709–723, including a requirement for a directors' statement and an auditor's report, and a right for members and creditors to apply to court for the cancellation of the resolution); public companies must redeem out of distributable profits (see 'Current position', pp 542ff) or from the proceeds of a new share issue made for the purpose (s 687);
(v) redeemed shares must then be cancelled, and the company must reduce its issued share capital by the nominal value of the cancelled shares (s 688);
(vi) to the extent that the redemption is made out of profits, the company must also transfer an amount equivalent to the nominal value of the redeemed shares to a new capital account called the '*capital redemption reserve*', which can only be reduced by transfer to the share capital account to pay up fully paid bonus shares, or otherwise as if it were part of the paid up share capital (s 733). In effect, this means that the company must have available a surplus equivalent to double the funds needed to effect the repurchase, and one-half has to be set aside and treated as capital thereafter.
(vii) there are extensive disclosure provisions.

Repurchase of shares

The essential difference between a *repurchase* and a *redemption* is as follows: in the former, the buyer and seller need to agree to the terms and conditions of repurchase at the time of the repurchase; whereas with the latter, the shares will have been issued as redeemable shares, so that the terms and conditions of the reacquisition will be known from the outset. Subject to that essential difference, however, the two transactions are treated by CA 2006 in broadly similar ways.

A company's power to repurchase its own shares is broad: subject to any constraints or prohibitions in the company's articles, a company may repurchase its shares in accordance with the rules set out in CA 2006 ss 690ff.

Again, it is necessary to pay strict attention to the detailed wording of the Act itself, although with the warning that these sections are long-winded and not easy to follow. Note that different rules apply to:

(i) a purchase by a company of its own shares *off the market*: a special resolution is necessary, and for public companies this authority cannot be granted for longer than 18 months (ss 694, 697 and 700); the shareholders whose shares are to be repurchased cannot be counted in the vote (ss 695 and 698);
(ii) a purchase by a (public) company of its own shares *on the market*: an ordinary resolution is required (s 701); the authority granted may be general or specific, and unconditional or conditional, but this authority cannot be granted for longer than 18 months.

(p. 523) Note, too, that:

(i) the company's right to repurchase its shares cannot be assigned (s 704);
(ii) shares cannot be repurchased unless fully paid (s 691);
(iii) the shares must be paid for in full at the time of repurchase (s 691);
(iv) the permitted sources of the purchase funds for repurchases by private and public companies are the same as for redemptions (see earlier) (ss 692 and 705), and when a private company uses capital to fund the purchase a declaration of solvency is needed;
(v) the rules on creation of a capital redemption reserve are the same as for redemptions (see earlier) (s 733);
(vi) the repurchased shares must be cancelled, and the company must reduce its issued share capital by the nominal value of the cancelled shares, *unless* the shares can be held and dealt with as '*treasury shares*'[12] in accordance with ss 724ff (s 706); and
(vii) there are extensive disclosure provisions.

Protection of shareholders

The rules discussed in this section are primarily aimed at protecting creditors while allowing companies to use their resources in an efficient and financially sensible manner. But the rules have built-in protections for both exiting and remaining shareholders that are worth noting:

(i) *Share redemptions*: these work largely on the 'buyer beware' principle, since the exiting shareholder is aware of the exit terms before the shares are purchased, and the ordinary shareholders are assumed to know that the company may issue such shares (either as a general power (private companies), or as expressly permitted in the articles (public companies)).
(ii) *Share repurchases*: agreement to the terms of the repurchase is a matter of choice for the exiting shareholder, who cannot be forced to exit; and the non-exiting ordinary shareholders are protected, either by majority vote plus normal on-market purchase rules, or by the protective requirement for a special resolution for off-market repurchases; and in both cases the intending exiting shareholders cannot vote in these general meetings. This is a rare formal protection in the context of shareholder voting.

➢ Notes

1. A statutory rule which has some links with these principles is that contained in CA 2006 s 136. This states that a company cannot itself be a member of a company which is its holding company, either directly or through a nominee (s 144).[13] The weakness of this provision, however, is that it is confined in its operation to 'holding companies' and their subsidiaries as these terms are defined by ss 1159ff. There is nothing in these definitions which stops company A from owning 40% of the shares in company B, which itself has 40% of the shares in company A. If a majority of the board of each of the two companies consists of the same persons, they can usually, in practice, wield unrestricted control of both companies, regardless of the size of their own individual shareholdings.

(p. 524) 2. In *Acatos & Hutcheson plc v Watson* [1995] BCLC 446 it was held not to be unlawful for a company, A & H plc, to acquire all of the shares in another company, A Ltd, whose only asset was a 29.4% shareholding in A & H plc itself, even though it would not have been legitimate for it to have bought these latter shares directly.

