# Chapter 2E — Related Party Transactions

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## [2E.207] Purpose — Annotations to section 207

***Key principles***

According to the general law, company directors and senior officers have a duty to act in good faith in the best interests of their company. They also have a fiduciary duty to avoid placing themselves in a position in which they will be tempted to prefer their own interests or the interests someone else over their duty to their company. This has led to the proposition ("the profit rule") that fiduciaries (including company directors and senior officers) must not misuse their position for the prospect of a personal benefit or benefit to a third party, except with their principal's fully informed consent, and if they do so without consent, they must account to the principal for any gains made in connection with their fiduciary office (see *Austin, Ford and Ramsay*, [9.6]). The general law duties are reinforced, in the case of company directors and officers, by ss 181–183 of the Corporations Act.

These principles have an important application, noted more fully at [2E.208], where directors cause their company to make loans to them on uncommercial terms. They also have an important application in the corporate group context. For example, when considering whether a subsidiary should enter into a transaction which benefits another entity within the group, the directors of the subsidiary are required to act in good faith in the best interests of the subsidiary, considered as a separate entity: *Walker v Wimborne* (1976) 137 CLR 1; 50 ALJR 446; 3 ACLR 529; (1975–76) CLC 40-251. If the directors cause their company to enter into a transaction (such as a loan or guarantee) in breach of this principle, the transaction is invalid; and the court will decline to grant specific performance of an agreement to procure guarantees: *ANZ Executors & Trustee Co Ltd v Qintex Australia Ltd* [1991] 2 Qd R 360; (1990) 2 ACSR 676; 8 ACLC 980.

However, notwithstanding that these are fairly strict principles, company law has for a long time supplemented them with specific prohibitions on particular kinds of transactions, such as loans to directors and (after the 1992 legislation) the giving of any financial benefits by a public company or its controlled entity to a related party.

Section 207 introduces the related party provisions of Ch 2E with a statutory statement of the purpose of the chapter. The purpose of Ch 2E is now stated to be "to protect the interests of a public company's members as a whole, by requiring member approval for giving financial benefits to related parties that could endanger those interests". The formula was changed by the CLERP Act 1999, and it is important to consider previous statements of the statutory purpose, in the legislation and in explanatory materials, to understand the current provision (see generally *History and explanatory materials*, below).

In the initial Australian loans to directors provisions, in UCA s 125, the emphasis was on the prohibition of certain activity, and member approval was introduced as a condition of the availability of certain exemptions (relating to directors' expenses and housing loans, and schemes for making loans to employees — typically employee share schemes). Amendments to the provisions over the period from 1961–1992 increased the emphasis on member approval, and when the provisions were rewritten in 1992 to become more general related party provisions, obtaining member approval for related party benefits came to be seen as part of the object of the provision, in the interests of preservation of the company's resources (particularly those available to pay creditors), and the interests of members as such.

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The driver for the reform of the loans to directors provisions was the abuse of the corporate form revealed after the collapses of the 1980s, as the Corporations and Securities Advisory Committee (CASAC) made clear in its 1991 Report, in the passage quoted below. The CSLRC had seen the underlying principle as being that the company's resources were only to be applied as required by the law or where the directors honestly and reasonably believed that the action would be for the benefit of the company as a whole. In the Bill annexed to their 1991 Report, CASAC proposed a statutory statement of purpose, which recited the opinion of the Parliament that the existence of certain relationships involving a company, any of its officers or any other person might expose the company to risks, and provide opportunities, that would not otherwise have existed, and that those relationships might therefore have a material effect on the performance and financial position of the company, so that members needed to be informed of any such relationships or proposed transactions involving the company, its officers or any other person. Therefore, said the draft, the object of the proposed revisions was to give investors in companies confidence that officers of companies would manage those companies, and the resources of those companies, honestly and diligently.

That statement was revised to become s 243A when Pt 3.2A was enacted in the Corporate Law Reform Act 1992. According to the EM to that Bill ([6]), the underlying principle of the Bill was the same as the principle underlying CASAC's draft. The EM said ([206]) that the related parties provisions were "intended to protect shareholders of public companies against the possibility that the value of their investment will be eroded by a related party arranging for the company to enter into a transaction which gives a benefit to the related party". . . The EM noted that uncommercial transactions benefiting related parties could involve breaches of the statutory duties of company directors and officers to act honestly and with appropriate care and diligence, but prosecutions for breaches of those predictions took place years after the transactions involved, and in most cases the assets involved were long gone (EM, [208]). The related parties provisions sought to encourage directors to bring such transactions to shareholders before they take place. The EM continued (at [210]):

> One cannot prevent dishonesty by legislation. What can be done, though, is to establish an environment which makes dishonesty less likely to result in losses for investors. Better enforcement is a key aspect of this, but the content of the law can also help, by establishing simple rules with a bias in favour of disclosure.

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Prior to the CLERP reform, s 243A said that the object of the related parties provisions was to protect a public company's resources (in particular those available to pay the company's creditors), and the interests of its members as members, by requiring that in general, financial benefits to related parties that could diminish or endanger those resources, or that could adversely affect those interests, be disclosed, and approved by general meeting, before they were given.

The CLERP Act 1999 removed the references to protection of creditors and the company's resources, and the reference to the interests of members "as members". No explanation was given for the change. It is hard to know what significance should be attached to these changes. The better view is probably that, as indicated by the EM to the CLERP Bill, no change of substance was intended. That would mean that the object of the related party provisions should still be seen as encompassing protection of the company's resources (including resources available to pay the company's creditors) as well as protection of the interests of members. Further, since s 243A is on its face a distillation of CASAC's views, assistance as the objects of Ch 2E can be drawn from CASAC's 1991 Report and the draft Bill that accompanies it. Consequently if a transaction prejudices a

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public company's ability to pay its creditors, the court should resolve any questions of construction in favour of applying the provision, even where the interests of members, as such, are not at stake.

There is probably no difference in substance between "the interests of its members as members" (the wording of s 243A) and "the interests of a public company's members as a whole" (the wording of s 207). Relevantly, the object of the section is to protect the interests of the members in their capacity as members, rather than in their capacity as (say) employees or consumers.

The use of the word "members" rather than "shareholders" emphasises that Ch 2E applies to non-shareholder public companies such as companies limited by guarantee (see generally [1.45]).

As to circumstances in which an underwriting or sub-underwriting agreement with related parties may fall within Ch 2E, see *Westgold Resources NL v Precious Metals Australia Ltd* (2002) 41 ACSR 672; [2002] WASC 85; BC200201816; *ACLPP* [10.1.0480]. As to the application of Ch 2E to the funding of employee incentive schemes, see *ACLPP* [10.1.0650] and [10.1.0660].

***Definitions and cross-references***

"Company", "member" and "public company" are defined in s 9. "Related parties" are defined in s 228 and "giving financial benefits" has a meaning affected by s 229. Note the adaptation of s 207 for registered managed investment schemes, in ss 601LA and 601LB.

***History and explanatory materials***

**The following notes relate to the history of the related parties provisions generally, not merely the statutory statement of the objects of those provisions**

According to the general law of fiduciary duties, directors who use their position to obtain loans from their company on uncommercial terms, without the company's fully informed consent, are accountable to the company for the advantage they have received, and the company may set the loan transaction aside and require restitution: see, eg, *PA Davies (Aust) Pty Ltd (in liq) v Davies (No 2)* [1983] 1 NSWLR 337; (1982) 8 ACLR 1. But the fiduciary duty may be qualified by the corporate constitution or shareholder approval. The general law also requires directors to act in good faith in the best interests of their company (see [2D.181]), and applies that requirement to corporate groups, so that the directors of a subsidiary will be in breach of duty if they cause a subsidiary to guarantee its parent's debts to the detriment of the subsidiary's minority shareholders. However, for a long time UK and Australian companies legislation has supplemented the general law in this area.

Under the Limited Liability Act 1855 (UK), the directors of a limited liability company were made personally liable if they made loans to the members of the company, but such loans were not prohibited. The Greene Committee, reporting in 1926 (Cmd 2657), received evidence and submissions about loans to directors but concluded that it was not "practical or desirable" to prohibit such loans ([48]–[49]). Instead the Committee recommended that a company's auditors should be required to state in a note to the accounts the total amount of money lent to directors, managers or other officers of the company during that period covered by the accounts, and loans made in previous periods that were still outstanding. This was because shareholders were entitled to know what loans had been made out of the company's funds to the directors, managers and officers of the company. Those recommendations were acted upon by the UK legislature.

The question was revisited by the UK Cohen Committee, which reported in 1945 (Cmd 6659). The Cohen Committee's view was that it was undesirable that directors should borrow from their companies ([94]):

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> If the director can offer good security, it is no hardship to him to borrow from other sources. If he cannot offer good security, it is undesirable that he should obtain from the company credit which he would not be able to obtain elsewhere. Several cases have occurred in recent years where directors have borrowed money from their companies on inadequate security and have been unable to repay the loans.

The Cohen Committee recommended that, subject to certain exceptions, it should be made illegal for a loan to be made to any director of a company, by the company, or by any of its subsidiary companies, or by any person under guarantee from or on security provided by the company or any of its subsidiary companies. The recommendations were substantially adopted in the Companies Act 1948 (UK), s 190.

