illegal and

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12 The Jenkins Committee, above n 7 at [173].
13 [1942] Ch 235, at 240-1. Inferentially, the Committee, which had addressed a particular social problem, had received no evidence of concern about financial assistance to subscribe for new issues of company shares.
See, also, Woodhouse J in Skelton v South Auckland Blue Metals Ltd [1969] NZLR 955 at 957 and 958.
unenforceable by a court.  

The 'unenforceability of illegal contracts' argument achieved its policy goal where the company had given a security, indemnity or guarantee in support of the improper financial assistance but appeared to preclude the recovery of corporate moneys loaned for the improper purpose.

This policy weakness was surmounted by Street CJ in *Dressy Frocks Pty Ltd v Bock*. Bock, who was purchasing shares in Dressy Frocks from Terrell, requested the company to pay Terrell the purchase price out of its own funds. The company agreed and, later, sued Bock to recover the moneys advanced. Bock raised the defence of illegality. All judges in the Full Court accepted that the defence was good but Street CJ, responding to the argument that acceptance of that defence would cause the company’s assets to be depleted, recognised that:

> in any event the company is not left without a remedy, inasmuch as the directors participating in this illegal transaction may themselves be required to make good to the company the loss which it would otherwise sustain, unless they can bring themselves within the provisions of s 361 of the Act, which would permit the Court to grant them relief in certain cases.

Nevertheless the operation of this principle can be complex. In *Shearer Transport Ltd v McGrath*, the company sued McGrath to recover moneys paid to him by the company, at the request of Connors, in payment for shares in the company sold by him to Connors. Both Connors and McGrath were directors of the company at the time of the transaction, which was designed to transfer control of the company to Connors. As it was acknowledged that the loan to Connors was irrecoverable because of illegality, O’Bryan J ruled that the company was entitled to recover the payment as an *ultra vires* gift received by a person who was knowingly involved in the contravention.

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16 *Lodge v National Union Investment Co Ltd* [1907] 1 Ch 300 at 306, per Parker J was cited by Roxburgh J in *Victor Battery Co Ltd v Curry’s Ltd* [1946] Ch 242 at 249 in the course of rejecting this argument.

17 As ought to have happened in *Victor Battery Co Ltd v Curry’s Ltd* [1946] Ch 242; see, also, *Heald v O’Connor* [1971] 1 WLR 497; *Firmin v Gray & Co Pty Ltd* [1985] 1 Qd R 160 (Full Court).

18 (1951) 51 SR (NSW) 390.

19 (1951) 51 SR (NSW) 390 at 393, per Street CJ, at 395, per Owen J and at 397-8, per Herron J. The judges relied particularly on *Harse v Pearl Life Assurance Co* [1904] 1 KB 558 at 563, per Collins MR, “It is clear law that where one of two parties to an illegal contract pays money to the other, in pursuance of the contract, it cannot be recovered back.”

20 (1951) 51 SR (NSW) 390 at 395.


22 [1956] VLR 316 at 318. Contrast Barrett, n 15 above, at 10 n 65, supporting this decision, with Baxt, R, “The Prohibition on Companies Financing Dealings in their own Shares: void or illegal contracts?” (1969) 3 *University of Tasmania Law Review* 174, at 183, who argues that this case is not consistent with *Dressy Frocks Ltd v Bock* (1951) 51 SR (NSW) 390. The court did not canvass the possibility that Connors, the controller of the company, who had received his controlling interest without payment, might be liable, with McGrath, to contribute toward the corporate reimbursement.
A refinement

The inadequacies of the prohibition argument were well known when the Jenkins Committee was appointed to review the working of the Companies Act 1948 (UK). They reported:

Many witnesses complained that the section is drawn in terms so wide and general that it appears to penalise a number of innocent transactions; some indeed questioned whether the section served any intelligible purpose and suggested that it might be repealed. Others, on the other hand, felt that the section should be retained and strengthened but agreed that it should be clarified. There seems to be general agreement that it is widely disregarded.23

They were “satisfied that section 54, as it is now framed, has proved to be an occasional embarrassment to the honest without being a serious inconvenience to the unscrupulous”24 but recommended that it “should be retained and strengthened”25 by providing an exception for companies that satisfied disclosure and solvency requirements. These recommendations were ignored until 1981, when, spurred by critical reaction to Belmont Finance Corporation Ltd v Williams Furniture Ltd (No 2)26 and Armour Hick Northern Ltd v Whitehouse27, the law was amended for private companies.28

The current provision29 retains the general prohibition on giving financial assistance, supported by criminal penalties,30 but permits various distributions or capital transactions, including financial assistance given in good faith as an incident of some larger purpose,31 transactions in the ordinary course of business32 and transactions taken in good faith to give employees, other than directors, a direct or indirect, beneficial interest in the company.33 Public companies can only engage in s 153(4) activities if their net assets are not thereby reduced or, to the extent that they are reduced, if the assistance is provided out of distributable funds.34 Private companies can give financial assistance for any purpose, provided the capital maintenance provision is

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23 Jenkins, above n 7, at [171].
24 Ibid, at [176].
25 Ibid, at [173].
26 [1980] 1 All ER 393 (CA).
28 Companies Act 1981 (UK), ss 42 – 44.
29 Companies Act 1985 (UK), Pt V, Ch VI, ss 151 – 158. See further Davies, PL (ed), Gower and Davies Principles of Modern Company Law, 7th ed, 2003, at 259 – 273, which includes an extended discussion of Brady v Brady [1989] AC 755 (HL), in which the complexities of the exemption for private companies were exposed.
30 Ibid, s 151(3).
31 Ibid, s 153(2).
32 Ibid, s 153(4)(a).
33 Ibid, s 153(4)(b),(bb) and (c), hereinafter “employee benefit provisions.”
34 Ibid, s 154. ‘Net assets’ is defined in s 154(2)(a); ‘distributable funds’ is not defined but appears to be the ‘distributable profits’ defined in s 152(1)(b). As net assets, before the transaction, will be actually or contingently diminished by the giving of financial assistance, the critical aspect of this test is that the assistance must be less than the amount of distributable funds available to the company.
satisfied, the directors can make a declaration of solvency, members in general meeting have approved the transaction by special resolution and, unless the resolution is approved by all members, four weeks have elapsed since the resolution was passed. However, in the absence of a court order, the assistance must be given within eight weeks of the statutory declaration being made.