3. Analogous to the acquisition of its own shares by a company is the taking of security over them. This, too, is forbidden by the Act in the case of *public* companies: see s 670, although there are exceptions when (i) the charge is to secure calls on partly paid shares, or (ii) it is an ordinary business dealing by a money-lending company.

➢ Questions

1. In the example given in Note 1, in which A Ltd and B Ltd have cross-shareholdings of 40% in each other, why is it that the board will usually have *de facto* control?

2. Is there any infringement of the principle of maintenance of capital in such a case?

Financial assistance by a company for the acquisition of its own shares

Another statutory rule that has links with the maintenance of capital principle is that contained in CA 2006 s 678, which imposes a prohibition against a *public* company or any of its subsidiaries[14] giving financial assistance to a person directly or indirectly for the purpose of an acquisition of its own shares.[15] Contravention of the prohibition constitutes an offence committed by every officer who is in default, and, more surprisingly, also by the company whose protection the section is intended to promote.

Before the introduction of the 2006 Act, the prohibition applied to all companies, although private companies had their own special 'whitewash' procedures which enabled them to avoid the application of the rule in certain circumstances. The exclusion of private companies from the prohibition means that there is no inhibition, at least from this source,[16] for private company 'management buy-outs' and other 'hiving-down' arrangements, under which

a business or part of it is sold off to the existing managers or to similar entrepreneurial figures who wish to become owner-executives of the business but cannot finance the purchase except through the direct or indirect use of the company's own assets as security.

The general prohibition on the giving of financial assistance by a public company is required by the Second EU Company Law Directive (77/91/EEC). The prohibition in the UK Act extends to post-acquisition assistance (see s 678(3)), although only if the company in which the shares were acquired is a public company at the time that the assistance is given.[17]

'Financial assistance' is defined in s 677, and includes any provision by the public company (or its subsidiaries) of assistance by way of gifts, loans, security arrangements, guarantees **(p. 525)** and, indeed, any arrangements where the company fulfils its side of a deal but those of the other party remain unfulfilled. There is also a catch-all provision that includes 'any other financial assistance given by the company' where the company has no net assets, or where the net assets of the company are reduced to a material extent.

Examples of the kind of transaction in question are where the public company (or its subsidiary):

(i) lends money to A to put A in funds so that he can buy shares from an existing member;
(ii) guarantees B's bank overdraft, and on the security of this the bank advances money to B so that he can buy shares in the company;
(iii) lends money to C so that C can repay a loan provided earlier by C's bank which C has already used to buy shares in the company;
(iv) buys an asset from D, on terms that materially reduce the net assets of the company, so that D can use the purchase money she receives to pay for shares in the company that she has agreed to buy.

The same kind of assistance can readily occur in a takeover: the person who seeks to buy all the shares, or a controlling block of shares, in a company may wish to use some of the company's own funds or assets to pay for the shares or provide security for their price.

If, in examples (i) to (iii), the purchaser of the shares repays the money he or she has borrowed, then no harm may be done. However, the risk is that the loan may never be repaid or that the bank may enforce the guarantee against the company after the customer has defaulted so that the company will have lost money which was part of its capital. Indeed, it may have been lost in favour of one of its shareholders so that the 'maintenance of capital' rule is infringed. Similar consequences necessarily follow in (iv) if the asset is not worth what the company has paid D for it. So it is not surprising that a statutory prohibition similar to s 678 has been in the Companies Acts since 1929.

Earlier versions of this provision (before 1981) were both much wider in their terms and notorious for the uncertainty of their language, which seemed to catch many quite innocent transactions. Responsible lending institutions and professional advisers were unwilling to be associated with schemes which might offend against the vague wording of the statute, and so companies were often prevented from taking a course of action which made good business sense and was not morally objectionable. At the same time, the relatively low penalty imposed for the offence was no real deterrent to the unscrupulous.

In 1981, amendments were made which were intended to define more precisely the conduct to be prohibited and introduce general and specific exemptions. These changes are all substantially carried forward in CA 2006 ss 677ff (apart from the provisions relating to private companies).[18]

There is a *general exemption* from the prohibition on the giving of financial assistance: such assistance is not prohibited if (i) the principal purpose of the assistance is not for an acquisition of shares, *or* (ii) the assistance is incidental to some other larger purpose of the company, *and* (in either case) the assistance is given in good faith in the interests of the company (ss 678(2) and (4), 679(2) and (4)). There are also a number of types of financial assistance (eg the payment of lawful dividends) that are specifically allowed (s 681), and a number of transactions that are exempted subject to specified conditions (s 682).

The principal cases on the meaning of 'financial assistance' and the application of the general exemptions are all somewhat controversial. The words of the Act must remain the **(p. 526)** primary source of guidance. The following

cases that deal with the civil consequences of an infringement of the statute arose under older versions of the statutory provisions, but may still be regarded as authoritative on the issues cited (although not on the application of the prohibition itself).

