

# FOCUS

## RESOURCES



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## PRE-EMPTIVE RIGHTS CLAUSES IN JOINT VENTURE AGREEMENTS

The recent Supreme Court of Victoria decision in *Beaconsfield Gold NL & Ors v Allstate Prospecting Pty Ltd & Ors*<sup>1</sup> centred on a pre-emptive rights clause in an unincorporated joint venture agreement, and whether or not the clause was triggered by a change in ownership in the 'corporate tree' of a joint venturer. The decision could ultimately have an impact on the drafting of pre-emptive rights clauses in joint venture agreements. Senior Associate Igor Bogdanich and Articled Clerk Victoria Wark report.

An examination of a recent court decision centred on a pre-emptive rights clause in an unincorporated joint venture agreement

### FACTS

Two wholly owned subsidiaries of Allstate Explorations NL (together, the **Allstate Venturers**) are joint venturers in the unincorporated Beaconsfield Gold Mine, established under a joint venture agreement dated October 1992 (*JVA*). The other joint venturers are Beaconsfield Gold NL and its wholly owned subsidiary, Beaconsfield Tasmania Pty Ltd (together, **Beaconsfield**).

Each joint venturer owns an interest in the Beaconsfield Gold Mine (located in Tasmania) as a tenant in common in proportion to its participating interest in the joint venture. Beaconsfield holds, in aggregate, a 48.49 per cent interest in the joint venture. The Allstate

Venturers hold the remaining 51.51 per cent interest. Over half the issued shares in Allstate Explorations NL - the immediate and direct holding company of the Allstate Venturers - are owned by two other companies. Each of those companies is, in turn, a wholly owned subsidiary of Otter Gold Mines Pty Ltd.

Through a series of 100 per cent or majority shareholdings in intermediate companies, Newmont Mining Corporation Ltd is the ultimate holding company of Otter Gold Mines Pty Ltd, Allstate Explorations NL and the Allstate Venturers (see the diagram below).

In July 2006, Allstate Explorations NL sought expressions of interest for a possible transaction involving the Allstate Venturers' 51.51 per cent interest in the Beaconsfield mine. In particular, Allstate Explorations NL sought expressions

1. [2006] VSC 320 (8 September 2006).



of interest from a party willing to purchase a controlling shareholding in Allstate Explorations NL, the idea being that shares in Allstate Explorations NL (not shares in the Allstate Venturers) would be placed with the purchaser.

Allstate Explorations NL would remain the immediate holding company of the Allstate Venturers even after any proposed transaction, and the Allstate Venturers would therefore not cease to be subsidiaries of Allstate Explorations NL.

Beaconsfield Gold NL (the **Plaintiff**) took issue with this proposal. The Plaintiff claimed that the restructuring triggered pre-emptive rights under the JVA. The Plaintiff relied on clause 20.5:

*Where a Joint Venturer is, at any time a subsidiary of another corporation and, by reason of any transaction or event, ceases to be a subsidiary of that corporation, the Joint Venturer must, within thirty days of the transaction or event, offer to sell its percentage interest to the other Joint Venturers pro rata to their respective Joint Venture Interests...[emphasis added].*

The Plaintiff maintained that, although the Allstate Venturers would continue to be fully owned by Allstate Explorations NL, they would cease to be *subsidiaries of another corporation* – namely, the Allstate Joint Venturers would cease to be subsidiaries of Otter Gold Mines Pty Ltd (and presumably each other corporation in the corporate ‘family tree’ above Allstate Explorations NL). This would, therefore, trigger the Plaintiff’s right to purchase the Allstate Venturers’ interests under clause 20.5 of the JVA.

Allstate Explorations NL and the Allstate Venturers (the **Defendants**) disputed the scope of clause 20.5 of the JVA. The Defendants maintained that, in ordinary language, the words ‘subsidiary of another company’ mean a company in which another company, the parent or holding company, holds a majority of the voting rights attached to its issued shares.

They argued that the words do not extend beyond this relationship to include companies further up the ‘corporate tree’, which, through corporate holdings, have the ability to control a majority of votes at a meeting of the subsidiary or control the composition of the board of the subsidiary. The Defendants also submitted that the legislative history of ‘subsidiary’ confines the concept to a direct relationship between a company and its immediate holding company.

## JUDGMENT

Supreme Court Justice Hargrave found in favour of the Plaintiff. His Honour was prepared to grant a declaration that each of the Allstate Venturers was a subsidiary of Otter Gold Mines Pty Ltd for the purposes of the JVA. It follows that the Plaintiff’s pre-emptive rights under the JVA would be triggered by Allstate Explorations NL’s proposal.

The parties’ submissions and the court’s decision focused on whether the Allstate Venturers could be said to be subsidiaries of any company other than the direct holding company of the Allstate Venturers.

Justice Hargrave held that the Allstate Venturers could be said to each be a subsidiary of each company above them in the relevant corporate ‘family tree’ and not just a subsidiary of their immediate holding company.

The judgment relies on technical reasoning, as well as, more pointedly, Justice Hargrave’s view of the ‘business commonsense’ underlying the operation of pre-emptive rights provisions.

The key arguments and reasoning from the judgment are summarised below.

## LEGISLATIVE MEANING OF ‘SUBSIDIARY’

Justice Hargrave dismissed the Defendants’ submission that the meaning of subsidiary at the time the JVA was entered into was limited to the direct or immediate relationship between a company and its holding company.

Justice Hargrave maintained that the relevant legislative meaning of the term ‘subsidiary’ in the (then) Corporations Law<sup>2</sup> - in operation at the time the JVA was entered into - included a wider concept of control, including controlling the composition of the board.

