

# LITIGATION ALERT:

## Don't second guess material prejudice: High Court confirms broad application of s 260A

---

The decision of the High Court of Australia in *Connective Services Pty Ltd v Sleat Pty Ltd* [2019] HCA 33 confirms a broad prohibition against a company providing financial assistance for the purposing of acquiring shares in the company, where that financial assistance is said to materially prejudice the interests of the company or its shareholders.

19 November 2019

### HOW DOES THE DECISION AFFECT YOU?

---

The High Court's decision in *Connective Services* has broadened the scope of “*financial assistance*” under the *Corporations Act 2001* (Cth), by expanding that term to include the situation where a company commences legal proceedings to enforce pre-emptive rights for the benefit of (some of) its shareholders.

*Connective Services* is a firm reminder that the prohibition against companies providing financial assistance applies broadly. It follows that directors, officers and shareholders need to take a conservative approach when considering whether any conduct could constitute financial assistance and, in turn, contravene section 260A of the *Corporations Act*.

An effective way to avoid breaching section 260A may be by seeking shareholder approval for the action pursuant to section 260B of the *Corporations Act*.

Finally, directors, officers and shareholders need to bear steadily in mind that where an injunction is sought in relation to an alleged contravention of s 260A(1), the burden of establishing that no material prejudice has been suffered falls on the company.

### LEGAL FRAMEWORK

---

Section 260A(1) of the *Corporations Act 2001* (Cth) provides that a company may financially assist persons in acquiring shares only where such assistance:

- does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors;<sup>1</sup>

---

<sup>1</sup> *Corporations Act 2001*, s 260A(1)(a).

- is approved by shareholders under section 260B (also requiring notice to ASIC);<sup>2</sup> or
- is exempt under section 260C.<sup>3</sup>

Significant penalties apply to a breach of section 260A, including criminal penalties where the breach is dishonest.

Section 1324(1B)(a) of the *Corporations Act* provides that where an injunction is sought and the ground relied upon is a breach of s 260A(1)(a), the Court must assume that the conduct constitutes a contravention of s 260A(1)(a) unless the company or person proves otherwise. Accordingly, the burden of establishing that the conduct is not materially prejudicial falls to the company.

## BACKGROUND

---

Slea Ltd Pty (“**Slea**”) was one of three shareholders in Connective Services Pty Ltd (“**Connective Services**”) in which it held a 33% stake.

A pre-emption clause in Connective Service’s constitution required that all shares be offered to existing shareholders prior to any external transfer.

After a falling out between the sole director and shareholder of Slea and his fellow shareholders at Connective Services, Slea purported to transfer its shares to a third party, Minerva Financial Group.

To compel compliance with the pre-emptive rights provision, Connective Services brought proceedings against Slea and Minerva funded by the company.

Slea then made an application for an injunction under section 1324 to restrain the legal action, on the basis that it contravened the prohibition against financial assistance under section 260A.

The financial assistance in this case related to the funding of litigation to enforce pre-emptive rights against a minority shareholder.

## THE HIGH COURT’S DECISION

---

In a unanimous judgement, the High Court dismissed the appeal by Connective Services and upheld the injunction sought by Slea under section 1324(1B).

The High Court held that in commencing the pre-emptive rights action, Connective Services had failed to discharge the burden of showing that no material prejudice would be suffered in the absence of shareholder approval under section 260B.

Importantly, the High Court held that:

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 its 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 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.<sup>4</sup>

Finding the implied prohibition in section 260A was enlivened, the High Court held that in commencing the action, Connective Services failed to discharge its burden of showing that no material prejudice would be suffered in the absence

---

<sup>2</sup> Ibid s 260A(1)(b).

<sup>3</sup> Ibid s 260A(1)(c).

<sup>4</sup> *Connective Services Pty Ltd v Slea Pty Ltd* [2019] HCA 33, [39] (Kiefel CJ, Gageler, Keane, Gordon and Edelman JJ).

of shareholder approval under section 260B. Connective Services' appeal was dismissed and it was ordered to pay the Sleat parties' costs of the proceeding.

## IMPLICATIONS

---

The High Court confirmed that financial assistance includes any action which stands to “[ease] *the financial burden that would be involved in the process of acquisition*”. The term “*acquire*” was also given a broad meaning to include any conduct “*in connection with the process of an acquisition*”.<sup>5</sup> This confirms that any action capable of directly or indirectly affecting acquisition may constitute financial assistance within the meaning of s 260A.

### The Unpredictability of Calculating Material Prejudice

The decision in *Connective Services* also expressly warns against the danger of forming a view that there is no material prejudice. The High Court emphasised that the determination of material prejudice is “*fact intensive*”.<sup>6</sup> In coming to the conclusion that the onus of disproving material prejudice had not been discharged, the Court was not persuaded that financial projections bore any significant weight, stating “*it does not assist to gloss the concept of material prejudice by the introduction of further concepts*”.<sup>7</sup>

### The Onus of Proving “No Material Prejudice” Falls on the Company

Section 1324(1B)(a) of the *Corporations Act* provides that where the ground relied on in an application for an injunction is 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.

The effect of s 1324(1B)(a) is that the onus is therefore on the Company to establish that the relevant conduct is not materially prejudicial.

It follows that *Connective Services* confirms a broad prohibition against a company providing financial assistance, where that financial assistance is said to materially prejudice the interests of the company or its shareholders. Directors, officers and shareholders need to exercise caution when taking any step which might constitute “*financial assistance*” for the purpose of s 260A of the *Corporations Act*.

## FURTHER INFORMATION

---

### JANE GOOD

Director  
T 03 9602 5800  
[jane@brandpartners.com.au](mailto:jane@brandpartners.com.au)

### TIM PRUDDEN

Lawyer  
T 03 9602 5800  
[tim@brandpartners.com.au](mailto:tim@brandpartners.com.au)

### GEMMA SIBLEY-LEWIS

Law Clerk  
T 03 9602 5800

---

<sup>5</sup> Ibid [23] (Kiefel CJ, Gageler, Keane, Gordon and Edelman JJ).

<sup>6</sup> Ibid [26] – [27] (Kiefel CJ, Gageler, Keane, Gordon and Edelman JJ).

<sup>7</sup> Ibid [26] – [27].

## **ABOUT BRAND PARTNERS**

*Brand Partners is a long established Melbourne based firm, working Australia wide. Our staff and partners are highly qualified with specialist accreditations and post-graduate degrees on our team. We work as a team to produce the best results for you.*

*Our principal goal is to provide the right legal advice to get you to where you need to be. We aim to be an instrumental part of each client's success.*

This publication is not intended to be a comprehensive review of all developments in the law, or to cover all aspects of those referred to. Readers should take legal advice before applying the information contained in this publication to specific issues or transactions. For more information please contact us on (03) 9602 5800. Further information about Brand Partners Commercial Lawyers can be found at [www.brandpartners.com.au](http://www.brandpartners.com.au).