The meaning of 'financial assistance'

The test of financial assistance is one of commercial substance and reality.

[10.06] Chaston v SWP Group Ltd [2002] EWCA Civ 1999, [2003] 1 BCLC 675 (Court of Appeal)

This case was decided under the Companies Act 1985 (CA 1985) provisions. CA 2006 s 678 would not apply, since the target company was a private company, but the Court of Appeal's discussion of the meaning of 'financial assistance' remains relevant.

The company allegedly providing financial assistance was the subsidiary, DRC Polymer Products Ltd (DRC) and its parent was Dunstable Rubber Company Holdings Ltd (DRCH). Chaston (C) was a director and majority shareholder in DRC. SWP wished to acquire the DRC Group by acquiring the shares of the holding company, DRCH, and needed a due diligence report on the Group for its members. Work for this report was done by the accountants, Deloitte and Touche (D&T). C agreed that D&T should invoice DRC for their fees for that work. It was not entirely clear whether DRC committed itself to pay the fees before the invoices were rendered, nor was it clear when the fees were paid by DRC.

The Court of Appeal held that the payment of D&T's fees by the subsidiary, DRC, was within the definition of unacceptable 'financial assistance' in CA 1985 s 152 [now CA 2006 s 677].

> ARDEN LJ: … It is clear from the way in which s 151 and s 152 [CA 2006 ss 678 and 677] are drafted that it covers financial assistance in many forms apart from loans (see for example the wide wording of s 152(3)). The general mischief, however, remains the same, namely that the resources of the target company and its subsidiaries should not be used directly or indirectly to assist the purchaser financially to make the acquisition. This may prejudice the interests of the creditors of the target or its group, and the interests of any shareholders who do not accept the offer to acquire their shares or to whom the offer is not made.
>
> Thus although s 152 proscribes a number of forms of financial assistance, it does not define the words 'financial assistance'. It is clear from the authorities that what matters is the commercial substance of the transaction: 'The words ["financial assistance"] have no technical meaning and their frame of reference is the language of ordinary commerce' (per Hoffmann J in *Charterhouse v Tempest Diesels* [see later], approved by the Court of Appeal in *Barclays Bank plc v British & Commonwealth Holdings plc* [1996] 1 BCLC 1 at 40). …
>
> It is thus apparent that ss 151 to 153 distinguish between various categories of transactions. First, there are the categories of financial assistance listed in s 152(1)(a)(i) to (iii) [CA 2006 s 677(1) (a)–(c)] which are prohibited whether or not there is any diminution in net assets, unless s 153 applies [ie certain exemption provisions noted later]. Second, there is financial assistance of a kind not specifically mentioned in s 152(1)(a)(i) to (iii). This does not contravene s 151 [CA 2006 s 678] provided the company has positive net assets and the reduction in actual net assets is immaterial [CA 2006 s 677(1)(d)]. (Again, I leave to one side the case of companies with no net assets.) Third, there are those which although carried out for the purpose of an acquisition of shares and have financial implications do not constitute financial assistance for the purposes of s 151. This category includes lawful dividends: see s 153(3) [CA 2006 s 681]. Fourth, there are transactions which although they constitute financial assistance within s 152(1)(a) are taken outside the prohibition in s 151 by the principal purpose defences in s 153(1) and (2) [CA 2006 s 678(2) and (4)]. Fifth, there are the **(p. 527)** transactions exempted by s 153(4), such as the lending of money by a money-lending company in the ordinary course of its business [CA 2006 s 682]. …
>
> Here as a commercial matter assistance was clearly given. D&T received payment for their services and both the purchaser and the vendors were relieved of any obligation to pay for this service themselves. Mr

Cunningham submits that s 151 should be restricted to assistance given to purchasers, alternatively to assistance given to vendors and purchasers. However, in so far as that point matters in this case there is no mandate in my judgment for reading any such limitation in that section. There is no reason why assistance which is paid to a subsidiary or associated company or other person nominated by one of the parties to the transaction should not be assistance contrary to the section. …

Mr Cunningham made a further submission that there was a distinction to be drawn between financial assistance given in advance of a transaction and financial assistance given in the course of a transaction. As to the former, this was not prohibited. On this, he relied on the four cases referred to above. In my judgment, this distinction is not justified by s 151. It prohibits financial assistance given 'directly or indirectly' and those words are sufficiently wide to cover 'pre-transactional' financial assistance. Moreover, s 151(1) provides that a transaction can offend the section even though a person is only 'proposing' to acquire shares. …

➢ Note

In this case it was irrelevant to the finding of financial assistance that:

(i) The value of the fees (about £20,000) was trivial in comparison with the total consideration for the acquisition (about £2.55 million).
(ii) The assistance was not provided to the purchaser of the shares. The reality was that the instructions to D&T were given at least in part to enable SWP to conclude a due diligence exercise which was SWP's responsibility and for SWP's benefit and which should therefore have been paid by SWP. By paying for part of that exercise DRC had given financial assistance to SWP.
(iii) There had been no financial detriment to the company being acquired, the financial assistance was not given in advance of or in the course of the takeover, and the payment of the fees had no impact on the share price.