The UK s 190 was followed in Australia in the Uniform Companies Act 1961, s 125. Section 125 prohibited a company from making a loan to a director of the company or of another company deemed to be related to the company. It also prohibited a company from entering into a guarantee or providing security in connection with a loan made to a director of the company or its related company by any other person. A company (the first company) was deemed to be related to another company (the second company) where the first company was the holding company of the second company, or was a subsidiary of the second company, or was a subsidiary of the holding company of the second company. If a company contravened the prohibition, every director who authorised the making of the loan or the giving of the guarantee or security was guilty of an offence.

There were six exceptions in s 125 to the prohibition on such loans, guarantees and securities:

(i) The prohibition did not extend to an exempt proprietary company. Section 125 established a procedure for a person taking a guarantee or security from a proprietary company to require the company to furnish a certificate signed by a director and secretary certifying that the company was an exempt proprietary company.

(ii) There was an exception to permit a subsidiary to make loans and give guarantees and security to its holding company, where the holding company was a director of the subsidiary.

(iii) A company was permitted to provide a director with funds to meet expenditure incurred or to be incurred for the purposes of the company or for proper performance of the director's duties as an officer of the company.

(iv) A company and its holding company were permitted to provide a director engaged in the full-time employment of the company with funds to meet expenditure in acquiring a home. But the exceptions in (iii) and (iv) were subject to a requirement of either prior shareholder approval or approval at the next annual general meeting, and in default of approval the directors authorising the transaction were jointly and severally liable to indemnify the company against any loss.

(v) A company was permitted to make a loan to a director engaged in full-time employment with the company or its holding company, where the company had approved a scheme at a general meeting for making loans to employees and the loan was in accordance with the scheme.

(vi) A company whose ordinary business included lending money, or giving guarantees in connection with loans made by other persons, was permitted to do so in the ordinary course of its business.

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Initially s 125 applied only in respect of loans to a director. In the United Kingdom the Jenkins Committee (Cmnd 1749, 1962, [98]–[99]) recommended that the UK provision be strengthened by extending it to prohibit loans by company to another company in which directors of the lending company directly or indirectly held a controlling interest. The UK Department of Trade's White Paper, *The Conduct of Company Directors* (Cmnd 7037, 1977) recommended that the statutory provision be widened to prohibit loans to families of directors and to companies in which a director had an interest.

In Australia, the 1976 amendments to UCA s 125 extended the scope of the provision more broadly than the Jenkins Committee's recommendations. A company was prohibited, whether directly or indirectly, from:

- (i) making a loan to
  - (a) a director of the company or a relative of a director of the company;
  - (b) a director of a related corporation or a relative of such a director; or
  - (c) a corporation in which a director of the company or of a related corporation or a relative of any such director had, or two or more such persons together had, a substantial shareholding (essentially a 10% relevant interest); or
- (ii) entering into a guarantee or providing security in connection with such a loan.

Section 230 of the Companies ([Name of State]) Code essentially adopted s 125, but added some considerable complexity. Thus:

- (i) The prohibition was extended to loans to the spouse or a relative of the spouse of a director, or to a trust in which the director or spouse or relative, or corporation in which they were interested through substantial holdings, had a beneficial interest.
- (ii) There was a special definition of relevant interest which excluded the company's interest from the calculation of the 10% relevant interest of the director-related parties.
- (iii) An exception was created for loans, guarantees and securities by a company in favour of a related corporation where the transaction was authorised by resolution of the directors.
- (iv) The exception to permit a company to facilitate a full-time director's acquisition of a home was confined to a principal place of residence.
- (v) It was specified that if an exception depended upon shareholder approval, approval was required by the company, its listed holding company (if any) and its ultimate holding company (if any).
- (vi) Loans made in the ordinary course of business were required to be on ordinary commercial terms as to interest, repayment terms and security.
- (vii) The provisions according to which directors who authorised a transaction in contravention would be guilty of an offence were elaborately expanded to apply to officers in default, and the persons guilty of an offence were made jointly and severally liable to indemnify the company against any loss arising out of the transaction (subject to a defence of absence of knowledge).
- (viii) A person making a loan for which a company gave a guarantee or provided security in contravention of the section was permitted to enforce the guarantee or security against the company only if a certificate signed by a director and secretary of the company had been obtained, certifying that the company was an exempt proprietary company or that it was not prohibited by the section from giving the guarantee or security, and the person taking the certificate did not know and had no reason to believe that the certificate was incorrect.

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The loans to directors provision had trebled in physical size since 1961, and had been magnified enormously in its complexity. Worse still, the complexity tended to obscure any underlying principle. The original idea of the Cohen Committee was that there was no justification for a company making loans to its directors and such a transaction risked unfairly benefiting the director at the expense of the company. But s 230 had extended this idea so much that by 1988, the law prohibited (for example) a loan by company A to company B, solely because a director of either company, or a director's spouse or a relative of the director or spouse, had a 10% relevant interest in company B.

In August 1988 the Companies and Securities Law Review Committee (CSLRC) published a discussion paper dealing with loans to directors (Discussion Paper No 8: *Director's Statutory Duty to Disclose Interest (Companies Act s 228) and Loans to Directors (Companies Act s 230)*), followed in November 1989 by a report dealing with that subject (Report No 9: *Director's Statutory Duty to Disclose Interest (Companies Act s 228) and Loans to Directors (Companies Act s 230)*). Most of the CSLRC's recommendations were quite narrow and technical. But two matters warrant comment, mainly because they were almost immediately reversed by CSLRC's successor.

First, the CSLRC raised the question whether s 230 of the Code should contain a statement of the underlying principle, namely the principle that the company's resources may only be applied as required by the law or where the directors honestly and reasonably believe that the action will be for the benefit of the company as a whole. The Committee did not recommend the adoption of such a statement of principle, apparently on the basis that most of the submissions it had received opposed the suggestion.

Second, the CSLRC considered a submission that a loan by a company to a related or affiliated company should not be a contravention where the loan was authorised by directors who had no relevant interest in the borrowing company. The Committee rejected this suggestion, saying that if there is a minority interest in the company, that minority (however small) is entitled to protection against the company making a loan to any other corporation in which a director has a relevant interest of not less than 10% (Report, at [100]).

Section 234 of the Corporations Law, as initially enacted, was in substantially the same terms as s 230 of the Code and did not respond to the CSLRC's recommendations.

The ASIC Act 1989 established the Companies and Securities Advisory Committee (CASAC), which replaced the CSLRC. CASAC was given authority to make recommendations to the Minister about corporate law reform of its own initiative. It responded to public concern about wrongdoing by some directors and officers of public companies during the 1980s, by embarking on a project to reform the law concerning loans to directors and other related topics.

In December 1989 CASAC released a paper prepared by two consultants, John Kluver and Jillian Segal, *Discussion of and Proposals on Reform in Principle of Australian Law relating to Loans to Directors, Loans to Related and Connected Companies and Executive and Intra-group Remuneration*. This was followed, in September 1990, by CASAC releasing a public exposure draft and an explanatory paper for a Corporations Amendment Bill 1991, and then, in July 1991, a *Report on Reform of the Law Governing Corporate Financial Transactions* ("the Report"). The Report contained a revised text for a Bill, then called the Corporations Amendment Bill (No 3) 1991.

CASAC described its concerns in the Report (p 1), as follows:

> Following the corporate collapses of the 1980s, it has become evident that some corporate controllers abused their positions of trust by arranging for the shifting of assets around and away from companies and corporate groups, and into their own hands. They achieved this by various means, including remuneration payments, asset transfers or loan arrangements, on terms highly

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> advantageous to themselves but to the detriment of these companies. In other instances, substantial inter-corporate loans were entered into with the apparent purpose or effect of disguising the true financial position of individual companies within the group. This was made easier by the lack of any general statutory requirement that shareholders either consent to, or be informed of, these transactions. These abuses generally involved significant losses of corporate funds, with adverse effects on investor and creditor returns and confidence. They also brought into question the integrity of the Australian financial markets, with detrimental consequences for the national economy.

CASAC's response to these concerns was to develop proposed legislation that would reform the law about loans to directors and executive remuneration, and introduce provisions about loans to related and linked companies, asset transfers between companies and their associates, and benefits arising from corporate asset transfers. The proposals would also tighten up the law about disclosure of directors' interests in corporate transactions.

CASAC was critical of the loans to directors provision, then CL s 234, which it said (Report, pp 5–6) was partly ineffective by virtue of its:

- incomplete coverage, given the limited definition of "loans", which did not extend to other forms of financial accommodation;
- unsatisfactory categories of permitted loans, in particular the open-ended nature of loans "for the purpose of enabling the person properly to perform duties as an officer of the company" (s 234(3)(e)) and loans by a company "in the ordinary course of its ordinary business" (s 234(3)(f));
- possible circumvention, by arrangement for the recipient not to be a director (under the extended s 60 definition) at the time of making the loan;
- failure to guarantee that complete and accurate information would be provided to shareholders in those circumstances where their consent is required (s 234(3)(e), s 234(4)(a)). For instance, under s 234(4)(a), only the "purpose and amount of the loan or the extent of the guarantee or security" was required to be disclosed. There was no requirement to disclose who were the interested parties, the financial impact of the loan, or whether its terms would be fair and reasonable to the lending company; and
- omission of any provision for the exclusion from voting of interested parties, either at the directors' or shareholders' meeting.

CASAC also recommended (p 6) specific legislative controls on inter-corporate loans between related or linked companies and asset transfers with associated persons, which at that time lacked specific regulation apart from general fiduciary duties and provisions about financial assistance. CASAC was concerned about upstream loans to a controlling shareholder on the basis of inadequate security or other unfavourable terms to the lender, putting at risk the interests of minority shareholders; and "skimming" or "dumping" whereby corporate controllers would purchase corporate assets at an under-value or sell their own assets to the company at an over-value (practices at that time regulated only by the ASX Listing Rules, LR 3J(3)).