The Jenkins Committee had recommended that this exception be available to both public and private companies but extension of the relief to public companies would have been and remains inconsistent with the European Community’s Second Company Law Directive. This partial solution is not ideal. The differential treatment of public and private companies can not be justified, except by the duty of obedience to a higher level of authority. However, even the rule adopted for private companies does not recognize the interests of all stakeholders in the company. While the capital maintenance requirement and directors’ declaration of solvency should ensure that neither the company or its creditors are jeopardized by improvident grants of financial assistance, creditors, the stakeholders primarily affected by any grant of financial assistance, are neither expressly informed nor formally provided with an opportunity to protest any proposal which they might consider, if alerted, to affect their interests adversely. Strangely shareholders, the risk takers, are provided with information, time to digest it and power to challenge improvident transactions both at the general meeting and in the courts. Where members are not unanimous in their acceptance of a proposal, creditors may, fortuitously, become aware of the resolution and be able to protect their interests in some cases.

The current proposal

Financial assistance was one of the matters considered in the Department of Trade and Industry review of the companies legislation that reported in 2001. Following an extensive review process, the Company Law Review Bill 2005

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35 Ibid, s 155(2), establishes the same standard for private companies as public companies: s 154, above n 34, namely no reduction in net assets beyond the amount of distributable profits.
36 Ibid, s 156. The declaration requires that the directors believe that the company will remain solvent for the next twelve months, or, if it is proposed to wind it up within that time, that the company will be able to pay its debts in full within twelve months of the commencement of that winding up and must be supported by a report from the company’s auditors: (4). The declaration must be available for inspection by members at the meeting to approve the assistance: s 157(4).
37 Ibid, s 157.
38 Ibid, s 158(2).
39 Ibid, s 158(4).
41 The directors’ declaration must be supported by an auditor’s certificate: Companies Act 1985, s 156(4).
42 Ibid, s 157(5).
43 Ibid, s 157. To enable dissident members to challenge a grant where a special resolution is required, financial assistance can not be given until four weeks after the special resolution, or the last of them, was passed.
(UK) was introduced on 1 November 2005. The Bill proposes simplifying the process for granting financial assistance by private companies, while retaining the general prohibition upon public companies.

The real problem - and a real solution!

It is submitted, with respect, that the Greene Committee’s analysis of the problem was inadequate. Former shareholders were annoyed that they had been bought out with company money. That practice was prohibited. However, it is probable that the real problem was that the shareholders had made a bad decision initially because they were not aware of the ‘real’ value of their company or of their shares. That situation arose because management, accountants and auditors had failed to ensure that annual reports and financial statements conveyed this important information to shareholders. Accounting practice was guided by the principle of conservatism, which required that assets be shown in the accounts at the lower of their cost or current market value. It ensured that assets would be marked down if the market fell but did not compel companies to alert their shareholders to increases in the value of company assets or of any failure by management to capitalise upon those rising market values. In contrast, adherence to the legal requirement for establishing profits that all assets be revalued at every balance date should have alerted such shareholders to both the current value of underlying assets and to failures by management to achieve a reasonable return on those assets.

However, even with the advantage of hindsight, it is difficult to blame the Committee for their oversight, when, even now, international financial accounting standards allow companies to choose whether to show property, plant and equipment in their books of account at cost less depreciation or fair (market) value.

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44 At clauses H18 and H19. See also the complementary explanatory statement, at H28: The Company Law Review committee concluded that, in the light of legislative developments such as the wrongful trading provisions in the Insolvency Act, it was no longer necessary to have elaborate safeguards specifically directed at financial assistance. Accordingly clause H18 provides for repeal of the prohibition on the giving of financial assistance and, as a consequence, of the “white wash” procedure in sections 155 to 158 of the current Act.

45 It is recognised that use of this term is unsatisfactory. Shares are worth what the market will bear and the worth of the underlying business of the company is not, usually, the sum of the value of its assets. Furthermore it is inherently unlikely that a book value, being the sum of the cost of assets, acquired at various times, will bear any relationship to the present value of the assets or the company.


47 In *re Spanish Prospecting Co Ltd* [1911] 1 Ch 92 at 98 – 101, Fletcher Moulton LJ stated this was necessary to establish whether a company had made profits from which a dividend could be declared.

The expanded reach of the Greene Committee recommendation

The Greene Committee was formed to review the Companies (Consolidation) Act 1908 (UK). In recommending prohibition as the solution to the financial assistance problem, they were reacting to complaints raised by former company shareholders in the United Kingdom. The problem may have been peculiar to the United Kingdom. However any amendment to overcome it was likely to be adopted in the many dominion and colonial jurisdictions that had adopted versions of English companies legislation as their own. Whether or not financial assistance had been a problem in these jurisdictions, many were content to update their legislation, if a practice of reviewing legislation was pursued, by adopting, with few variations, amending legislation enacted by the British parliament. This occurred on this occasion, sometimes long after the flaws in the legislation had become apparent.

The adoption of financial assistance legislation, modeled on imperial precedents, may have been expected but the persistence of such legislation in many of these jurisdictions, after they had become independent and had undertaken reviews to make their companies legislation more reflective of their national needs and objectives was less predictable. The diversity of these second and third generation provisions testifies to the difficulty experienced in developing a rule which controls the risks inherent in financial assistance while according companies the ability to garner the benefit of such activity, either in the ordinary course of business or when interested parties are satisfied that the risk element is low enough to be acceptable. The diverse products of these legislative efforts can be evaluated to determine both their strengths and weaknesses and whether any provide superior outcomes to the common law position.

Commonwealth Developments

In the following section, attention is paid to developments in the Commonwealth jurisdictions on or near the Pacific Rim, where stark differences have appeared both in the statute book and in law reform proposals.

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49 Above n 9.
50 That provision was followed in many Commonwealth jurisdictions, for example Canadian Companies Act, RSC 1927, s 56D, a 1930 amendment; Companies Act 1926 (South Africa), s 86 bis; Companies Act 1931 (Qld), s 57; Companies Act 1934 (S A), s 62; Companies Act 1936 (NSW), s 148; Companies Act 1938 (Vic), s 45; Companies Act 1943 (WA), s 154; Companies Act 1933 (NZ), s 56.
51 Uniform Companies Act 1961-2 (Australian States), s 67. This first attempt to produce uniform legislation for all Australian State and Territory jurisdictions, was, like the Companies Act 1955 (NZ), modeled on the Companies Act 1948 (UK).
52 In any such evaluation, little or no regard is had to local practices. The assessment is made in terms of relevant disclosure, controls on irresponsible financial assistance and opportunities for creditors to object to such assistance.
53 The term as used, without geographic precision, in this article comprehends both Malaysia and Singapore.
54 My attention was drawn to some of these developments by Dr A Mohd Sulaiman, whose conference paper at the Australasian Law Teachers’ Association conference at Waikato University, Hamilton, NZ, in July 2005 has been published as “A Cross-jurisdictional Study of Financial Assistance Provisions
Canada

The Constitution Act 1867, s 92 (11) expressly vests the power to incorporate “companies with provincial objects” in the provinces but the federal government has assumed a power to incorporate companies for more general purposes. Financial assistance does not appear to be a major issue. Most differences between the jurisdictions are more reflective of governments adopting different variants of the United Kingdom legislation, than of major reform efforts. Most provinces have an absolute prohibition on the practice but Nova Scotia permits the giving of financial assistance where there is no loss of capital, while Ontario permits the practice where there is disclosure to and acceptance by shareholders. Exceptionally the British Columbia statute makes no reference to the practice. The federal Act is a restrictive version of the current United Kingdom legislation. Exceptions to the general prohibition are permitted to allow a shareholder in a private company to acquire the shares of an existing shareholder or of a person entitled to those shares by reason of the death or bankruptcy of a former shareholder or to fund employee benefit schemes.