A more commercial approach in defining 'financial assistance'?

[10.07] Anglo Petroleum Ltd v TFB (Mortgages) Ltd [2007] EWCA Civ 456, [2007] BCC 407 (Court of Appeal)

The facts are complicated, since the alleged financial assistance involved a series of transactions. Shares in APL had been sold by APL's parent, Repsol, to another company (Kaluna) for £1. At the same time under a compromise agreement Repsol agreed to release APL's indebtedness to Repsol of £30 million and APL agreed to pay Repsol £6 million immediately and £9 million after six months. To secure that debt APL gave Repsol a charge over a number of petrol stations. Under the share purchase agreement, Kaluna guaranteed the performance by APL of its obligations under the compromise agreement and that guarantee was secured by a charge granted by Kaluna to Repsol over the shares in APL. Three months later APL borrowed £15 million from the respondent (TFB) under a credit agreement and used £9 million to effect early repayment of the £9 million owed to Repsol. The charge given by APL to Repsol was released and replaced by a security agreement between APL and TFB relating to the same or substantially the same properties. S had given a guarantee of APL's liabilities under the credit agreement. APL went into receivership and TFB claimed against APL and S. APL claimed against TFB on the ground that the security agreement was in breach of CA 1985 s 151 (CA 2006 **(p. 528)** ss 677 and 678). Preliminary issues were tried as to whether the credit transactions were accordingly illegal and void. APL argued that, by entering into the compromise agreement and giving the charge to Repsol, APL incurred liabilities and thereby gave financial assistance for the purpose of the acquisition of its shares by Kaluna within the meaning of s 151(1) and that by borrowing money from TFB and using it to discharge the balance of its indebtedness to Repsol, APL gave financial assistance for the purpose of discharging liabilities incurred for the purpose of the acquisition of the shares within the meaning of s 151(2), and that TFB knew the purpose of the loan and was therefore not entitled to enforce it; alternatively, that the guarantee given by Kaluna under the share purchase agreement and the supporting charge over the shares in APL were liabilities incurred by Kaluna for the purposes of its acquisition of

the shares in APL, and that APL's repayment of its outstanding indebtedness to Repsol, using money borrowed from TFB, amounted to giving financial assistance for the purpose of discharging Kaluna's outstanding liabilities to Repsol.

TOULSON LJ:

1 This appeal [concerns] the validity of three agreements … The three agreements ('the credit transactions') were a Credit Agreement made between Anglo Petroleum Limited ('APL') as borrower and TFB (Mortgages) Limited ('TFB') as lender, a Security Agreement made between the same parties, and a Guarantee given to TFB by Mr Paul Sutton.

2 Three months before the credit transactions, APL's shares had been the subject of an acquisition. It is contended by APL that it gave financial assistance for the acquisition in breach of [CA 1985] s 151 and that this tainted the credit transactions. The judge rejected these contentions. …

Validity issues

19 APL advanced two arguments (referred to as Routes 1 and 2) in support of the contention that the credit transactions were illegal and void.

20 The focus of Route 1 was on APL's dealings with Repsol. It was contended that, by entering into the Compromise Agreement and the APL/Repsol charge, APL incurred liabilities and thereby gave financial assistance for the purpose of the acquisition of its shares by Kaluna within the meaning of s 151(1). By borrowing money from TFB and using it to discharge the balance of its indebtedness to Repsol, APL gave financial assistance for the purpose of discharging liabilities incurred for the purpose of the acquisition of the shares within the meaning of s 151(2). TFB knew the purpose of the loan and was therefore not entitled to enforce it. …

22 The focus of Route 2 was on Kaluna's dealings with Repsol. It was contended that the guarantee given by Kaluna under the Share Purchase Agreement and the supporting charge over the shares in APL were liabilities incurred by Kaluna for the purposes of its acquisition of the shares in APL, and that APL's repayment of its outstanding indebtedness to Repsol, using money borrowed from TFB, amounted to giving financial assistance for the purpose of discharging Kaluna's outstanding liabilities to Repsol. …

24 The essential issues on the appeal are:

(i) Did the payment of £9 million by APL to Repsol (from the TFB loan) in discharge of APL's indebtedness to Repsol constitute the giving of financial assistance within the meaning of s 151, either via Route 1 or via Route 2?
(ii) If so, is TFB prevented by the doctrine of illegality from enforcing the credit transactions? …

26 It is understandable that it has not been thought wise for the legislature to lay down a precise definition of financial assistance because of the risk that clever people would devise ways of defeating the purpose of the section while keeping within the letter of the law. However, the absence of a clear definition means that the section can give rise to uncertainties and has the potential to catch transactions which might be considered innocuous. In cases where its application is doubtful, it is important to remember its central purpose, to examine the commercial realities of the transaction and to bear in mind that it is a penal statute.

