pilchconnect

a specialist legal service
for community organisations

17 December 2010

Ms. Emma Skilton
Emerging, Mining & Resources
Australian Securities and Investments Commission
GPO Box 9827
Perth WA 6001

By email: policy.submissions@asic.gov.au

Dear Ms. Skilton,

Consultation Paper 142: Related Party Transactions

In light of Consultation Paper 142 (**CP 142**), PilchConnect welcomes the opportunity to provide to ASIC the following comments relevant to the related party transactions provisions of the *Corporations Act 2001* (Cth) **(the Act).**

1. About PilchConnect

PilchConnect is a specialist community legal service that supports not-for-profit organisations (**NFPs**), and is one of six services operated by the Public Interest Law Clearing House (Vic) Inc. (**PILCH**). PilchConnect provides free and low cost legal information, training, and advice for NFPs, and is able to match eligible Victorian public interest NFPs with PILCH member law firms to receive free legal assistance on complex legal issues. Our service is unique within Australia.

2. Our submission

The focus of our submission is on a discrete area of law that ASIC's proposed guidance, as detailed in CP 142, does not appear to have considered. Specifically, we comment on the inconsistent application of the provisions regarding the disclosure of related party transactions for companies limited by guarantee (**CLGs**). This inconsistency arises from the fact that the rules regarding disclosure of related party transactions are applied differently to CLGs, depending on whether they hold a name licence or not. CLGs which have been granted a name licence are exempt from the related party transaction provisions under the Act.

a) Related party transactions and the 'name licence' exemption

PilchConnect notes that the provisions regarding related party transactions are applied differently to companies limited by guarantee, depending on whether or not the company holds a name licence. The definition of 'public company,' for the purposes of Chapter 2E of the Act, does not include a company that holds a licence to omit the word 'limited' from its name by virtue of the name licence created under s150 or s151 of the Act. We note that these provisions require a CLG to have charitable purposes and not pay directors' fees.

It follows, therefore, that the Act provides for an exemption to a sub-group of NFP incorporated as CLGs from reporting and gaining member approval for related party transactions, given that companies that hold a name licence are not bound to comply with related party transaction provisions.

Even though a name licence means that the CLG cannot pay its directors, the exemptions create an opportunity for CLGs within the 'name licence' category to provide a financial benefit to a related party (such as the relative of a director) that is, for example, in excess of what can be regarded as reasonable remuneration, without first seeking member approval.[1]

PilchConnect notes the potential for abuse of this apparent exemption, particularly in light of new tiered reporting requirements for CLGs.[2] PilchConnect is conscious that the combination of limited reporting responsibilities and an exemption from related party transactions could limit the ability of members of some CLGs to properly to properly assess the appropriateness of related party transactions.

As highlighted in CP 142, the objective of the related party provisions in Chapter 2E is to protect the interests of members of public companies by requiring member approval of related party transactions where members' interests could be endangered.[3] Contrary to this objective, the exemption from related party transaction provisions appears to limit the protection offered to the interests of members of 'name licence' companies.

While we acknowledge the historical development of name licence provisions, we cannot find a contemporary policy justification for the exemption created by the provisions. Failing any clear policy reason to the contrary, we recommend the adoption of a consistent policy approach that strikes a balance between an appropriate level of transparency and the imposition of onerous reporting obligations for NFP organisations. We note the need for reliable information regarding the number and size of CLGs that hold a name licence, to better inform a policy decision on this issue.

We acknowledge that consistency in the application of the provisions may be achieved by amending the definition of public companies to include those holding a name licence. However, PilchConnect submits that the existing related party transaction provisions are complex and largely inappropriate for NFPs, for example, issuing securities or granting share options to a related party. We therefore do not advocate the imposition of the provisions regarding related party transactions in their current form.

b) Transparency

Building and preserving confidence in NFP organisations involves, as a matter of priority, maintaining a high degree of transparency. The interests of the public, donors, clients, and volunteers, who form the diverse range of stakeholders of NFP CLGs, differ significantly from the interests of shareholders or members of for-profit companies.

Preserving stakeholder confidence is fundamental to the sustainability of NFPs, particularly given the importance this confidence has on securing donations and public support. PilchConnect submits that transparency in the operations of NFP incorporated as CLGs is diminished by providing an exemption from obtaining member approval for related party transactions.

However, PilchConnect acknowledges that this need for transparency and accountability must be balanced with the imposition of regulation on NFPs – many of which have limited financial resources and rely heavily on volunteers. We submit that existing provisions regarding related party transactions are inappropriate for NFP incorporated as CLGs and their imposition on NFP some companies does not achieve this desired balance. Rather, changes should be made to the overall structure of CLGs[4] that include the adoption of a clear and consistent approach to ensuring member approval is obtained for related party transactions.

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[1] See Woodward, S & Marshall, S 'A Better Framework: reforming not-for-profit regulation', The University of Melbourne, Centre for Corporate Law and Securities Regulation, 2004, p 216.

[2] See Part 2M.3 *Corporations Act 2001* (Cth) which provides that small CLG's with annual revenue of less than $250,000 who do not have DGR status are not automatically required to provide financial or Director's reports or conduct an audit or review of accounts, unless requested by 5% of members or by ASIC.

[3] S 207 of the *Corporations Act 2001* (Cth).

[4] See Woodward, S & Marshall, S 'A Better Framework: reforming not-for-profit regulation', The University of Melbourne, Centre for Corporate Law and Securities Regulation, 2004, p 54.

3. Recommendation

PilchConnect notes the importance of transparency in the operations of NFP organisations. To this end, we support the development of appropriate mechanisms to ensure member approval is gained before NFP CLGs enter in to related party transactions that do not fall within a valid exception. We do not, however, advocate the comprehensive imposition of existing related party transaction provisions for all CLG's. Rather, overall improvements to the structure of CLGs are required to better accommodate for the specific needs of NFP organisations. It is recommended that these overall changes incorporate requirements for member approval all CLGs of related party transactions that fall outside of the relevant exceptions.

PilchConnect would be happy to discuss our submission in further detail.

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