New Zealand

The Companies Act 1955 was a modeled on the United Kingdom Act of 1948, so it is unsurprising that, at s 62, it prohibited financial assistance, except in the ordinary course of business or for the purpose of benefitting employees.

Its successor, in 1993, which was the result of extended consultation between the Law Reform Commission, a special companies’ committee and inputs by the public, adopted a very different approach. Financial assistance is permitted provided that the company satisfies one of four sets of conditions:

1. pursuant to the unanimous agreement of entitled persons
2. with the written consent of all shareholders;
3. as financial assistance not exceeding 5% of shareholders’ funds; or


55 The existence of the federal power was confirmed by Citizens Insurance Co of Canada v Parsons (1881) 7 App Cas 96 (PC). For a discussion of constitutional powers, see Welling B, Corporate Law in Canada: The governing principles, 2nd ed, 1991, at 2-11.

56 It does not rate an entry in the Index to Welling, above n 55.

57 Business Corporations Act 2000 (Alberta), s 45; Business Corporations Act 1985 (New Brunswick), s 43; Corporations Act 1988 (Prince Edward Island), s 69; Corporations Act (Quebec), s 95.

58 Corporations Act 1989 (Nova Scotia), s 110(5).


60 Business Corporations Act 2002 (British Columbia).

61 Corporations Act (Canada), s 17.

62 Dugan, above n 7, at 186, notes, perceptively, that the provision vacillated between the two extremes of creditor protection. Unless permitted, the transaction was prohibited; whereas if permitted, the transaction was allowed, without regard to corporate solvency or its effect on creditors.

63 Companies Act 1993 (New Zealand), s 76 (1), summary adapted from Dugan, above n 7, at 186-188. Dugan deals with the present law at para [11.19] but throughout chapter 11 places financial assistance within a broader economic and accounting-oriented perspective.
as “special “financial assistance, subject to additional rules.

In all cases the grant of financial assistance is subject to the company satisfying a solvency test, in which the proposed financial assistance is not recognized as an asset of the company but obligations to be created, whether present or contingent, are recognized as liabilities and, with exception of the first, a board resolution that the procedure is in the best interests of the company and the terms and conditions are fair to the company.

In the normal case, where the amount of financial assistance to be given and that outstanding, if any, from previous grants is less than 5% of the company’s capital and reserves, the board will give the financial assistance first and give notice of the transaction to members within ten working days. Otherwise, a special financial assistance situation may arise. Where the amount to be given exceeds the 5% limit, the board must resolve both that the procedure will be of benefit to shareholders not receiving the assistance and that the terms are fair and reasonable to those shareholders and send all shareholders a disclosure document that details the terms and conditions of the financial assistance, identifies the beneficiary and contains the supporting board member’s assessments of the procedure and all other information required by a reasonable shareholder to understand the nature of and implications for the company and shareholders of the transaction. The transaction can not occur until ten days have elapsed, which allows concerned shareholders time to seek an order restraining implementation of the proposal. Notwithstanding these procedures, where all interested parties are unanimous in their support for the procedure, only the solvency test needs to be satisfied but, if the directors can not be certain of receiving that support, they may provide the solvency declaration and ‘best interests’ declaration to shareholders and await the return of signed approvals by all shareholders.

The New Zealand procedure treats financial assistance as primarily a decision for directors. That financial assistance is not an ordinary management decision is recognized by the obligation of directors to inform shareholders when they have taken such action, in the normal case, or before they take action, where the amount involved exceeds 5% of the company’s capital and reserves. In that latter situation, a shareholder or the company may apply to court to restrain implementation of the procedure but the Act pays no regard to the superior claims of creditors, whose interests may be adversely affected

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64 Ibid, ss 4, 77(6) and 108.
65 Ibid, s 76 (2).
66 Ibid, s 80.
67 Ibid, s 78 (1).
68 Ibid, s 79.
69 Ibid, s 78(6) & (7).
70 Ibid, ss 107(1) (e) & 108.
71 With respect, this appears to be an otiose procedure. It is unlikely to work, except in small companies, where it is unlikely to be of use, except where all members can not meet to satisfy the first procedure.
72 Companies Act 1993 (NZ), s 78(7).
by implementation of procedures, which directors and members consider to be in the long term interest of the company and its members.

**Australia**

In the Australian federation, the power to incorporate companies was vested in the States but, since the end of the Second World War, commercial interests have been attempting to persuade state and federal governments to regard Australia as one market. One of the first fruits of that effort was the *Uniform Companies Acts* 1961-2, which were the product of state co-operation. Drafters were aware of problems in the United Kingdom legislation when developing a template based on the *Companies Act* 1948 (UK) but made no effort to overcome them. However, when the Commonwealth developed legislation for the Companies Code regime, established in 1981, a longer and more complex provision was developed. There were numerous similarities with the British model but some significant differences. The controlling prohibition, in s 129(1), was supplemented by clarifying subsections, a more extensive list of exempted transactions and an authorised exception. The major differences were that these provisions were available to both public and proprietary (private) companies and that the authorised exception had a different focus from that of its British counterpart.

The authorized exception procedure could involve directors, shareholders, creditors, the regulator and the courts. If the board approved the granting of financial assistance, the directors were bound to prepare an explanatory memorandum, containing sufficient information to ensure that shareholders were fully informed about details of the proposed transaction and its likely effect on the company, its creditors and shareholders. This was forwarded to all shareholders, the Corporate Affairs Commission in its state of incorporation and any trustee for debentureholders, along with the notice of meeting. At that meeting the special resolution for the giving of financial assistance would be put. If the resolution was passed, the company was bound to publish advertisements in newspapers circulating in each Australian state or territorial jurisdiction in which the company carried on business advising members and creditors of the terms of the resolution and of their right to oppose court approval of the proposal. If no objections were received within twenty one days or any objection was withdrawn before the end of that period, the company could proceed to grant financial assistance but, otherwise, the grant

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73 *New South Wales v The Commonwealth* (1990) 169 CLR 482 (HCA) but see Ford, above n 4, at [2.170] for an outline of the steps to transfer company formation and regulation from State to federal control.