(p. 529) 27 Recognition of the need to examine the commercial realities, rather than search for a legal formula for the meaning of 'financial assistance', comes from the judgment of Hoffmann J in *Charterhouse Investment Trust Limited v Tempest Diesels Limited* [1986] BCLC 1 at 10, cited by Arden LJ in *Chaston* **[10.06]** at para 17:

'There are two elements in the commission of an offence under s 54 [the section that preceded s

151]. The first is the giving of financial assistance and the second is that it should have been given "for the purpose of or in connection with", in this case, a purchase of shares … There is no definition of giving financial assistance in the section, although some examples are given. The words have no technical meaning and their frame of reference is in my judgment the language of ordinary commerce. 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.'

28 The court would not in any event strain a statute to cover transactions which are not fairly within it, but the fact that the statute is penal provides an additional reason for caution in doubtful cases. …

34 There was discussion during the course of the argument about the meaning of the word 'purpose', and the court was referred to the observations of Lord Oliver in*Brady v Brady* **[10.08]**, 779–780, where he drew a distinction between a purpose and a reason for forming a purpose.

35 A purpose requires a mind. The relevant purpose is that of the company or subsidiary, through its relevant officer or officers, in giving the alleged assistance. At stages of his argument Mr Martin came close to eliding purpose and effect, arguing that if a person does an act knowing that it will have a particular consequence it must be his purpose (or at least one of his purposes) in doing the act to produce the consequence. There is no must about it. Whether the consequence was the actor's purpose is a matter for inference from all the circumstances. There may be many situations in life in which a person does a particular act knowing that it will have a particular consequence, but without that consequence being the purpose for which he does the act.

Financial assistance—conclusions

43 … Standing back from the minutiae of the arguments, and looking at the transactions attacked by APL from a commercial perspective, I do not consider that they exemplify the mischief against which the section is aimed.

44 Mr Martin's arguments are ingenious and were skilfully deployed, but in my view the commercial reality is that APL and Mr Sutton are seeking to avoid their liabilities to TFB, for what was in essence a straightforward commercial loan, by a strained reading of the statute.

45 I begin with the Compromise Agreement, the nature of which was that APL's liability to Repsol was reduced. I do not consider that it should be characterised as giving financial assistance to the purchaser on account of the fact that it thereby made the company a more attractive acquisition and can thus be said to have smoothed the path to its acquisition. Just because it smoothed the path to the acquisition, it does not follow that it amounted to financial assistance. Nor can the APL/Repsol charge, by which APL gave security to Repsol for its reduced indebtedness, properly be described as financial assistance to the purchaser.

46 As to the purpose of the transactions from APL's viewpoint, the judge fairly described them as 'a bona fide restructuring of APL's indebtedness with a significant reduction in exchange for a security'. Repsol's reason for wanting to restructure APL's indebtedness was in order to sell the shares to Kaluna and to obtain security for the reduced amount of the indebtedness, but that does not make APL's purpose in entering into the restructure that of giving financial assistance to the purchaser.

47 In any event, the liabilities undertaken by APL under the Compromise Agreement did not come within any of the categories identified in s 152 (1) as capable of amounting to financial assistance under s 151. The APL/Repsol charge was ancillary to the Compromise Agreement in that its purpose was to secure APL's obligation under the Compromise Agreement. The giving of security **(p. 530)** over a company's assets can come within s 152(1)(a)(ii), but the APL/Repsol charge did not in my judgment amount to giving financial assistance within s 151 in the present circumstances where it was merely a means of enforcing an obligation of APL which did not involve the giving of financial assistance.

48 Moving on from the issues under s 151(1) to s 151(2), the next step of Mr Martin's argument presents further difficulty. He accepts that APL's agreement to pay £15 million to Repsol under the Compromise Agreement was not unlawful (because it did not fall within s 152 (1)), but he submits that APL's payment of £9 million in discharge of that obligation was unlawful. That is a surprising proposition and goes against the grain of the authorities that the repayment by a company of its lawful indebtedness is not prohibited by s 151. Mr Martin does not dispute the correctness of those authorities, but he seeks to distinguish them by reference to the cost of the borrowing from TFB.