CASAC proposed the enactment of a Corporations Amendment (No 3) Bill that would introduce a new Pt 3.2A to cover the regulation of financial transactions and disclosure of officers' interests and benefits. Though the reforms were not introduced in the form recommended by CASAC, they should be noted because they tend to explain the origins and purpose of some of the current provisions, including in particular the current exemptions.

CASAC's proposed Pt 3.2A would begin with a declaration of the object of the Part, which was to give investors in companies confidence that officers of companies would

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manage those companies, and the resources of those companies, honestly and diligently. Apart from disclosure reforms, the proposed Pt 3.2A would reform the law on loans to directors and introduce new provisions about inter-corporate transactions and asset transfer transactions with associates.

The major reforms that were proposed to the loans to directors provisions were:

(i) to broaden the class of regulated financial arrangements to include (in addition to loans) quasi-loans, credit transactions, certain investments in redeemable preference shares, and other arrangements amounting to disguised loans;

(ii) subject to the exemptions noted below, to inhibit a company from entering into loans or similar transactions with its directors (and certain other persons linked with its directors), except for transactions between related bodies corporate, and transactions under approved housing assistance or executive share acquisition schemes, in each case subject to a strict approval procedure involving consent by a fully informed general meeting (and in some instances, the Commission (then the ASC));

(iii) the exemptions from the prohibition would be:
- transactions by exempt companies (exempt proprietary companies and other companies having not more than 15 members);
- certain transactions by financial corporations, including loans not exceeding annual emoluments and loans by banks or life assurance companies on fully commercial terms;
- transactions approved by 95% of members holding not less than 95% of voting shares in the company;
- transactions not exceeding $25,000 or another prescribed amount;
- exceptional transactions for which Commission approval was obtained.

Subject to the exemptions noted below, the proposed Pt 3.2A would prohibit a company from entering into loans or similar transactions with related or linked bodies corporate, except in compliance with a strict members' approval procedure, similar to that regulating directors' loans and involving consent by a fully informed general meeting. The exemptions from this prohibition would be:

- transactions by exempt companies (exempt proprietary companies and other companies having not more than 15 members);
- transactions in relation to group bodies corporate (holding companies and wholly owned or closely held (90% or more) subsidiaries);
- transactions not exceeding 5% of members' funds;
- transactions by banks and life assurance companies on fully commercial terms (described by CASAC as "genuine 'arm's length' transactions"); and
- joint venture transactions.

Subject to the exemptions noted below, the proposed Pt 3.2A would prohibit the company from entering into asset transfer transactions with associates, except in compliance with a strict members' approval procedure, similar to inter-corporate loans. The exemptions to this prohibition would be:

- transactions by exempt companies (exempt proprietary companies and other companies having not more than 15 members);
- transactions in relation to group bodies corporate, as above;
- transactions not exceeding 5% of members' funds; and
- joint venture transactions.

CASAC's proposed legislation had the effect of vastly increasing the complexity of the already complex loans to directors provisions (from about 5 pages to about 38 pages of legislative text). In February 1992 the Government released draft legislation and an

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explanatory paper for the Corporate Law Reform Bill 1992, which (amongst other matters) proposed the implementation of CASAC's Report, in legislation based closely on CASAC's draft. After receiving submissions that the proposed provisions were too detailed and complex, the Attorney-General's Department comprehensively redrafted the proposed Pt 3.2A, reducing the text by about half. But according to the EM for the Corporate Law Reform Bill 1992 ([6]):

> The underlying principle remains the same — that financial benefits given to people who are in a position to significantly influence the decision to give the benefit should be subject to shareholder approval unless they are on commercial terms.

And later ([41]):

> [T]he overall object of the new Part 3.2A is to protect a public company's resources and the interests of its members by requiring that financial benefits to related parties that could diminish or endanger those resources, or that could adversely affect those interests, be disclosed, and approved by general meeting, before they are given.

The redrafted 1992 Bill was in substance the legislation as enacted and continued to the present time. The drafters of the Bill placed reliance on statements of general principle, supported by examples, rather than long and detailed "black-letter" prescriptions, and reduced the number of cross-references and definitions as far as possible, so that each provision would be (as far as practicable) self-contained and easy to read (EM, [42]). Thus, rather than prohibiting an extensive list of transactions that were either loans or of similar effect, the re-drafted Pt 3.2A prohibited the giving of a "financial benefit", defined so that the economic and commercial substance and effect of the transaction would prevail over its legal form (EM, [44]). The prohibition was on a public company or its "child entities" giving a financial benefit, and "child entity" was defined in terms of entities of any kind over which the public company might exercise control. A financial benefit was not to be given to a "related party" of the public company, defined to include the public company's directors and immediate family plus any other entity in a position to exercise control over the public company (EM, [44]).

The text of the legislation enacted in 1992 (and commencing on 1 February 1993) remained unchanged until 1998, except for changes introduced in 1994 to deem indemnities and insurance premiums paid in respect the officers' liability to be remuneration, hence requiring shareholder approval unless protected by the "reasonable remuneration" exception. The Company Law Review Act 1998 converted Pt 3.2A into a new chapter of the Corporations Law, Ch 2E, without changing the substance or numbering of the provisions.

More extensive changes were made by the CLERP Act 1999, which renumbered and rewrote Ch 2E. The EM to the CLERP Bill claimed that this was rewriting "without substantial change" ([4.3], [6.111]), while acknowledging that there were "minor policy changes" relating to the definition of "related party", reasonable remuneration and the consequences of contravention.

The changes introduced by the CLERP Act are noted in the *History and explanatory materials* annotations to the individual sections. Only minor changes have been made since the 1999 amendments.

***Texts and literature***

*Ford* [9.470]; *ACLPP* [3.2A.0005], and as to the overlap between Ch 2E and ASX Listing Rules 10.1–10.10, see [10.1.0825]; *Austin, Ford and Ramsay* [15.5].

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# Part 2E.1 — Member approval needed for related party benefit [ss 208–227]

## Division 1 — Need for member approval [ss 208–209]

### [2E.208] Need for member approval for financial benefit — Annotations to section 208

***Key principles***

Section 208(1) says that for a public company, or an entity that the public company controls, to give a financial benefit to a related party of the public company, either (a) the public company or entity must obtain the approval of the public company's members in the way set out in ss 217–227, and give the benefit within 15 months after the approval, or (b) the giving of the benefit must fall within an exception set out in ss 210–216.

Section 208 covers the ground of the previous loans to directors provision: it applies to loans, guarantees and the provision of security by a public company or its controlled entity to directors of the public company. It also applies to loans, guarantees and the provision of security by a public company to its parent entity (if any) or the parent's directors. But it extends well beyond loans, guarantees and the provision of security. It may apply, for example, to management or consulting agreements between a public company and director-controlled entities, or supply or trading contracts with director-controlled entities, or professional fees to a law firm if a partner is on the board, or to benefits given to spouses of directors such as free overseas travel.

*An implied prohibition*

Section 208(1) lays down the requirements to be complied with for the giving of a financial benefit to a related party of a public company, either by the public company itself or by an entity that the public company controls. It says that either the public company or entity "must" obtain member approval in the manner set out, and give the benefit within 15 months after the approval, or the giving of the benefit "must" fall within one of the stated exceptions. As a matter of construction, the question of control of an entity by a public company is to be determined at the time when the entity gives a financial benefit to a related party of the public company.

As explained below, the predecessor of s 208 (former s 243H) had a different structure: it prohibited a public company or its child entity from giving a financial benefit to a related party of the public company, except as permitted by the member approval procedure or an exception. Now s 208 (like s 207) emphasises the central importance of shareholder approval by being expressed in positive terms. Given the historical context, "must" should be taken to mean that if the required condition (shareholder approval or

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applicable exception) is not available, the giving of financial assistance is a contravention by the public company or controlled entity. On that basis, the change of wording is not a change of substance.

That being so, where the exceptions from s 208, found in ss 210–216, say that "member approval is not needed to give a financial benefit" on certain terms, the exception in fact has a broader consequence, explained in s 208(1)(b), namely that if the giving of the benefit falls within the relevant exemption, the public company or controlled entity may give the benefit, and others may be involved in the giving of the benefit, without contravention of ss 208 and 209.

*A public company or an entity that the public company controls*

Section 208(1) imposes restrictions on the giving of a financial benefit by either a public company, or an entity that the public company controls. "Public company" is specially defined for the purposes of Ch 2E, to include (in effect) a listed body corporate that was incorporated under some other legislation (and hence is not a "company" as defined in s 9). "Entity" is defined in s 9, for the purposes of Ch 2E, to include a body corporate, a partnership, an unincorporated body, an individual, the trustee of a trust with a single trustee, and the trustees of a trust with more than one trustee.

An entity is restrained by s 208(1) from giving a financial benefit only if a public company controls the entity. "Control" is defined in s 50AA. The issue to be considered is whether the first entity "has the capacity to determine the outcome of decisions about the . . . financial and operating policies" of the second entity: s 50AA(1). In determining whether the first entity has this capacity, the practical influence it can exert (rather than the rights it can enforce) is the issue to be considered, and any practice or pattern of behaviour affecting the second entity's financial or operating policies is to be taken into account (even if it involves a breach of an agreement or a breach of trust): s 50AA(2). It appears from the EM to the CLERP Bill ([6.123]) that these words are an attempt to replicate, in a legal definition, the application and operation of the definition of control used for the purposes of the accounting standard on disclosure of related party benefits.