74 Section 67 was a transcript of *Companies Act* 1948 (UK), s 54.


76 *Companies Act* 1981(ACT), operating as the Companies Code in the Australian States, s 129(10).

77 The following material is a refinement of ideas expressed in Fletcher K, “FA, after 75 years” (2005) 17 *Australian Journal of Corporate Law* 323 at 328 – 333.

78 As this part of the process afforded creditors an opportunity to seek repayment or security for their loans or outstanding credits, companies would rarely embark on the process unless their finances were sound or they had negotiated arrangements with their major creditors.
was dependent upon the court action being brought to a successful conclusion. Parliamentary recognition of the complexity of this procedure could be inferred from inclusion of subsection (11), which permitted companies, pursuing this path, to obtain a declaration of substantial compliance from the court.

More significant reforms were contained in s 130, which expressly recognised that a contract or transaction for providing financial assistance which contravened s 129(1) was not invalid but voidable at the option of the company. A court could authorise a member or director of the company, a debentureholder or trustee for debentureholders to give notice of invalidity in the name of the company.79 Where such a contract or transaction was avoided, the Court was empowered to ameliorate loss or damage to the parties by making such orders as were just and equitable in the circumstances.80

These provisions were the first to recognize that creditors possess an interest in financial assistance proposals. They resolved the problems manifest in the original legislation but created further difficulties and failed to project a clear policy direction. The prohibition upon companies giving financial assistance was maintained but contravening companies were not guilty of an offence. However, company officers involved in the contravention were liable to criminal penalties and could be required to compensate the company or any other person who suffered loss or damage as a result of the contravention.81 A wide range of activities in the ordinary course of business that might, incidentally, provide financial assistance were permitted, as was giving financial assistance to or for the benefit of employees,82 while other forms of financial assistance were permitted, provided the company followed the s 129(10) procedure.83

Section 130 was the chief source of the policy confusion. By expressly declaring that the validity of a contract or transaction was not affected by a contravention of s 129(1)(a), it overcame the illegal contracts problem which had bedevilled the earlier legislation. However permitting contravening companies to determine whether or not to avoid these transactions virtually ensured that the procedure would not be used, except where control of the company had changed or external administrators appointed. The original controllers of the company would not be tempted to avoid a transaction as it could expose their contravention of the law and attract the attention of members or debentureholders, who were empowered to seek court orders to avoid the transaction and obtain a just and equitable solution between the parties.84 However, the potential of this provision was severely limited by the ruling of the majority judges in Darvall v North Sydney Brick & Tile Co Ltd (No

79 Companies Code, s 130(3).
80 Ibid., s 130(4).
81 Ibid., subs 129(5) & (6). Officers faced a potential penalty of a $10,000 fine, imprisonment for 2 years or both.
82 Ibid., subs 129(8) & (9).
83 See discussion, above at 11 -2.
84 Companies Code, ss 130(4) & (5).
2)\textsuperscript{85} that a member should not be allowed to usurp the management role of the directors, unless the Court was satisfied that their failure to act would amount to a fraud on their powers.

These provisions were retained under the Corporations Law regime\textsuperscript{86} until 1998.

**Simplification**

With drafting that was “extensive and complicated” and basic concepts that “were very unclear” the financial assistance provisions were likely candidates for review when the Commonwealth introduced its Corporate Law Simplification Program in 1994.\textsuperscript{87} The Simplification Taskforce introduced its proposals in the draft *Second Corporate Law Simplification Bill* 1996, which, following a change of government, reappeared, with minor changes, as the *Company Law Review Bill* 1997.

The accompanying Explanatory Memorandum\textsuperscript{88} recognised:

12.75 …The prohibition performs a useful function in deterring a range of undesirable transactions having the potential to prejudice a company’s financial position. However it impedes many normal commercial transactions.

12.76 The Bill therefore prevents a company giving financial assistance to a person to acquire shares, or units of shares, in the company or a holding company if the transaction would materially prejudice the interests of the company or its shareholders, or materially prejudice the company’s ability to pay its creditors (Bill s 260A(1)(a)). This is subject to the exception that a company will be able to give financial assistance if the transaction has been approved by the company’s shareholders in the manner set out in section 260B (Bill s 260A(1)(b)).

12.85 The Law currently contains a range of exceptions to the prohibition that relate financial assistance given in the ordinary course of commercial dealing, and financial assistance given in the ordinary course of moneylending business (current s 205(8) and (9)). These exceptions will be preserved (Bill s 260C).

\textsuperscript{85} (1989) 7 ACLC 659 (NSWCA) per Mahoney and Clarke JJA; contrast Kirby P (dissenting), who ruled that the Court should authorise an applicant member to give notice where it is satisfied that directors have acted in breach of their duty to the company.

\textsuperscript{86} The regime, a further applied law scheme, in which the States accepted the federal *Corporations Act* 1989 as State law and authorized the federal Australian Securities Commission, formed under the *Australian Securities Commission Act* 1989, to administer that law, commenced on 1 January 1991. The financial assistance provisions appeared as Corporations Law, Pt 2.4, Div. 4, ss 205 and 206.

\textsuperscript{87} Ford, above n 4, at [24.670].

The proposals, thus described, were enacted as Pt 2J.3 of the Corporations Law by the Company Law Review Act 1998, and have constituted the Australian law on financial assistance since 1 July 1998.

Part 2J.3 met many of the simplification and economic reform objectives sought by the Commonwealth since it assumed responsibility for corporate law and regulation in 1991. By recognising that financial assistance is permitted, where statutory conditions are satisfied, it encouraged companies to provide financial assistance for a wider range of commercially beneficial activities\(^89\) without having to concern themselves with the possible complications arising under the former provisions.\(^90\)

However the Part is not without problems. The first, which will be resolved in time, is to determine the meaning of "no material prejudice".\(^91\) This key term is not defined in the legislation and little guidance is provided in the Explanatory Memorandum. Until that issue is resolved, all companies engaging in conduct which may involve financial assistance are likely to need legal advice. However, if a board is satisfied that the 'no material prejudice' test is satisfied, it may grant financial assistance of its own initiative, with no disclosure to shareholders or creditors.\(^92\)

The second is the role of s 260B, which implements the second aspect of para [12.76] in the Explanatory Memorandum.\(^93\) It was introduced to "bring the requirements for financial assistance more closely into line with those proposed for capital reductions".\(^94\) While that is a desirable objective, it should be secondary to the primary aim of ensuring that the financial assistance provision operates effectively. In itself, the section appears to impose reasonable requirements in the shape of a requirement that an information statement to be forwarded with notice of the meeting for members to consider either the passage of a special resolution, with no votes in favour being cast by the potential beneficiary or any associates, or a resolution agreed to by all

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\(^89\) Notwithstanding use of the term “ordinary course of commercial dealing” in both s 260C and Explanatory Memorandum, above n 88, at [12.85], it should be noted that the term is strictly qualified and the extent of the statutory exemption is more limited than in the previous provisions: Corporations Law, ss 205(8) and (9). Ford, above n 4, at [24.740] lists the exceptional activities but reserves discussion for the looseleaf edition, at [24.741]-[24.744].