49 I am not persuaded that this [is] a valid ground of distinction. Mr Martin makes the point that the cost of borrowing reduced APL's assets, but I do not see how logically this converts the discharge of the company's indebtedness from a lawful act into the giving of unlawful financial assistance. …

51 As to the Security Agreement (between APL and TFB), I agree with the judge's reasoning that 'if it is lawful for a company to repay its own indebtedness and there is a genuine commercial justification it must also equally be lawful [for] the company to assist that repayment by providing security.' …

53 Accordingly, I reject the Route 1 argument that APL incurred a liability for the purpose of Kaluna's acquisition of the shares or (which would require a tortuous reading of the statute) that it gave financial assistance for the purpose of discharging such liability by repaying £9 million to Repsol. As to the Route 2 argument, there is no dispute that Kaluna undertook obligations for the purpose of its acquisition of the shares, but I reject the argument that APL by repaying its own indebtedness to Repsol gave financial assistance for the purpose of discharging Kaluna's liabilities. … [And see the discussion of illegality, 'Consequences when a transaction breaches the prohibition', pp 536ff.]

85 I would dismiss the appeal.

SMITH and MUMMERY LJJ concurred.

➤ Note

Kaluna could clearly afford to pay £1 for the shares it acquired. The issue of 'financial assistance' arose because of the associated compromise agreement over the £30 million debt that APL owed to Repsol. The wide statutory definition of financial assistance makes these related transactions material (now see CA 2006 s 677).

Further guidance on the meaning of 'financial assistance'

The following cases were all decided under the predecessors to CA 2006 ss 677 and 678, but to the extent that they discuss the meaning of 'financial assistance' they remain relevant to the interpretation of the 2006 Act.[19]

On its terms, *Chaston* **[10.06]** adopts a market-friendly test of financial assistance, looking to the 'commercial substance and reality' of the transaction; but in its application to the facts, the Court of Appeal's approach might lead to the conclusion that many transactions will fall foul of the provisions and will find no relief in the 'principal purpose' test.

Earlier and later cases have adopted a more 'commercial' approach, often finding as a matter of commercial reality that *no* financial assistance has been given. *Chaston***[10.06]** may well come **(p. 531)** to be regarded as a high-water mark, much like *Brady* **[10.08]** on the 'principal purpose'/'main purpose' exceptions. See:

(i) *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd* [1986] BCLC 1: this case was decided under the repealed Companies Act 1948 (CA 1948) s 54, and concerned a 'management buy-out' transaction under which Charterhouse hived off a subsidiary company, Tempest, by selling its entire shareholding to one of its managers, Allam. Hoffmann J was asked to decide whether a surrender of tax losses by Tempest to Charterhouse, as part of the transaction, constituted financial assistance. In ruling that it did not, he said:

> … There is no definition of giving financial assistance in the section, although some examples are given. The words have no technical meaning and their frame of reference is in my judgment the language of ordinary commerce. 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.
>
> The *Belmont* case **[10.10]** indicates that the sale of an asset by the company at a fair value can properly be described as giving financial assistance if the effect is to provide the purchaser of its shares with the cash needed to pay for them. It does not matter that the company's balance sheet is undisturbed in the sense that the cash paid out is replaced by an asset of equivalent value. In the case of a loan by a company to a creditworthy purchaser of its shares, the balance sheet is equally undisturbed but the loan plainly constitutes giving financial assistance. It follows that if the only or main purpose of such a transaction is to enable the purchaser to buy the shares, the section is contravened. But the *Belmont* case is of limited assistance in deciding whether or not an altogether different transaction amounts to giving financial assistance.
>
> The need to look at the commercial realities means that one cannot consider the surrender letter [relating to the tax losses] in isolation. Although it constituted a collateral contract, it was in truth part of a composite transaction under which Tempest both received benefits and assumed burdens. It is necessary to look at this transaction as a whole and decide whether it constituted the giving of financial assistance by Tempest. This must involve a determination of where the net balance of financial advantage lay. I see no contradiction between this view and anything which was said in the *Belmont* case. In *Belmont* the company made cash available to the purchaser. This amounted to giving financial assistance and no less so because it was done without any net transfer of value by the company. On the facts of this case there is no question of cash being provided and the only way in which it can even plausibly be suggested that Tempest gave financial assistance is if it made a net transfer of value which reduced the price Mr Allam would have had to pay for the shares if the transaction as a whole had not taken place.

(ii) *MT Realisations Ltd v Digital Equipment Co Ltd* [2003] EWCA Civ 494, [2003] 2 BCLC 117, CA: the Court of Appeal held that there was no financial assistance in breach of CA 1985 s 151, since the chosen method of arranging the share purchase reflected the commercial realities of the deal, not some disguised form of financial assistance. The claimant, MTR, was a subsidiary in the Digital group of companies, which were suppliers of computer equipment. MTR was loss-making and insolvent. It owed £8 million to another company in the group, repayable on demand. MTI bought all the shares in MTR from Digital for £1, and also bought the £8 million loan for £6.5 million, payable in instalments. The facts are complicated, but the fundamental claim was that when money due to MTR was paid to MTI and then used by MTI to pay the loan instalments to Digital, financial assistance was given for the purchase of MTR's shares. The Court of Appeal rejected the argument on the basis that: (i) it was never claimed that the shares were worth more than £1, or that MTI could not afford £1, so no assistance (p. 532) was needed; (ii) the liability to make the loan repayments was not incurred for the purpose of acquiring the shares; and (iii) when MTR made payments to MTI under the loan agreement, it was only paying a debt which it already owed before any of the acquisition dealings were commenced.