The drafters of s 50AA evidently had in mind AASB 1017 *Related party disclosures*, which said that control means the capacity of the first entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the second entity so as to enable the second entity to operate with it in pursuing the objectives of the first entity. Accepting that the statutory definition is to be applied by reference to practical influence rather than legal rights, and practices or patterns of behaviour even if in breach of contract or trust, there nonetheless appears to be a difference between the question whether the first entity has the capacity to dominate the decision-making of the second entity so as to enable the second entity to operate with it in pursuing the first entity's objectives, and the question whether the first entity has the capacity to determine the outcome of decisions about the second entity's financial and operating policies. One dominates decision-making by another by having the strongest influence, whereas one determines the outcome of another's decision by making the decision, or at least by being the decisive input. And it appears that the capacity to determine the outcome of decisions must exist for both financial and operating policies before an entity can be said to be in control.

A significant question, for the purposes of applying the definition of "control" in the related party context, is whether more than one entity can control another. That can happen in a vertical context: if entity B controls entity C because it determines the outcome of decisions about C's financial and operating policies, but entity B acts on the directions of entity A, A also controls C. But the application of the definition of control is less certain in a horizontal context, where A and B each have a degree of influence over

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C. B does not control C merely because B and A jointly have the capacity to determine the outcome of decisions about C's financial and operating policies: s 50AA(3). A fortiori, it seems that if B and A are not acting jointly, they cannot both be said to control C, even if both of them separately have a powerful influence over the outcome of decisions about C's financial and operating policies.

*Giving a financial benefit to a related party of the public company*

Giving a financial benefit is explained in s 229. The concept is broad and is to be assessed by reference to the economic and commercial substance of the conduct rather than its legal form. The question is not whether the transaction confers, on balance, a net benefit to the related party, but whether any benefit is conferred even if for adequate consideration. Further, see [2E.229].

"Related party" is defined in s 228. The concept extends to an entity that controls the public company, directors of the public company or its controlling entity (if any), spouses of the directors, and parents, children and controlled entities of the directors and spouses. See [2E.228]. But a controlled entity of a public company is not a related party of the public company, and so the public company may enter into an uncommercial transaction with its controlled entity, provided that the controlled entity is not a public company (in which case s 208 would constrain the controlled entity from entering into the transaction: see EM to the Corporate Law Reform Bill 1992, [220]).

It is important to bear in mind that s 208 applies only if the financial benefit is to be given to a related party *of the public company*. Section 208 does not prevent an entity controlled by a public company from giving a financial benefit to a related party of the controlled entity (such as a director of the controlled entity), provided that the controlled entity is not itself a public company and the transaction does not amount to the public company indirectly giving the benefit.

*Member approval*

The alternative means of satisfying s 208(1) are by member approval under s 208(1)(a) or by falling within one of the exceptions in ss 210–216. As to member approval, the requirement is to obtain the approval of the public company's members "in the way set out in sections 217 to 227". Sections 217–227 deal with the procedure from member approval in some detail. The wording of s 208(1)(a)(i) suggests that there must be full and complete compliance with every aspect of the member approval procedure. But s 227 permits the court to declare that the member approval requirements have been satisfied if it finds that they have been substantially satisfied.

Section 208(1)(a)(ii) requires that the benefit begin within 15 months after the member approval. This is to prevent the company from acting on a stale approval.

*The giving of a benefit required by a contract*

Section 208(2) deals with the case where the giving of a benefit is required by contract and member approval is obtained for the making of the contract. It says that if the contract is made within 15 months after member approval, or was made before member approval was given but was conditional on the approval being obtained, then member approval for the giving of the benefit (presumably, the benefit contemplated by the contract) is taken to have been given and the benefit need not be given within 15 months of the approval of the contract.

The provision impliedly recognises that a contract that provides for the giving of a benefit itself constitutes the giving of a benefit (the benefit being the contractual right to receive the benefit that the contract provides for). Therefore it is necessary to obtain

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member approval for the benefit given by the contract. Indeed, according to s 229(2)(b), the giving of a benefit may arise out of an informal agreement with no binding force, although it appears from the statutory language that s 208(2) only applies in the case of a legally recognised contract.

Section 208(2) offers two concessions. First, while generally a financial benefit must not be given without prior member approval, the subsection permits a contract for the giving of a benefit to be entered into before shareholder approval is obtained, provided that the contract is conditional on approval being obtained. Second, the subsection removes the necessity for a further member approval for the giving of the benefit under the contract, provided that either the contract was made within 15 months after member approval or was made before member approval but was conditional on member approval being obtained.

It appears that the benefit contemplated by the contract can be given at any time, without a time limit, provided that it is a benefit "required by" the contract. A benefit authorised but not required by contract apparently requires member approval even if the contract has been approved, and the concessions of s 208(2) are not available.

*ASX Listing Rules*

In the case of a listed public company, s 208 substantially overlaps with Ch 10 of the ASX Listing Rules. The Listing Rules contain seven separate requirements for shareholder approval of specified related party transactions: LR 10.1, 10.11, 10.14, 10.16, 10.17, 10.18 and 10.19. Where shareholder approval is required by the Listing Rules, there are special requirements for the notice of meeting and voting exclusion arrangements are required to be put in place. What follows is a brief summary account of Listing Rules, for the purpose of comparison with Ch 2E.

Rule 10.1 says that an entity must ensure that neither it, nor any of its child entities, acquires a substantial asset from, or disposes of a substantial asset to, certain specified persons without the approval of holders of the entity's ordinary securities. The specified persons are a related party, a subsidiary, a substantial holder of at least 10% of the votes attaching to voting securities, an associate of any of these persons, or "a person whose relationship to the entity or [any of the listed persons] is such that, in ASX's opinion, the transaction should be approved by security holders". The definitions of "child entity" and "related party" in Ch 19 of the Listing Rules correspond with the concepts of controlled entity and related party in Ch 2E. An asset is substantial if its value, or the value of the consideration for it is, or in ASX's opinion is, 5% or more of the equity interests of the entity set out in the latest accounts given to ASX under the Listing Rules (LR 10.2). There are some limited exceptions to Rule 10.1 in Rule 10.3. If a listed entity contravenes Rule 10.1, ASX may require it to take various corrective actions set out in Rule 10.9.

Listing Rule 10.1 covers much of the same ground as Ch 2E, but there are differences. For example, the listing rule is more limited in that it is confined to the acquisition and disposal of a "substantial asset", while it is broader in that the class of counterparties to the listed entity's transaction extends well beyond related parties and the listing rule gives ASX a discretion in that regard.

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Listing Rule 10.11 says that a listed entity must not issue or agree to issue equity securities to specified persons without the approval of holders of ordinary securities. The specified persons are a related party, or a person whose relationship with the entity or a related party is, in ASX's opinion, such that approval should be obtained. There are substantial exceptions to this requirement, for example to permit participation in a pro rata issue. Listing Rule 10.11 covers some common ground with Ch 2E, but again there are differences. For example, the listing rule applies, subject to exceptions, whenever the listed entity issues agrees to issue equity securities to the specified persons, regardless of whether in doing so it is giving them a benefit; and again ASX has a discretion to apply the rule where securities are issued to a person who is not a related party.

Listing Rule 10.14 says that a listed entity must not permit any of specified persons to acquire securities under an employee incentive scheme without the approval of holders of ordinary securities. The list of persons includes directors of the entity, their associates, and a person whose relationship with the entity, its directors or their associates is, in ASX's opinion, such that approval should be obtained.

Listing Rule 10.16 prevents a listed entity from permitting directors and their associates to underwrite a dividend or distribution plan, and again ASX has a discretion to extend the rule to a person whose relationship with the entity, its directors or associates is such that in ASX's opinion, the person should not underwrite the plan.

Listing Rule 10.17 says that a listed entity must not increase the total directors' fees payable by it or any of its child entities without the approval of holders of its ordinary securities.

According to Listing Rule 10.18, a listed entity must ensure that no officer of the entity or any of its child entities will be entitled to termination benefits (or any increase in them) if a change occurs in the shareholding or control of the listed entity or child entity.

Under Listing Rule 10.19, a listed entity must ensure, in the absence of the approval of holders of ordinary securities, that no officer of the entity or any of its child entities will be or may be entitled to termination benefits, if the value of those benefits and the termination benefits that are or may become payable to all officers together exceed 5% of the equity interests of the entity set out in the latest accounts given to ASX under the listing rules.

***Definitions and cross-references***

"Benefit", "company", "entity", "member" and "public company" are defined in s 9. "Control" is defined in ss 9 and 50AA. "Related parties" are defined in s 228 and "giving a financial benefit" has a meaning affected by s 229. The ASX Listing Rules dealing with related party transactions are in Ch 10 of the Listing Rules, *Transactions with persons in a position of influence*.

As to measurement of the period of 15 months after member approval, see Acts Interpretation Act 1901, ss 35–37.

Section 103 provides that, except so far as the Act otherwise provides (relevantly, it does not), an act, transaction, agreement, instrument, matter or thing is not invalid merely because of (amongst other provisions) a contravention of s 208 or s 209. Note the adaptation of s 208 for registered managed investment schemes, in ss 601LA and 601LC (see *ACLPP* [3.2A.0135]–[3.2A.0140]).