\(^90\) Notably, the question: What is financial assistance? – that was central to consideration of the previous law, see, for example, Austin RP in Austin & Vann, above n 4, at 198 – 213; Collier B, “Giving Financial Assistance in Breach of s 205(1)(a) of the Corporations Law: What does it mean?” (1994) 4 Australian Journal of Corporate Law 337 at 346-56; Fletcher, above n 8, at 127-31; Ford, above n 4, at [24.670] – [24.710] – but has been relegated to a secondary role in the current regime.\(^91\) Fletcher, above n 8, at 132-134, proposed what has been described as a ‘doomsday’ test: if the assisted party suffered a total financial collapse immediately after receiving the financial assistance, would the company be able to pay its debts in the ordinary course of business, maintain its level of dividends to shareholders and avoid being placed in external administration? that was criticised as ‘unworkable’ in Cho Y & Kishore V, above n 3, at 202 n 28, although Cornwell P, above n 3, at 749 favours a more rigorous test, of the sort detailed in Ford, above n 4, at [24.710], which involves consideration of the likely effect of the transaction on the balance sheet, future profitability and cashflows of the company.

\(^92\) Corporations Act 2001 (Cth), s 260A(1)(a).

\(^93\) Above n 88.

\(^94\) Ibid, at [12.76]. Capital reduction requirements are detailed in Corporations Act 2001 (Cth), Pt 2J.1, Div 1, ss 256B-256E.
the ordinary members. If the resolution is carried, there is a prohibition on dispensing the assistance until fourteen days after notice of approval has been lodged with ASIC.

The problem with this provision is that it may provide a means for approving improvident transactions of the sort condemned by the Greene Committee. The ‘shareholder approval’ test is an alternative to the ‘no material prejudice’ test. Shareholders asked to vote on the proposal will be informed of likely economic effects in the information memorandum that accompanies the notice of general meeting but, especially where the appropriated funds will be used to buy them out on favourable terms, shareholders may approve a proposal that is potentially harmful to the company.

That risk would be negated if the delay period offered creditors or dissident shareholders an opportunity to seek injunctive relief. This is what s 1324 seems designed to do. However, peculiarly, the s 260B procedures are structured to ensure that interested creditors can be alerted to proposed financial assistance transactions, but afford them or dissident members no capacity to prevent the company implementing shareholder–approved financial assistance that causes or has the potential to cause material prejudice to the company, shareholders or creditors. If injunctive relief is sought when notice of the meeting is given, the applicant has no standing to prevent the meeting being held and the court would accept an assurance by the defendant company that it would not implement the proposal unless the requisite resolution is obtained. If the applicant waits until shareholder approval is given, the court will be powerless to grant an injunction because

95 The interpretation of s 260B has excited some controversy. In _Batoka Pty Ltd v Jackson_ (1998) 30 ACSR 67 the court held that a successful bidder in a takeover was not able to vote in favour of a special resolution to approve financial assistance by the target company and, more controversially, that the unanimous resolution obtained at that meeting did not satisfy the second alternative. Ford, above n 4, at [24.741], argues that a unanimous vote at a general meeting does not satisfy the s 260B(1)(b) requirement, unless all the members are present and vote.


97 Corporations Act 2001 (Cth), s 260A(1)(b).

98 See, particularly subss (1A), (1B) which create a reversal of onus of proof where a creditor or member claims that a company has breached s 206A(1)(a) but, contrary to Fletcher, above n 8, at 135 and Ford, above n 4, at [24.741], especially “The creditor itself may seek an injunction under s 1324 and is deemed to have standing to do so (s 1324(1A)), and in those proceedings the court must assume that the financial assistance does not meet the ‘material prejudice’ test unless the company or other defendant proves otherwise (s 1324(1B)).’’ - which assume that provisions designed to benefit creditors or members by altering the burden of proof would operate in this situation, they do not.

99 The ASIC Alert system will inform subscribers when the notice of meeting, information statement and Form 2602 are lodged with ASIC prior to being sent it members: s 260B(5), notice of special resolution: s 260B(7), if passed, and notice of approval of financial assistance: s 260B(6) are lodged with ASIC.

100 Fletcher, above n 8, at 134 – 5, details the six step process involved.

there will be no contravention of s 260A(1)(a) to enliven its jurisdiction or to activate the statutory reversal of the onus of proof under s 1324(1B).\textsuperscript{102}

Furthermore there is a risk that creditors could be adversely affected by the company engaging in activities within the scope of exempted financial assistance\textsuperscript{103} but this risk is broadly equivalent to the commercial risk encountered in dealings with any business enterprise.

While the statutory scheme does not achieve its aims directly, it may succeed indirectly in deterring company officers from making profligate grants of financial assistance. Section 260B, at its worst, may be merely a procedure to free persons involved in the grant of financial assistance from possible civil\textsuperscript{104} or criminal\textsuperscript{105} consequences but s 260E provides that compliance with such requirements does not relieve directors from meeting their fiduciary or statutory duties toward the company. In rare instances, concerned members may be able to institute statutory derivative actions\textsuperscript{106} against directors for breach of their fiduciary duty to act in good faith in what they consider to be the best interests of the company.\textsuperscript{107} However, it is more likely that dissident members or creditors will alert the Australian Securities and Investments Commission (ASIC), which has power to investigate and instigate proceedings where it suspects a contravention of the Corporations Act 2001 (Cth) has occurred.\textsuperscript{108} Financial assistance that results in the company becoming insolvent will, also, be likely to attract action by a liquidator or creditor under s 588M for the recovery of the loss or damage sustained, if ASIC does not proceed under s 588G.