(iii) *Dyment v Boyden* [2004] EWCA Civ 1586, [2005] 1 WLR 792, CA: the applicant and the two respondents entered into partnership to run a residential care home. The real property was owned by the partners in equal shares. The business was operated through a company, and the partners were each directors of the company. The company's registration under the Registered Homes Act 1984 was cancelled by the local authority when one of the respondents was charged with assault. The partnership was then dissolved by an agreement under which the respondents transferred their shares in the company to the applicant who in turn transferred her interest in the property to the respondents, who then granted a 21-year lease of the property to the company at a rental well above the market rate. The applicant contended that payment of the additional rent above the market rate was 'financial assistance' because it had the effect of reducing the company's net assets to a material extent, and since that assistance had been given in relation to a transaction involving the acquisition by the applicant of the respondents' shares, it had therefore been

given either directly or indirectly for the purposes of that acquisition, contrary to s 151(1). The Court of Appeal affirmed the finding of the trial judge that the rent insisted on by the respondents was simply not linked to the acquisition of the shares, and not agreed 'for the purpose of' acquiring the shares.

Exceptions to the statutory prohibition

Recall the statutory exceptions noted at 'The meaning of "financial assistance"', p 526. Here the focus is on the 'purpose' exceptions.

Proof by the company that the 'principal purpose' is not the acquisition of shares, or that the acquisition is merely 'an incidental part of a larger purpose' requires proof of something more than an alternative reason why the transaction was entered into.

[10.08] Brady v Brady [1989] AC 755 (House of Lords)

A group of companies run by the Brady brothers, Bob and Jack, had a haulage and drinks business in Barrow-in-Furness. Following differences between the two brothers, it was agreed that they should divide the business in two, Jack taking the haulage side and Bob the drinks side. A complex scheme of reconstruction was drawn up under which drinks business assets were transferred from the principal company ('Brady') to a new company controlled by Bob. Jack (through his company Motoreal) acquired his brother's shares in Brady. This transfer, it was conceded, involved the giving of financial assistance by Brady towards discharging the liability of its holding company ('Motoreal') for the price of shares which Motoreal had purchased in Brady, and so there was a prima facie infringement of CA 1985 s 151 [CA 2006 s 678]. Accordingly, when Jack brought proceedings for specific performance of the agreement, Bob (who had had second thoughts) argued that the transaction was illegal.[20] However, Jack contended that the financial assistance was an incidental part of a larger purpose of the company, namely the resolution of the conflict and deadlock between the brothers which was paralysing its business and threatening to lead to its liquidation, so that the exception set out in s 153(2)(a) [CA 2006 s 678(2)] applied. The House of Lords rejected this argument: the alleged 'larger purpose' was nothing **(p. 533)** more than the reason why the transaction was entered into. However, it ruled that an order for specific performance should be made because Brady was a solvent private company and could lawfully give financial assistance by following the procedure prescribed by ss 155–158 [abolished by CA 2006, since s 678 no longer applies to private companies].

> LORD OLIVER OF AYLMERTON: Where I part company both from the trial judge and from the Court of Appeal is on the question of whether para (a) [of CA 1985 s 153(2), now CA 2006 s 678(2)] can, on any reasonable construction of the subsection, be said to have been satisfied. As O'Connor LJ observed, the section is not altogether easy to construe. It first appeared as part of s 42 of the Companies Act 1981 and it seems likely that it was introduced for the purpose of dispelling any doubts resulting from the query raised in *Belmont Finance Corpn Ltd v Williams Furniture Ltd (No 2)* **[10.10]** whether a transaction entered into partly with a genuine view to the commercial interests of the company and partly with a view to putting a purchaser of shares in the company in funds to complete his purchase was in breach of s 54 of the Companies Act 1948. The ambit of the operation of the section is, however, far from easy to discern, for the word 'purpose' is capable of several different shades of meaning. This much is clear, that para (a) is contemplating two alternative situations. The first envisages a principal and, by implication, a subsidiary purpose [CA 2006 s 678(2)(a)]. The inquiry here is whether the assistance given was principally in order to relieve the purchaser of shares in the company of his indebtedness resulting from the acquisition or whether it was principally for some other purpose—for instance, the acquisition from the purchaser of some asset which the company requires for its business. That is the situation envisaged by Buckley LJ in the course of his judgment in the *Belmont Finance* case as giving rise to doubts. That is not this case, for the purpose of the assistance here was simply and solely to reduce the indebtedness incurred by Motoreal … The alternative situation is where it is not suggested that the financial assistance was intended to achieve any other object than the reduction or discharge of the indebtedness but where that result (ie the reduction or discharge) is merely incidental to some larger purpose of the company [CA 2006 s 678(2)(b)]. Those last three words are important. What has to be sought is some larger overall corporate purpose in which the resultant reduction or discharge is merely incidental. The trial judge found Brady's larger purpose to be that