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

Prior to the CLERP amendments, 1999, former s 243H prohibited a public company or a "child entity" (essentially, a controlled entity) of a public company from giving a

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financial benefit to a related party, except in limited circumstances. Now s 208(1) says that for a public entity or an entity that it controls to give a financial benefit to a related party of the public company, the public company or entity "must" obtain shareholder approval and give the benefit within 15 months after the approval, or the giving of the benefit "must" fall within one of the exceptions (compare approximately similar re-wording of the financial assistance provision, s 260A, which uses the expression "only if").

Prior to the CLERP amendments, "entity" was defined in s 243C, which allowed the accounting standards to override the definition that would otherwise be applicable. Now "entity" is defined in s 9 and there is no reference to the accounting standards. "Control" was defined in s 243E, which made the question of control depend upon the application of an accounting standard. Now "control" is to be found in s 50AA, which uses commercial terms partly borrowed from the accounting standards, but does not in terms depend on an accounting standard. The change to the definition of "control" was introduced, according to the EM to the CLERP Bill ([6.123]) because defining control by reference to the accounting standards made it necessary for users of the Corporations Law to refer to external material to understand their obligations under the Law, and therefore a new test for control based on the accounting standards was introduced into the Corporations Law itself. That commendable approach has not been carried into effect consistently (see, for example, the definition of "remuneration" in s 9).

The definitions in s 243D of "parent entity" and "child entity" had the effect that an entity was the parent entity of another if it controlled that other entity or was its holding company, and an entity was a child entity of another if the other entity was its parent. An entity was a "sibling entity" of another entity if they had a parent entity in common and neither was the parent of the other. The CLERP amendments abandoned these three concepts in favour of the concept of an entity that a public company controls, "control" being defined in s 50AA. "Sibling entity", which was used in the definition of "related party", was not replicated in the post-CLERP provisions, though the concept but not the label appears in ss 211(1)(a)(iv) and 211(2)(a)(iv) (further, see [2E.228]).

The predecessor of s 208(2) was s 243R, but s 243R was narrower in that it did not permit the making of a contract to give a financial benefit prior to but conditional on member approval (note also former s 243K(2), which permitted a body corporate to pay or provide remuneration to an officer as required by a contract that it was reasonable for the body corporate to make).

***Texts and literature***

*Ford* [9.480], [9.490] (financial benefit), [9.500] (related parties), [9.510] (control), [9.515] (case law), [9.550] (member approval), [9.560] (consequences of breach); *ACLPP* [3.2.0543], [3.2A.0010]–[3.2A.0035] (elements of s 208), [3.2A.0085] (member approval), [3.2A.0115] (consequences of breach), [3.2A.0135] (comparison of s 208 with Pt 5C.7 concerning managed investment schemes); *Austin, Ford and Ramsay* [15.6].

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## [2E.209] Consequences of breach — Annotations to section 209

***Key principles***

As noted at [2E.208], a public company or controlled entity that gives a financial benefit to a related party of the public company, otherwise than with member approval or under an exception, contravenes s 208. Consequently a court may order an injunction, on the application of ASIC or an interested party under s 1324, to restrain the public company or entity from giving the benefit to the related party, as the note to s 209(1) points out. But according to s 209(1)(b), the public company or entity is not guilty of an offence.

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However, an offence is committed by a person dishonestly involved in the contravention: s 209(3). This could include the related party that receives the benefit, or the directors, officers or advisers of the public company or entity or of the related party. The maximum penalty for the offence of dishonest involvement is high, namely 2000 penalty units or imprisonment for 5 years or both (Sch 3, item 50).

Where the involvement in the public company or controlled entity's contravention is not dishonest, the person involved contravenes s 209(2), which is a corporation/scheme civil penalty provision (see s 1317E(1)(b)). According to s 1317J(1), only ASIC may apply for a declaration of contravention of a corporation/scheme civil penalty provision under s 1317E or for a pecuniary penalty order under s 1317G, though under s 1317J(3) the corporation is entitled to intervene in the application. ASIC may apply for a disqualification order under s 206C. ASIC or the corporation may apply for a compensation order under s 1317H.

Involvement in a contravention is defined in s 79, in terms requiring knowledge of the essential factual ingredients of the contravention: see *Yorke v Lucas* (1985) 158 CLR 661; 61 ALR 307; [1985] HCA 65; BC8501069. There is no longer a contravention for someone who is recklessly concerned in or party to a contravention without that degree of knowledge (compare former s 243ZE(3)). Involvement for the purposes of s 209(2) requires knowledge of the essential facts constituting the contravention. In *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; 168 FLR 253; [2002] NSWSC 171; BC200200827 (appeal largely dismissed: *Adler v ASIC* (2003) 46 ACSR 504; 179 FLR 1; [2003] NSWCA 131; BC200303670), Santow J held that HIH and HIHC contravened s 208 when HIHC paid $10 million to Pacific Eagle, an entity controlled by Adler. He held that Adler and Williams were "involved" in that contravention within the meaning of s 209(2). They had actual knowledge of the essential facts constituting the contravention, as the payment was carried out at the instigation of Adler with the concurrence and direction of Williams, bypassing the investment committee of HIH and the HIH board. He observed at [195] that, having that knowledge, they would not be assisted by showing that they mistakenly considered the transaction to be on arm's length terms and hence excepted from the related parties provision by s 210.

Liability for involvement in a contravention of s 208 may extend not only to directors and other insiders of the public company or the related party, or the related party itself, but also to advisers and financiers, where they have the requisite degree of knowledge.

Section 209(1)(a) states that if a public company or entity contravenes s 208, the contravention does not affect the validity of any contract or transaction connected with the giving of the benefit. Presumably that would include a contract which itself gives a benefit. There is overlapping between this provision and s 103, which probably does not add anything and is a leftover from the previous law.

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***Definitions and cross-references***

"Benefit", "company", "entity" and "public company" are defined in s 9. "Giving financial benefits" has a meaning affected by s 229. A person is "involved" in a contravention in the circumstances set out in s 79. As to the powers of the court in proceedings for contravention of s 208 or s 209, see ss 1323 (freezing order, etc) and 1324 (injunction).

Section 103 provides that, except so far as the Act otherwise provides (relevantly, it does not), an act, transaction, agreement, instrument, matter or thing is not invalid merely because of (amongst other provisions) a contravention of s 208 or s 209.

### *History and explanatory materials*

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

The former s 243H prohibited a public company or its child entity from giving a financial benefit to a related party of the public company, subject to exceptions. If a public company or child entity gave a prohibited financial benefit, it contravened s 243H. Section 103 prevented a contravention of s 243H or of s 243ZE from invalidating the transaction.

Under s 243ZE, if a public company or child entity contravened s 243H:

- the related party who received the benefit contravened s 243ZE(2), subject to the defence in s 243ZE(6);
- a person involved (as defined in s 79) in the contravention by the public company or child entity or related party contravened s 243ZE(3)(a);
- a person who was "by act or omission, director indirectly, recklessly concerned in, or party to" the contravention by the public company or child entity or related party contravened s 243ZE(3)(b);
- neither the public company nor the child entity who contravened s 243H was guilty of an offence, or was taken to be involved in all a concerned in all a party to the contravention by the related party or by the persons who contravened under s 243ZE(3)(a) and (b).

The defence in s 243ZE(6) permitted the related party to prove that it was unaware of the factual circumstances essential to the contravention of s 243H by the public company or its child entity.

Subsections 243ZE(2) and (3) were civil penalty provisions to which Pt 9.4B of the Corporations Law applied, but s 243H was not.

The EM to the CLERP Bill noted that under the then current law, a related party who was given a financial benefit in contravention of s 243H contravened s 243ZE(2) even if they may not have sought the benefit that was given. The Bill therefore proposed to provide, instead, that a related party would contravene the Law only if they were involved in the contravention of the related party provisions ([6.126]).

The CLERP Act introduced s 209(2), which stated simply that a person would contravene the subsection if they were involved in a contravention of s 208 by a public company or entity. This removed not only the special contravention provision for the related party, but also the provision creating a contravention for anyone recklessly concerned in or party to a contravention. For related parties, directors, officers and advisers, there was a single contravention which depended upon being involved in the contravention by the public company or controlled entity as defined in s 79 (which requires knowledge of the elements of the contravention). The reform went substantially further than merely exonerating a related party who had not sought the benefit that was conferred.

### *Texts and literature*

*Ford* [9.560]; *ACLPP* [3.2.0543], [3.2A.0115]; *Austin, Ford and Ramsay* [15.21].

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# Division 2 — Exceptions to the requirement for member approval [ss 210–216]

## [2E.210] Arm's length terms — Annotations to section 210

***Key principles***

Section 210 says that member approval is not needed to give a financial benefit on terms that would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length, or are less favourable to the related party in such terms. The EM to the Corporate Law Reform Bill 1992 stated ([282]) that as the object of the related party provisions is the protection of the public company's resources by requiring that transactions with related parties that could diminish or endanger those resources be disclosed and approved by the members, transactions with related parties that are on terms and conditions no more favourable to the related party than would apply if the transaction was on arm's length terms do not endanger or diminish the public company's resources and therefore should be exempt.

The EM gives some examples as to the circumstances in which the exemption could apply ([284]):

- management services provided to the public company by its holding company, or a company controlled by its directors; or
- equity or debt financing provided to the public company by its directors, holding company or any other related party.