The present legislation is flawed. It provides creditors and shareholders with favoured access to the courts in the situation where court intervention is least likely to be required\textsuperscript{109} but excludes them in more risky situations.\textsuperscript{110} Arguably it provides less adequate regulation than its immediate predecessor provisions.\textsuperscript{111}

\textsuperscript{102} I accept the critique of Fletcher, above n 8, at 135, in Welsh M, “The Corporations Act financial assistance provisions offer limited assistance to creditors” (2003) 17(1) Commercial Law Quarterly 3, at 5-6, particularly, “[T]he tests in ss 260A(1)(a) and (1)(b) are alternatives…there will be no contravention of s 260A if one of the alternatives are (sic) satisfied. If there is no contravention or attempted contravention an injunction can not be obtained for breach of s 260A.” See, also, Cornwell, above n 3, at 750 n 20, to the same effect.
\textsuperscript{103} Corporations Act 2001 (Cth), s 260C.
\textsuperscript{104} Ibid, s 260D(2). See Pt 9.4B, ss 1317DA – 1317L and s 206C for possible civil consequences of a contravention.
\textsuperscript{105} Ibid, s 260D(3): 2,000 penalty units, imprisonment for 5 years or both
\textsuperscript{106} Ibid, Pt 2F.1A
\textsuperscript{107} Ibid, s 181
\textsuperscript{108} Australian Securities and Investments Commission Act 2001(Cth), ss 49 (prosecutions) and 50 (civil proceedings).
\textsuperscript{109} Corporations Act 2001 (Cth), s 260A(1)(a).
\textsuperscript{110} Ibid, s 260A(1)(b) & (c).
\textsuperscript{111} See above 11 - 3.
**Singapore**

Since achieving independence and separation from Malaysia in 1965, Singapore has shown a commitment to ensuring that its corporate and commercial laws are kept up to date. In the case of companies, this has usually meant adopting relevant developments in United Kingdom and Australian law. The British financial assistance provisions were adopted in the Companies Act 1967 but the Australian Companies Codes provided inspiration for the 1994 legislation. However from January 2006 a simpler and more effective law developed from the current United Kingdom Bill has operated.

A company can give financial assistance where the amount involved is not more than 10% of the total share capital or all shareholders agree to the transaction, provided, in either case, that the directors make a declaration that the company is solvent and that its assets exceed its liabilities. However, while comment in the ACRA Legal Digest refers to regard being paid to the ‘interests of creditors,’ this is, at best, implicit in these financial assistance situations, whereas the practical measures of public advertisement and opportunity for creditors, dissident shareholders and the Registrar of Companies to object to the passage of a special resolution approving a grant of financial assistance under the existing s 76(10) are detailed in s 76(12).

**Malaysia**

The Companies Act 1965 is modeled on the Companies Act 1948 (UK) but adopts some of the distinctive features of the Australian Uniform Companies legislation. Like them, it prohibits a company from providing financial assistance. A review of that legislation is taking place but no legislative activity is anticipated in the near future.

**Hong Kong**

Hong Kong became a Special Administrative Region of the People’s Republic of China in 1997 but retains its common law heritage. The Companies Ordinance of Hong Kong is closely modeled upon the Companies Act 1985 (UK). Sections 47A to 48 contain a general prohibition upon the giving of financial assistance.

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112 Companies Act 1994, ss 76 - 77 replicate Australian Companies Code, ss 129 – 130, see discussion above at 11 – 3.
113 The Companies (Amendment) Act (Sing) 2005, see discussion of the UK Bill, above at 6 -7.
114 ACRA Legal Digest No 9 (August 2005) “Highlights of the Companies (Amendment) Act 2005’’ at [1.10] & [1.11], see, also, “Commonly Asked Questions’’ at questions 11 & 12. (’ACRA’ is the acronym for the official Accounting and Corporate Regulatory Authority.)
116 This is a provision derived from the Australian Companies Codes, see above at 11-3. It is, also, found in the related capital reduction provision: Companies Act 1994 (Sing), s 73.
118 See Dr A Mohd Sulaiman, above n 54, at 168.
119 Sections 151 – 158, discussed above at 5 - 6. The major difference is that Hong Kong does not prohibit public companies from engaging in the practice but distinguishes between listed and unlisted companies.
financial assistance but then permit a listed company to take advantage of the exceptions, found in s 47C, that allow financial assistance incidental to some larger purpose when taken in good faith in the interests of the company, financial assistance by way of dividend, share buyback or capital reduction and financial assistance undertaken by a company in the ordinary course of its lending business or as part of an arrangement to provide benefits for employees, provided its net assets are not reduced or the net assets are reduced but the assistance is made from distributable profits.  

Those solvency criteria, also, apply to an unlisted company. It may grant financial assistance provided it meets either of those criteria, has the assistance approved by a special resolution and its directors publish a statement, in which the beneficiaries of the transaction are identified, the terms of the financial assistance detailed and the directors declare their belief in the company’s solvency after the event. The assistance can not be given within four weeks after the declaration is published or after three months either of that date or the satisfactory conclusion of any actions taken to challenge the proposed grant. The solvency requirements and delay on implementation seem well designed to protect corporate and creditor interests.

**Is there a financial assistance problem?**

The United Kingdom, New Zealand, Australia and Singapore have shown concern about the financial assistance provisions; elsewhere differences in the legislation appear to reflect more of the vintage of their legislation and the jurisdiction from whose legislation their law was modeled than concern with the operation of the law. The only possible exception is the provincial legislation in British Columbia which has eliminated reference to the term from its Act and, thereby, recognized that this is a discretion to be exercised by directors in good faith with due regard to the interests of the company as a whole.

The financial assistance provisions in the jurisdictions considered range from no provision, which confers a fiduciary discretion upon the directors, to prohibition after the manner of the original English provision. Only British Columbia’s reversion to the common law position supports the ‘no problem’ position that the decision to grant financial assistance is a matter of

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120 Companies Ordinance (Hong Kong), s 47D.  
121 Ibid, s 47E.  
122 Ibid, s 48.  
123 See above at 2 – 7.  
124 See above at 9 – 10.  
125 See above at 11 – 16.  
126 See above at 16 – 17, particularly the Companies (Amendment) Act 2005.  
127 Business Corporations Act 2002, see above at 9 and Hughes v Northern Electric and Manufacturing Co (1915) 21 DLR 358, above at n 2, the Supreme Court of Canada authority for the proposition.  
128 Ibid  
129 Companies Act 1929 (UK), s 45, above at 3, is similar to Companies Act (Can), s 17, above at 9, while Companies Act 1965 (Mal), s 67, above at 17, replicates the very similar Companies Act 1948 (UK), s 54, rather than the original section.
management to be determined by directors acting in good faith in the interests of the company as a whole.\textsuperscript{130} It is submitted that such a view substantially disregards the interest of creditors in protecting their entitlement to be paid or repaid from corporate assets in those situations where directors overreach themselves and drive the company towards or into insolvency. Conversely the original general prohibition on financial assistance is overly protective of creditor interests and may deprive management and shareholders of opportunities to use corporate resources to the fullest extent consistent with the interests of the company as a whole.