of freeing itself from the deadlock and enabling it to function independently and this was echoed in the judgment of O'Connor LJ where he observed that the answer 'embraces avoiding liquidation, preserving its goodwill and the advantages of an established business'. Croom-Johnson LJ found the larger purpose in the reorganisation of the whole group. My Lords, I confess that I have not found the concept of a 'larger purpose' easy to grasp, but if the paragraph is to be given any meaning that does not in effect provide a blank cheque for avoiding the effective application of s 151 in every case, the concept must be narrower than that for which the appellants contend.

The matter can, perhaps, most easily be tested by reference to s 153(1)(a) where the same formula is used. Here the words are 'or the giving of the assistance for that purpose' (ie the acquisition of shares) 'is but an incidental part of some larger purpose of the company'. The words 'larger purpose' must here have the same meaning as the same words in sub-s (2)(a). In applying sub-s (1)(a) one has, therefore, to look for some larger purpose in the giving of financial assistance than the mere purpose of the acquisition of the shares and to ask whether the giving of assistance is a mere incident of that purpose. My Lords, 'purpose' is, in some contexts, a word of wide content but in construing it in the context of the fasciculus of sections regulating the provision of finance by a company in connection with the purchase of its own shares there has always to be borne in mind the mischief against which s 151 is aimed. In particular, if the section is not, effectively, to be deprived of any useful application, it is important to distinguish between a purpose and the reason why a purpose is formed. The ultimate reason for forming the purpose of financing an acquisition may, and in most cases probably will, be more important to those making the decision than the immediate transaction itself. But 'larger' is not the same thing as 'more important' nor is 'reason' the same as 'purpose'. If one postulates the case of a bidder for control of a public company financing his bid from the company's own funds—the obvious mischief at which the section is aimed—the **(p. 534)** immediate purpose which it is sought to achieve is that of completing the purchase and vesting control of the company in the bidder. The reasons why that course is considered desirable may be many and varied. The company may have fallen on hard times so that a change of management is considered necessary to avert disaster. It may merely be thought, and no doubt would be thought by the purchaser and the directors whom he nominates once he has control, that the business of the company will be more profitable under his management than it was heretofore. These may be excellent reasons but they cannot, in my judgment, constitute a 'larger purpose' of which the provision of assistance is merely an incident. The purpose and the only purpose of the financial assistance is and remains that of enabling the shares to be acquired and the financial or commercial advantages flowing from the acquisition, whilst they may form the reason for forming the purpose of providing assistance, are a by-product of it rather than an independent purpose of which the assistance can properly be considered to be an incident. Now of course in the instant case the reason why the reorganisation was conceived in the first place was the damage being occasioned to the company and its shareholders by reason of the management deadlock, and the deadlock was the reason for the decision that the business should be split in two, so that the two branches could be conducted independently. What prompted the particular method adopted for carrying out the split was the commercial desirability of keeping Brady in being as a corporate entity. That involved, in effect, Jack buying out Bob's interest in Brady and it was, presumably, the fact that he did not have free funds to do this from his own resources that dictated that Brady's own assets should be used for the purpose. No doubt the acquisition of control by Jack was considered, at any rate by Jack and Robert [Jack's nephew], who were and are Brady's directors, to be beneficial to Brady. Indeed your Lordships have been told that the business has thriven under independent management. But this is merely the result, and no doubt the intended result, of Jack's assumption of control and however one analyses the transaction the only purpose that can be discerned in the redemption of loan stock is the payment in tangible form of the price payable to enable the Brady shares to be acquired and ultimately vested in Jack or a company controlled by him. The scheme of reorganisation was framed and designed to give Jack and Robert control of Brady for the best of reasons, but to say that the 'larger purpose' of Brady's financial assistance is to be found in the scheme of reorganisation itself is to say only that the larger purpose was the acquisition of the Brady shares on their behalf. For my part, I do not think that a larger purpose can be found in the benefits considered to be likely to flow or the disadvantages considered to be likely to be avoided by the acquisition which it was the purpose of the assistance to facilitate. The acquisition was not a mere incident of the scheme devised to break the deadlock. It was the essence of the scheme itself and the object which the scheme set out to achieve. In my judgment therefore, sub-s (2)(a) of s 153 is not satisfied and if the matter rested there the appeal ought to fail on that