His Honour maintained that the ‘circumstances in which a company will be taken to control the composition of the board of another company are not limited...[and] they can include relationships other than that between a company and its immediate holding company.’<sup>3</sup>

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2. Sections 46 and 47 of the Corporations Law.

3. Beaconsfield Gold NL & Ors v Allstate Prospecting Pty Ltd & Ors, 43.

## ORDINARY MEANING OF 'SUBSIDIARY'

Justice Hargrave stated that 'the ordinary meaning of the word "subsidiary" extends well beyond the relationship between a company and its immediate holding company'.<sup>4</sup> Justice Hargrave also considered that this was the commercial understanding of the term 'subsidiary'. His Honour referred to case law that supported this commercial perception of the term 'subsidiary', including specifically the comments of Justice Barrett that:

*... the term 'subsidiary' when used today by commercial people in relation to corporations generally indicates a situation in which the corporation described as 'subsidiary' is subject to the control of another corporation...[and] 'ordinary and intelligent commercial persons ... would probably say that they would know 'control' when they saw it.*<sup>5</sup>

Justice Hargrave observed that Otter Gold Mines Pty Ltd had the capacity to control the casting of a majority of votes at general meetings of the Allstate Venturers, and thus to control the composition of their respective boards of directors. Accordingly, it was held, each of the Allstate Venturers was a subsidiary of Otter Gold Mines Pty Ltd.

## BUSINESS COMMONSENSE

The Defendants argued that the Plaintiff's position was commercially absurd because it would require a joint venturer to monitor its shareholdings up the 'corporate tree' to ensure that it meets its obligations when it ceases to be a subsidiary of any company in the 'corporate tree'. Justice Hargrave rejected this argument, on the basis that it did 'not accord with business commonsense'.<sup>6</sup>

This was because, if the Defendants' argument was correct, it would mean that the sale of shares in any intermediary holding companies would not trigger the pre-emptive rights under the JVA, even though the commercial effect of the transaction would be identical to a sale of shares in the immediate holding company (which would trigger the right).

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4. Beaconsfield Gold NL & Ors v Allstate Prospecting Pty Ltd & Ors, 44.

5. Opal Group Holdings (Aust) Pty Ltd v Franklins Ltd [2005] NSWSC 718, 8.

6. Beaconsfield Gold NL & Ors v Allstate Prospecting Pty Ltd & Ors, 52.

## PURPOSE OF PRE-EMPTION PROVISIONS

The focal point of the judgment appears to be Justice Hargrave's discussion of the purpose of pre-emptive rights provisions in joint venture agreements:

*Given the importance of the identity, financial capacity and reliability of the participants in a joint venture, pre-emptive rights operate to ensure that existing participants are empowered to exclude new participants by purchasing the outgoing participant's interest if they so desire. They also permit a joint venturer who may take the view that it has expended a significant amount of money in a high risk area to have an opportunity to increase its interest if another joint venturer desires to withdraw from the joint venture. This allows an enhanced opportunity to reap the rewards from past risk-taking and expenditures.*<sup>7</sup>

Justice Hargrave seemed to be of the view that, in interpreting pre-emptive rights provisions, a court should keep the purposes of such provisions, as described, firmly in mind, and that the objectives should not be defeated by a narrow interpretation. His Honour referred to clause 20.5 of the JVA as, in effect, an 'anti-avoidance' provision.

## WHAT DOES THIS MEAN FOR YOU?

The judgment contains some technical reasoning, relating to the intended meaning of the term 'subsidiary'. In this respect, the judgment may not carry broader implications, as the relevant reasoning principally turned on the exact wording of the JVA and the specific facts of the case.

The point of interest in the judgment - of potential application to all joint venture agreements - is that Justice Hargrave made much of the *purpose* of the assignment and pre-emptive rights provisions.

His Honour also indicated that pre-emptive rights provisions should be interpreted broadly, not narrowly, having regard to their purpose. On one view, this departs from an existing line of authority, under which courts have tended

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7. Beaconsfield Gold NL & Ors v Allstate Prospecting Pty Ltd & Ors, 33.

to interpret assignment and pre-emptive rights provisions on a more literal or narrow basis.<sup>8</sup>

This judgment suggests that, where several interpretations of a pre-emptive rights clause in a joint venture agreement are reasonably open, the interpretation that accords with the objective purpose of the provision should be preferred. In this regard, the judgment also endorses the view that pre-emptive rights provisions should be viewed as having 'an obvious anti-avoidance purpose'.<sup>9</sup>

Some commercial parties may take issue with any assumption that pre-emptive rights provisions have an 'anti-avoidance purpose', and would maintain that the purpose of those provisions is to regulate only the conduct expressly described in them. In the present case, the fact that the key term 'subsidiary' was not defined left the pre-emptive rights provision open to interpretation.

Drafters and readers of pre-emptive rights provisions should keep in mind the possibility that a court may adopt a broad, purposive approach to the interpretation of pre-emptive rights provisions, making the pre-emptive rights easier to trigger.

We understand that the Defendants have appealed the decision. In light of the existing line of authority noted above, it will be interesting to see how the Victorian Supreme Court of Appeal responds.

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8. See, for example, *Mount Isa Mines Ltd v Seltrust Mining Corporation Pty. Limited*, unreported decision Supreme Court of Western Australia, 5 July 1985.

9. *Beaconsfield Gold NL & Ors v Allstate Prospecting Pty Ltd & Ors*, 32.



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CORPORATE STRUCTURE (TAKEN FROM THE JUDGMENT)