**Seeking an optimum solution to the problem**

Between the two extremes, there are a number of provisions to relax the prohibition in specific circumstances or to permit financial assistance being given, provided conditions are satisfied. Absent niceties of language, both these types of mid-range provision recognize that financial assistance is not wholly bad but should be used with care to ensure that interests, other than those of the company as a continuing entity, are safeguarded.

The differences in the provisions arise primarily because different filters are used to separate normal from unusual transactions and, secondarily, because the persons whose interests the law seeks to protect are differently defined in the various jurisdictions. It is possible that shareholders and creditors are considered in all situations but in many jurisdictions shareholders have an express role to play in decision making, whereas creditors are rarely conceded a specific function in the process. However, it is arguable that, unless the filter mechanism affords both shareholders and creditors fair protection against the possibility of ill-judged action by directors, the legislation should first ensure that the interests of creditors, who rank before shareholders on a liquidation and have no role in the appointment of directors, are adequately protected. This latter task is undertaken, perhaps ineffectually, by some of the time limitations imposed by the provisions.

**Primary filters**

Filters take a number of forms. The primary filter in the current United Kingdom\textsuperscript{131} legislation is the condition that financial assistance may be given if ‘the company has net assets which are not thereby reduced, or, to the extent that those assets are thereby reduced, if the assistance is provided out of distributable profits.’ That test is not applied where a public company gives financial assistance in good faith as part of a wider purpose or for regulated capital transactions\textsuperscript{132} but is limited to lending transactions in the ordinary

\textsuperscript{130} See Hughes v Northern Electric and Manufacturing Co (1915) 21 DLR 358, above at n 2, and the arguments adduced by Cho & Kishore, above n 3, and Cornwell, above n 3.

\textsuperscript{131} Companies Act 1985 (UK), 154(1) for public companies and s 155(2) for private companies. The company must have net assets before it can give financial assistance but, as it seems inevitable that net assets will be reduced or risked as a result of giving financial assistance, the real filter is the availability of distributable profits, essentially retained earnings. See, also, Companies Ordinance (Hong Kong), s 47D, discussed above at 17 – 8.

\textsuperscript{132} Ibid, s 153(1) – (3).
course of business and ‘employee benefit transactions.’ The test applies to private companies where it is used in conjunction with the so called ‘whitewash’ provisions. These latter provisions will be repealed if the Company Law Reform Bill 2005 is enacted in its present form. New Zealand grounds its law on a strict solvency test. Australia imposes no special test on financial assistance in the ordinary course of commercial or financial business and employee benefit transactions or where shareholders approve a proposal under s 260B procedures but does not permit directors to act on their own initiative unless they are satisfied that ‘giving the assistance does not materially prejudice the interest of the company or its shareholders or the company’s ability to pay its creditors.’ There is considerable uncertainty about the meaning of ‘no material prejudice,’ which is not defined in the Act and has not been the subject of judicial interpretation, but, at the least, the term would seem to involve consideration of the company’s future solvency. Similarly the former Singaporean requirement that a disclosure document be prepared before a shareholders’ meeting implied but did not mandate that the company be solvent following the grant of financial assistance whereas, under the 2005 amendments, the twin requirements of solvency and a surplus of assets over liabilities will underpin all corporate financial assistance.

**Secondary controls**

The first issue to be considered is whether a company that meets an objective solvency test should be required to undergo further checks? If so, what kind of checks are appropriate?

The United Kingdom does not require further checks to be made on public companies, that have limited capacity to engage in financial assistance but has imposed further tests, including an auditor’s opinion, on private companies. These should protect a creditor’s interests but do not explicitly permit creditors to oppose a transaction that they consider may adversely affect their position. However, if the current Company Law Review Bill 2005 is enacted in its present form, the ‘whitewash’ provisions relating to private companies will be repealed and regulation of this conduct left to the wrongful trading provisions of the Insolvency Act 1986 (UK). Hong Kong

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133 Ibid, s 153(4).
134 Ibid, s 155(2).
135 Ibid, ss 156 – 158, which require a solvency report by auditors attached to a statutory declaration by the directors and a special resolution of shareholders.
136 See cl 151A (3) of the Bill and “The current proposal” at 6 -7 above.
137 Companies Act 1993 (New Zealand), s 4 & 77 (6), discussed above at 9 -10.
138 Corporations Act 2001(Cth), s 260C.
139 Ibid, s 260A(1)(a).
140 See discussion at 14 above, esp at n 92.
141 Companies Act 1994 (Sing), s 76 is modelled on Companies Codes (Aus), s 129, discussed above at 11 – 3.
142 See above at 16 – 7, esp n 114.
143 Companies Act 1985, s 154.
144 Ibid, s 156 – 8, above at 5 – 6.
145 Clauses H18 & H19, discussed above at 6 - 7.
146 Sections 213 -5.
will retain the equivalent of the former controls on British public and private companies for its listed and unlisted companies respectively.\textsuperscript{147} New Zealand requires no further controls where the solvency test is satisfied and the proposal has received the unanimous support of the membership\textsuperscript{148} but otherwise imposes different rules for proportionately large or small transactions. The critical figure is five (5) per cent of the company’s capital and reserves. If the assistance is for a lesser amount, shareholders must be informed within ten days of the transaction occurring,\textsuperscript{149} whereas for larger amounts, notice must be given ten days before the transaction is scheduled to occur.\textsuperscript{150} Where proportionately larger amounts are involved, the law recognizes the interests of shareholders expressly but does not recognize that creditors may, also, be interested in these transactions. The new Singaporean law\textsuperscript{151} operates in a similar manner to the New Zealand provision but adopts a more generous ten (10) per cent cut off point. Below that level the directors make the decision for the company\textsuperscript{152} but no greater assistance can be given without a unanimous resolution or approval by all shareholders.\textsuperscript{153} The interests of creditors are not specifically addressed in this arrangement, whereas Companies Act 1994 (Sing), s 76(12) permits creditors, along with dissident shareholders or the Registrar of Companies to oppose court approval being given where financial assistance under the s 76(10) procedure is permitted\textsuperscript{154}. Given the incoherence of the Australian filter provisions, it is not surprising that secondary controls are either absent or ineffective. Where there is ‘no material prejudice’\textsuperscript{155} or the transaction is in the ordinary course of commercial dealing,\textsuperscript{156} the transaction occurs without notice being given to either shareholders or creditors. If the transaction receives shareholder approval,\textsuperscript{157} assistance can not be given until fourteen days after notice of approval is lodged with ASIC but neither dissident shareholders nor creditors have standing to seek the statutory injunctive relief.\textsuperscript{158} While it is not possible to establish any common rule from the positions adopted, it is general practice to allow directors to give financial assistance, of a limited amount, provided the solvency of the company is established\textsuperscript{159} but to require shareholder approval when larger amounts are at stake.