The EM noted ([283]) that if the directors are concerned as to whether a particular transaction is on arm's length terms because it does not come within the ordinary business of the company, it is possible for them to obtain an independent expert's report on the transaction. Presumably the drafters of the EM had in mind that the expert's report would address both the question whether the transaction is in the best interests of public company or controlled entity that will give the benefit, and the question whether the transaction would be reasonable in the circumstances of that entity if the parties were dealing at arm's length.

*Australian Securities and Investments Commission v Australian Investors Forum Pty Ltd (No 2)* (2005) 53 ACSR 305; 23 ACLC 929; [2005] NSWSC 267; BC200501725 indicates a general approach of the courts to s 210, and includes observations on the relevance of experts' reports. Palmer J said (at [455]) that in applying this test the court is required to assess the terms of the subject transaction against objective standards: what the parties themselves thought about the reasonableness of the terms is relevant as an explanation of the transaction but is not decisive as to whether the terms were reasonable for the purposes of the section. He continued:

> [456] In applying the test the court assumes that the transaction is being entered into by a public company which is:
>
> - unrelated to the other party to the transaction in any way, financially or through ties of family, affection or dependence;
> - free from any undue influence or pressure;
> - through its relevant decision-makers, sufficiently knowledgeable about the circumstances of the transaction, sufficiently experienced in business and sufficiently well advised to be able to form a sound judgment as to what is in its interests;
> - concerned only to achieve the best available commercial result for itself in all of the circumstances.

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> The terms of the transaction, as would reasonably be achieved by a hypothetical public company in this position, are the standard against which the terms of the transaction in question are measured.
>
> [457] What is a reasonable commercial result for the public company in the transaction is, of course, itself a matter of judgment upon which honest and experienced commercial minds may legitimately differ. The court may receive expert evidence as to what would be within the range of reasonable outcomes of the transaction for the public company. Common experience or usual terms of trade in a particular market may sometimes prove a useful guide.
>
> [458] The court is not, however, bound to rely only upon such expert evidence and to blind itself to common sense and obvious commercial prudence. A transaction may be so clearly improvident from the public company's point of view that the court can see for itself that the transaction could never have resulted from an arm's length dealing in which the public company was able to advance and protect its own commercial interests.

(See also *ACI Operations Pty Ltd v Berri Ltd* (2005) 15 VR 312; [2005] VSC 201; BC200503994; *Orrong Strategies Pty Ltd v Village Roadshow Ltd* (2007) 207 FLR 245; [2007] VSC 1; BC200700161.)

For s 210 to apply, the financial benefit must be given on terms satisfying either of two alternatives. But the two alternatives are really part of the same concept, separated apparently for only drafting reasons. The concept was expressed in the predecessor provision, s 243N(1), by the requirement that the benefit be given on terms and conditions "no more favourable to the related party" than those on which it was reasonable to expect the company or entity to give the benefit directly if dealing with the related party at arms' length in the same circumstances. In the present section, "no more favourable" becomes, in effect, two requirements, namely "as favourable as (ie, reasonable)" and "less favourable than".

The first alternative is that the financial benefit is given on terms that "would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length". This literally requires attention to be given to the terms on which the benefit is given, rather than the content or nature of the benefit itself. But presumably "terms" is a broad enough concept to encompass the degree of benefit that is to be conferred. In the case of a loan or other financial accommodation, the terms to be considered would include terms relating to the amount of the financing, interest and charges, credit risk, security, and the timetable for repayments. These were matters expressly set out in the former s 243N(2), but the present broad language is sufficient to encompass them.

The question posed by the first alternative is not about what would be reasonable terms if a reasonable person in the shoes of the public company or entity were dealing with a reasonable person in the shoes of the related party on arm's length terms. Instead, the statutory question requires the court to take the public company or entity and the related party as it finds them, and to consider what would be reasonable for those particular entities to agree if they were dealing at arm's length. The question posed by the first alternative is a question of fact and judgment, amenable to expert evidence, but it is necessary to have regard to the particular circumstances of the parties. The time for determining whether a transaction is on arm's length terms is when the transaction is entered into (EM to the Corporate Law Reform Bill 1992, [282]).

The second alternative is that the financial benefit is given on terms that are less favourable to the related party than the terms that would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length.

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Section 210 will have its most frequent application where a company deals with the related party in the ordinary course of its ordinary business. But the section also applies to transactions that are not in the ordinary course of the company's business. And there will be some transactions that are such that they cannot fit within the description of "arm's length terms" contained in the section: for example, remuneration paid to a director or intra-group loans.

A transaction of a kind that could not satisfy s 210 was under consideration in *HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; 168 FLR 253; [2002] NSWSC 171; BC200200827 (appeal largely dismissed: *Adler v ASIC* (2003) 46 ACSR 504; 179 FLR 1; [2003] NSWCA 131; BC200303670). In that case, HIH was a listed public company and controlled HIHC, and Adler was a director of HIH. Adler was the sole director of Pacific Eagle, of which Adler Corporation was the only shareholder. HIHC paid $10 million to Pacific Eagle and some weeks afterwards, Australian Equities Unit Trust was constituted with Pacific Eagle as trustee. Then HIHC was issued with units in the Trust at an issue price of $10 million and Adler Corporation was issued with a small quantity of units. The Trust invested in HIH shares and in some unlisted venture capital investments which it acquired from Adler Corporation. Santow J held that by virtue of the transaction HIH and HIHC (its controlled entity) contravened s 208 by giving a financial benefit to related parties of HIH and HIHC, namely Pacific Eagle, Adler Corporation and Mr Adler. He rejected a contention that s 205 applied, because the transaction could not be described as on arm's length terms, that is to say it was not on terms that "would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length" (at [176]).

*ASIC's consultation paper*

In Consultation Paper 142, *Related Party Transactions*, ASIC has given some guidance to help companies comply with their obligations when providing financial benefits to related parties, and to help experts prepare independent expert reports on these transactions. The Consultation Paper contains policy proposals developed by ASIC in light of a review of related party transactions entered into by a number of public companies and registered schemes, almost all of which are listed ([11]).

ASIC says its review indicated that almost all companies had general policies on managing conflicts of interest, which were at a very high level, but there were varying practices about the circumstances in which companies applied the "arm's length" exemption, and in many cases companies relied on the exemption with insufficient consideration given to the reasons for doing so, and only by reference to isolated factors without considering all relevant factors ([13(c)]). For example, some companies failed to consider whether interested directors had participated in, or been privy to, negotiations with the related party ([46]). In ASIC's view ([49]), the circumstances to be considered include whether there are alternatives open to the company that do not involve related parties, the prevailing economic conditions and their impact on the parties and their relevant industries, and any special value to the transaction (such as available synergies).

The Consultation Paper proposes (at [B1]) to provide guidance in RG 76 *Related party transactions* about factors that companies and responsible entities should take into account in deciding whether the arm's length exception applies. ASIC also proposes (at [B2]) to provide guidance in RG 76 that companies should consider seeking member approval in cases where, having taken into account all the factors identified by ASIC, there is doubt about whether the transaction is at arm's length terms.

ASIC found in its review that an expert's report was often obtained on the issue of securities to, and acquisitions of assets from, related parties, but far less often on other transactions, such as related party loans or contracts for administrative, technical or other

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services ([13(e)]). ASIC proposes to provide guidance on independent expert reports for related party transactions, covering when an expert report is needed ([C1]), how the expert should assess related party transactions ([C2]) and on the independence of experts ([C3]).

Comments are due on the consultation paper by 17 December 2010, and it is proposed that a revised regulatory guide will be released in March 2011.

***Definitions and cross-references***

"Benefit", "company", "entity", "member" and "public company" are defined in s 9. "Related parties" are defined in s 228, and "giving financial benefits" has a meaning affected by s 229. Note ASIC Consultation Paper 142 (October 2010), *Related Party Transactions*.

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

Section 234(3)(f) of the Corporations Law exempted from the prohibition on loans to directors a loan, guarantee or security provided by a company in the ordinary course of its business, where the company's business included lending money and giving guarantees or providing security in connection with loans made to other persons, and the loan that was made by the company, or in respect of which the company gave a guarantee or provided security, was made on ordinary commercial terms as to the rate of interest, terms of repayment of principal and payment of interest, the security to be provided and otherwise.

When the legislative amendments proposed by CASAC were comprehensively revised by the Attorney-General's Department in 1991–2 (see [2E.207]), that provision was expanded into a more general exception for financial benefits given on arm's length terms, reflecting the drafter's perception that permitting commercial transactions without shareholder approval was a fundamental part of the new law.

According to the EM to the Corporate Law Reform Bill 1992, the exemption for financial benefits given to a related party on arm's length terms reflected a focus on "the central policy question" ([45]). The proposed Pt 3.2A was intended not to prevent a public company from entering into full value, commercial transactions with related parties, and was only to prevent "uncommercial" transactions, that is the kind of transactions that have a potential to adversely affect shareholders' interests ([206]). According to the EM ([211]):

> Proposed Part 3.2A . . . says to the honest director, 'If the related party transaction which is proposed is on ordinary commercial terms, it can be approved by the Board. But if it is an uncommercial transaction, it must be referred to shareholders, and shareholders must be fully informed of the details'. If all directors are aware of these rules, inappropriate transactions should not slip through unchallenged, as they often did during the 1980s.

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As introduced in 1992, s 243N was substantially to the same effect as the present s 210. But in the case of a loan or other financial accommodation, s 243N(2) said that the matters to be considered were to include:

(a) the amount of the loan or the extent of the accommodation;
(b) what interest or charges were payable;
(c) the credit risk;
(d) what security was given;
(e) the timetable for repayments of amounts owing and the payment of interest and charges.