\textsuperscript{147} Companies Ordinance (Hong Kong), ss 47A – 48, discussed above at 17 - 8.
\textsuperscript{148} Companies Act 1993 (NZ), ss 107(1)(e), 108
\textsuperscript{149} Ibid, s 80.
\textsuperscript{150} Ibid, ss 78-9, discussed above at 10.
\textsuperscript{151} Companies Act 1967 (Sing), as amended by Companies (Amendment) Act 2005.
\textsuperscript{152} Companies Act 1967 (Sing), s 76(9A)
\textsuperscript{153} Ibid, s 76(9B)(e)(i) requires a unanimous resolution by all members present in person or by proxy at a meeting, whereas, in the case of a mail out resolution, (ii) all shareholders must approve.
\textsuperscript{154} See above at 17. The s 76(10) procedure is the same as that adopted under the Australian Companies Codes, discussed above at 11-3.
\textsuperscript{155} Corporations Act 2001 (Cth), s 260(1)(a).
\textsuperscript{156} Ibid, ss 260A(1)(c), 260C.
\textsuperscript{157} Ibid, ss 260A(1)(b), 260B.
\textsuperscript{158} This anomaly is discussed above at 15. The position would be changed dramatically if the section references in Corporations Act 2001 (Cth) s 1324 (1A)(b)(ii) and (1B)(b)(iii) were to s 260A, not s 260A(1)(a).
\textsuperscript{159} The United Kingdom with regard to public companies and the proposal for private companies; Hong Kong, New Zealand and Singapore.
Australia provides a notable exception to this practice because it does not mandate that a solvency test underpin financial assistance. Such a test is inherent in the 'no material prejudice' test but it forms no part of the exempted financial assistance provision and warnings about the economic consequences of granting financial assistance, contained in a s 260B information memorandum, can be ignored by shareholders. Nevertheless the s 260B procedure, although deeply flawed, should not be totally ignored as it is the only provision that appears to recognize that creditors should be able to seek injunctive relief where a company plans to give financial assistance in situations which adversely affect their interests. That, indeed, may be the major contribution from all Australian legislative activity in this field. In those situations where a board is not empowered to act of its own volition, shareholders in general meeting are appropriate persons to ratify its decision but creditors or lenders should have standing to object to transactions which could adversely affect their interest in being paid or repaid in a timely manner.

**Time**

In all financial dealings, timing is important. With financial assistance, it is critical that the company granting the assistance should be solvent immediately after the financial assistance is given. In several jurisdictions, that likelihood is enhanced by requiring the assistance to be given within a short time of the solvency declaration being made. New Zealand and Singapore do not set fixed time limits but require directors to prevent financial assistance being given if the company ceases to satisfy the solvency test requirements at any time before the assistance is given. This obligation is more onerous than a single solvency declaration but is more consistent with the directors’ duties to the company and the public policy interest in ensuring that financial assistance is not given for non-core activities when the company may be unable to meet obligations incurred in the ordinary course of business.

**Conclusion**

The financial assistance provision was introduced into British law some seventy seven years ago to prohibit a practice which was disturbing to those shareholders who had been bought out with company money. However, it was not necessarily harmful to the company. Notwithstanding its dubious credentials, it was accepted into the law of many British dominions and

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160 *Corporations Act* 2001 (Cth), s 260A(1)(a), discussed above at 14. The advantage of this test is that it is directly related to the size of the financial assistance envisaged.
161 Ibid, s 260C.
162 Discussed above at 15 and at 21. Section 1324 would be a powerful instrument for creditor protection if it referred to s 260A(1), instead of the more specific s 260A(1)(a).
163 *Companies Act* 1985 (UK), s 158(4), within eight weeks of declaration of solvency for private companies but this condition will be removed upon coming into operation of *Company Law Review Bill* 2005 (UK); *Companies Ordinance* (HK), s 48.
164 *Companies Act* 1993 (NZ) s 77(3); *Companies Act* 1994 (Sing), s 76 (9C), introduced by the *Companies (Amendment) Act* 2005.
colonies and for the most part has remained there in near original or variant forms.

It is possible that company law has developed other protective mechanisms to such a degree that the provision could be repealed but, if legitimate concern remains in the community about such transactions, a solvency test should offer primary protection, with shareholder approval required where a significant proportion of corporate assets are committed, actually or contingently, to the transaction. In recognition of the risk run by creditors in situations where companies engage in improvident behaviour, it is submitted that notice of any meeting to obtain shareholder ratification of an intended transaction should be given to the regulatory authority and that concerned creditors, if unable to persuade the company to settle any outstanding claims, should have standing to protect their interests by injunction.

Financial assistance was a problem in the United Kingdom in the 1920s. It may have been, but probably wasn’t, a problem in the numerous British dominions and colonies that subsequently adopted the prohibition imposed by Companies Act 1929 (UK), s 45. Over the succeeding seventy seven years, many jurisdictions either by following British amendments or in exercise of their own initiative found ways to overcome the problem. However the dysfunctional provision retains the potential to cause trouble in Canada, which has not identified financial assistance as a problem, Malaysia, which has recognized financial assistance as one of the matters to be considered in its company law reform program, and Australia, which has engaged in an extensive company law reform program over the past decade but failed to free its companies and their creditors from the adverse consequences of this ill-judged legislation.

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165 See Malaysia, above at 17, and the Canadian provinces of Alberta, New Brunswick, Prince Edward Island and Quebec, above at 9.
166 Business Corporations Act 2002 (British Columbia) has no provision for financial assistance. And see Cho & Kishore, above n 3, at 210; Cornwell, above n 3, at 747.
167 The two element test in Companies Act 1985 (UK), s 154(1) has won acceptance in Hong Kong and Singapore, and is functionally similar to the test propounded in Companies Act 1993 (NZ), ss 4 and 77(6)
168 This is the situation that would apply if the protective injunctions available under Corporations Act 2001 (Cth) s 1324 were available for all s 260A situations, instead of being confined to s 260A(1)(a)see discussion above at 15 and at 21-2.
170 Companies Act 1993 (NZ), Pt VI, ss 76 – 81; Business Corporations Act 2002 (BC).
171 See discussion above at 9.
172 See discussion above at 17.
173 The reforms of 1981 effectively neutralised the sting of the original prohibition but the 1998 reforms, while recognising what needed to be done, were misaligned and effectively deprive creditors of the recognition of their interest in these transactions, see discussion above at 11 - 6.