These matters were not reproduced when the CLERP Act 1999 replaced s 243N with the present s 210.

***Texts and literature***

*Ford* [9.520], [9.530]; *ACLPP* [3.2.0543], [3.2A.0020], [3.2A.0045]; *Austin, Ford and Ramsay* [15.18].

## [2E.211] Remuneration and reimbursement for officer or employee — Annotations to section 211

***Key principles***

The corporate constitution usually permits the company to pay remuneration to directors and to reimburse their business expenses (see, for example, the replaceable rule in s 202A). The payment of non-director officers is a matter of contract between the company and the officer.

There is a risk that the company will favour insiders such as directors and officers with excessive remuneration. Part of the strategy adopted by the Corporations Act to address this risk is a disclosure strategy. The annual directors' report of a public company must include a remuneration report containing substantial information about the remuneration of directors and senior officers: ss 300, 300A. Members have a statutory right to ask questions about the remuneration report at the annual general meeting (s 250SA), and the remuneration report must be put to the meeting for a non-binding vote (s 250R).

Another part of the Corporation Act's strategy for regulating remuneration is found in Pt 2D.2 Div 2 relating to termination payments and Ch 2E. These provisions prohibit the payment of remuneration to directors and certain others in stated circumstances, without member approval. Section 208 impliedly prohibits the payment of remuneration by a public company or its controlled entity to a related party of the public company such as a director, unless member approval is obtained or the payment of the remuneration is protected by one of the exceptions in ss 210–216. Section 211 is the most obviously applicable exemption, but in some cases the exemption for indemnities etc in s 212 or the "small amounts" exception in s 213 may be relevant.

Section 211(1) says that member approval is not needed to give a financial benefit if the benefit is remuneration given to certain related parties identified in s 211(1)(a), and to give the remuneration would be reasonable in the circumstances identified in s 211(1)(b). The structure of the provision is curious. Under s 208(1), member approval is needed, in the absence of an available exception, only where a public company or an entity that the public company controls proposes to give a financial benefit to a related party of the public company. Section 211(1) and (2) say that member approval is not needed to give a financial benefit in some circumstances where there is no suggestion of a member approval requirement at all, namely where the person receiving the remuneration is a related party who is an officer or employee of some entity other than the public company.

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The related parties identified in s 211(1)(a) are related parties who are officers or employees of the public company itself, or of an entity that the public company controls, an entity that controls the public company, or an entity that is controlled by an entity that controls the public company. Note that "entity" is broadly defined in s 9 to include individuals, partnerships and trustees of trusts, as well as bodies corporate. "Control" is defined in s 50AA by reference to whether an entity has the capacity to determine the outcome of decisions about another entity's financial and operating policies.

Officers and employees are not necessarily related parties of the company for whom they work, or for any related company. "Related parties" are defined in s 228 as directors, their spouses, relatives of directors and spouses, or entities controlled by any of these persons (further, see [2E.228]). The concept underlying s 211(1)(a) seems to be that a financial benefit by way of remuneration may be given to a person who is both a related party under s 228 and also an officer or employee of any of the entities listed in the subsection.

Section 211(1)(b) says that member approval is not needed to give a financial benefit by way of remuneration to such a related party, if to give the remuneration would be reasonable, given the circumstances of the public company or entity giving the remuneration, and the related party's circumstances (including the responsibilities involved in the related party's office or employment). The section does not give any guidance as to when the giving of the remuneration would be "reasonable", except by reference to the company's circumstances and the related party's circumstances. Compare s 212(3), where in another context some relevant criteria are stated. It has been suggested that the "person's circumstances" refers to the character of the office held rather than the officer's personal wealth, for it surely cannot be necessary to consider, for example, that the officer has won the lottery and has therefore become wealthy: *Ford* [9.540].

Section 211(2) is closely similar to s 211(1), except that while subs (1) deals with the giving of remuneration, subs (2) deals with the giving of a financial benefit that is the payment of expenses incurred or to be incurred, or reimbursement of expenses incurred, by a related party performing duties as an officer or employee of entities corresponding with the entities listed in subs (1). Under subs (2), member approval is not needed for the giving of such financial benefits if to give the benefit would be reasonable in the circumstances of the public company or entity giving the benefit. Unlike subs (1), subs (2) does not refer to the related party's circumstances, presumably because the related party's circumstances are not relevant to the issue of reasonableness of the company's payment of the officer's expenses.

As noted below, the predecessor of s 211, s 243K, listed a number of benefits that were to be taken to be remuneration provided by a body corporate to its officer. At that time there was no definition of remuneration, but now there is a definition which takes one to the accounting standards, in particular AASB 124; see *Mott v Mount Edon Goldmines (Aust) Ltd* (1994) 12 ACSR 658 at 665; 12 ACLC 319; BC9401532. Note that the definition of remuneration is relevant to the exception, not the prohibition. That is, whether or not a benefit given by a public company or its controlled entity to a related party of the public company is "remuneration", it cannot be given without shareholder approval unless an exception is available. The most relevant exception, under s 211, is only available if the benefit is "remuneration" and it is reasonable.

Some of the matters expressly mentioned as remuneration in the former provision, namely salary, wages, bonuses, allowances for the purpose of meeting expenses in connection with performing services as an officer, and fringe benefits, are "remuneration" for the purposes of s 211, as defined, in s 9, by reference to the accounting standards. However, s 211(3) follows the former s 243K by expressly providing that contributions by

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a body corporate to a fund for superannuation benefits for an officer or the officer's dependants, and financial benefits given to a person because of the person ceasing to hold office or employment as an officer or employee of a body corporate, are in each case remuneration provided to the person in their capacity as an officer of the body. Therefore if they are reasonable, the exception to s 208 will be available.

The reference to termination benefits in s 211(3)(b) raises an issue as to the relationship between Ch 2E and Pt 2D.2. The position is that if an entity proposes to give a benefit to a person in connection with a person's retirement from an office in the circumstances identified in s 200B, member approval under s 200E is needed for the giving of the benefit unless there is an available exception. If a public company or its controlled entity proposes to give a financial benefit to a related party of the public company, the public company or entity is required by s 208 to obtain the approval of the public company's members in the manner prescribed in Ch 2E and give the benefit within 15 months after the approval, unless an exception is available. The requirements for termination payments and related party benefits must be seen as separate. Sometimes s 208 but not s 200B will apply: for example, where a benefit is given to a related party (such as a spouse of a director) who does not occupy a managerial or executive office as defined in s 200AA, and the benefit is not "reasonable remuneration" for the purposes of s 211. Sometimes s 200B but not s 208 will apply: for example, where the holder of a managerial or executive office in a public company is not a director and not otherwise a related party of the public company, or where the retirement benefit constitutes "reasonable remuneration" for the purposes of s 211. Sometimes both s 200B and s 208 will apply to require member approval for the giving of the benefit, but where that is the case there must be separate member approvals under each set of provisions.

If a public company or its controlled entity enters into a contract to provide remuneration to a related party of the public company, member approval will be required to under s 208(1) unless an exception is available. Section 211 is not available at the point of entry into the contract because at that point the benefit that is given is the contractual entitlement to remuneration, whereas s 211 only applies to the giving of a benefit that is remuneration. Consequently member approval is necessary unless some other exception applies. However, under s 208(2), if the contract is made within 15 months after member approval, or is made before member approval but is conditional on member approval being obtained and it is obtained, any benefit required by the contract may be given at any time without further member approval (and regardless of whether, if the benefit is remuneration, it is reasonable remuneration). As the EM to the Corporate Law Reform Bill 1992 observed (at [275]) in relation to the predecessor provision, the provision allows a company to enter into employment contracts with its officers that have a period longer than 15 months.

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***Definitions and cross-references***

"Benefit", "body corporate", "company", "entity", "member", "officer", "public company" and "remuneration" are defined in s 9. "Control" is defined in s 9 and s 50AA. "Related parties" are defined in s 228 and "giving a financial benefit" has a meaning affected by s 229.

As to the definition of "remuneration", which refers to an accounting standard, see AASB 124 *Related party disclosures*.

Note s 202A, a replaceable rule that allows the company in general meeting to determine the remuneration of directors, subject to Ch 2E. As to disclosure or remuneration of directors and certain officers in the remuneration report which is part of the annual directors' report, see ss 300 and 300A. As to discussion of the remuneration

report at the AGM of a public company, see s 250SA, and as to the requirement for a non-binding vote on the remuneration report, see s 250R.

Note the discussion of Ch 10 of the ASX Listing Rules at [2E.208]. As to the overlap between Ch 2E, on the one hand, and Pt 2D.2 and ASX Listing Rules 10.18–10.19 dealing with retirement benefits, on the other hand, see *ACLPP* [10.1.0825] and [10.1.0855].

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

The original loans to directors provision, UCA s 125, permitted a company to provide a director with funds to meet expenditure incurred for the purposes of the company or for proper performance of the director's duties as an officer, and also permitted the company to provide a full-time director with funds to meet expenditure in acquiring a home. In both cases shareholder approval was required either before the benefit was given, or at the next annual general meeting. The company was also permitted to make a loan to a full-time director under a scheme approved in general meeting, for making loans to employees (such as a funded employee share scheme). Those provisions were developed but remained substantially to the same effect, in later Australian legislation up to 1992.

One of the concerns identified by CASAC, when it recommended substantial revisions to the law in 1991, was that in the 1980s corporate controllers had abused their positions by moving corporate funds into their own hands by, amongst other means, remuneration payments on terms highly advantageous to themselves. Plainly the related party provisions, when enacted in 1992, were intended to be an important component of the regulation of directors' remuneration. Remuneration paid by a public company or its controlled entity to a director of the public company is obviously the giving of a financial benefit to a related party of the public company.

The initial "reasonable remuneration" exception, in s 243K, was substantially to the same effect as the present s 211, though the drafting has been clarified and in particular, s 211 now deals expressly with reimbursement of expenses. Until the amendments in 2004, s 243K stipulated that certain things were remuneration paid by a body to an officer, namely salary, wages, bonuses, allowances to meet expenses, fringe benefits, superannuation benefits and a financial benefit given to a person because the person ceases to hold an office or employment as an officer or employee of a body corporate.

***Texts and literature***

*Ford* [9.520], [9.530]; *ACLPP* [3.2.0543], [3.2A.0060]; *Austin, Ford and Ramsay* [15.19].

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## [2E.212] Indemnities, exemptions, insurance premiums and payment for legal costs for officers — Annotations to section 212

### *Key principles*

Section 212(1) says that member approval is not needed to give a financial benefit if three conditions are satisfied. The structure of the subsection implies that is about a public company or controlled entity of a public company giving a financial benefit to a related party of the public company. It seems that the three conditions are to be satisfied at the time when the company agrees to grant the indemnity or exemption or to make the payment: EM to the CLERP Bill, [6.125].

The first condition is that the benefit is for a related party (presumably, of the public company) who is an officer of the public company or entity. If the related party is a director of the public company or entity they will necessarily be an officer of that entity. But in some cases the related party is not a director and therefore not necessarily an officer — for example, where the related party is the spouse or relative of a director. The exception is not available to such a related party unless they happen to be an officer of the public company controlled entity for some other reason.

The second condition is that the benefit must be an indemnity, exemption, or insurance premium in respect of the liability incurred as an officer of the public company or entity, or an agreement to give an indemnity or exemption, or to pay an insurance premium, of that kind. As to indemnities and exemption's given to officers of corporations by a corporation, see [2D.199A]. As to insurance premiums, see [2D.199B].

The third condition is that to give the benefit would be reasonable in the circumstances of the public company or entity giving the benefit. Section 212(3) says that in working out whether the giving of the benefit is reasonable in the circumstances, one is to assess whether it would be reasonable on the basis of circumstances existing at the time when the agreement is made (if there was an agreement), or at the time when the benefit is given (if there was no agreement); and one must disregard any other financial benefit given or payable to the officer by the public company or entity.

A note to s 212(1) points out that ss 199A–199C may prevent giving an indemnity or exemption or paying an insurance premium for an officer. Presumably s 212(1) will only apply to indemnities, exemptions and insurance premiums that are lawful, as it would appear to be necessarily unreasonable to give an indemnity or exemption or pay an insurance premium contrary to the law.

Section 212(2) is a provision corresponding with subs (1) where the benefit is the making of, or an agreement to make, a payment (whether by way of advance, loan or otherwise) in respect of legal costs incurred by the officer in defending an action for a liability incurred as an officer of the public company or entity. Here, in addition to the requirement of reasonableness, the exemption is not available unless either s 199A does not apply to the costs, or if it does, the officer is required to repay the amount paid if the costs become costs for which the company must not give the officer an indemnity under that section. See [2D.199A].

### *Definitions and cross-references*

"Benefit", "company", "entity", "member", "officer" and "public company" are defined in s 9. "Related parties" are defined in s 228 and "giving a financial benefit" has a meaning affected by s 229. As to indemnities, exemptions, insurance premiums and payment of legal costs for officers generally, see ss 199A–199C.

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***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

When the related party provisions were first introduced by the Corporate Law Reform Act 1992, there was no express exemption for the matters now in s 212. However, when the provisions of the Corporations Law concerning indemnification, exemptions and insurance of officers were extensively revised in the Corporate Law Reform Act 1994 (see [2D.199A]), that Act introduced ss 243K(7A) and 243K(7B). Those provisions stipulated that indemnities and insurance premiums for officers' liability were to be treated as remuneration for the purposes of the "reasonable remuneration" exemption from the related party provisions.

The current s 212 was introduced by the CLERP Act 1999. According to the EM for the CLERP Bill ([6.125]), suggestions had been made that it was not appropriate to count indemnities and insurance premiums as remuneration, and so the Bill proposed to include a separate section exempting from the requirement of shareholder approval a reasonable indemnity or insurance premium given to an officer who is a related party. It may have been thought that deeming indemnities, exemptions and insurance premiums to be remuneration had the consequence that the reasonableness of those benefits was to be assessed in conjunction with other aspects of remuneration. The result of this might have been that quite reasonable indemnity and insurance arrangements would not be exempted because other aspects of the remuneration package were unreasonable. Now s 212(3) gives guidance as to the criteria to be used for assessing reasonableness in this context, and says that other financial benefits are to be disregarded.

***Texts and literature***

*Ford* [9.520]; *ACLPP* [3.2A.0060].

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## [2E.213] Small amounts given to related entity — Annotations to section 213

***Key principles***

Under s 213(1) it is permissible for a public company or its controlled entity to give one or more financial benefits to a related party if the total of all of the amounts given in the financial year is not more than $5000 for that related party. The EM to the Corporate Law Reform Bill 1992 ([278]) said of the predecessor provision that "the relatively minor nature of such advances could not ordinarily be said to constitute a significant diminution of the resources of the company".

As a matter of construction of s 213(1), the limit of $5000 is applied separately to each related party. Thus, for example, under s 213 a public company may, subject to the general law of directors' duties, give one of its directors an allowance of $5000 per year for (say) private air travel, and matching allowances for the director's spouse, parents and children, all of whom are related parties of the public company (though note that there would obviously be tax and disclosure issues).

In calculating the amount of the benefit for the purpose of applying the $5000 cap, one is to confine attention to amounts or values of financial benefits given to the related party in the financial year, for which member approval was not needed because of s 213: s 203(1)(b).

One must include in the calculation all amounts or values of financial benefits given to that related party in the financial year by not only the public company, but also any entity

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controlled by the public company or controlled by its controlled entity: s 213(2)(a). The question whether an entity is controlled by a public company is to be assessed at the time the entity gives the financial benefit to the related party of a public company: s 213(2). The reference to the public company "or entity" is confusing because the only restriction imposed on related party benefits by Ch 2E is on financial benefits given by a public company or an entity that the public company controls. The effect of s 203(2)(a), when read together with s 208, appears to be that the $5000 cap applies to the total of the financial benefits received by the related party of a public company in a financial year from the public company and all controlled entities of the public company.

However, under s 213(1)(b), one takes into account only benefits for which member approval was not needed because of s 213. That is, in respect of each amount given to the related party by the public company or controlled entity in the financial year, one considers whether, in the absence of s 213, any other exemption from s 208 would be available, and if not, whether s 208 would be applicable to require member approval. That approach is confirmed, but probably not added to, by s 213(2)(b)(ii), which says one is to disregard amounts that fall under any other exception in Pt 2E.1.

Initially the "small amounts" exemption was confined to an advance of money to a director or the director's spouse (former s 243L), and required the aggregation of all amounts "still owing". There is a remnant of this history in s 213(2)(b)(i), which says that in calculating annual benefits for the purposes of s 213, one is to disregard "amounts that have been repaid". In other words, if the benefit is in the form of an advance (necessarily an advance made in the present financial year, as the limit is refreshed each year) and it has been repaid, the limit for that financial year is to be calculated without taking into account that advance.

***Definitions and cross-references***

Regulation 2E.1.01 prescribes the amount of $5000 for the purposes of s 213(1). "Benefit", "company", "entity", "member", and "public company" are defined in s 9. "Related parties" are defined in s 228 and "giving a financial benefit" has a meaning affected by s 229. "Control" is defined in ss 9 and 50AA. "Financial year" is defined in ss 9 and 323D.

The related party provisions apply, with modifications, to a registered managed investment scheme (s 601LA) as if s 213 (amongst other provisions) were omitted (s 601LD) (see *ACLPP* [3.2A.0145]).

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

The idea that there should be an exception to the prohibition for "small amounts" was first put forward by CASAC in its 1991 Report. CASAC proposed that there be an exemption from the loans to directors prohibition for transactions not exceeding $25,000, or some other prescribed amount. CASAC also recommended legislation prohibiting a company from entering into loans or similar transactions with related or linked bodies corporate, and from entering into asset transfer transactions with associates, subject to exceptions. One of these was for transactions not exceeding 5% of members' funds. That echoed the listing rule on related party transactions, then Rule 3J(3) (see now Rule 10.2).

The Corporate Law Reform Act 1992, s 243L, opted for a more limited exemption, confined to an advance of money to a director or the director's spouse, not exceeding $2000 or such greater amount as prescribed. Section 213, when first introduced by the CLERP Act 1999, was redrafting without substantial change. But s 213 was repealed and replaced with the current wording by the Corporations Legislation Amendment (Simpler

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Regulatory System) Act 2007, which made some significant changes. In particular, the new provision applies to the giving of any financial benefit, not only money; the permissible benefit may be given to any related party (not only a director of the public company or their spouse); the permissible amount is calculated afresh each financial year; and the total permissible amount per financial year (as prescribed by regulation) is $5000. The new provision commenced for the financial year beginning on 1 July 2007. According to the EM to the 2007 Bill, [4], the purpose of the amendment was to remove burdensome member approval requirements in relation to small transactions between public companies and related parties.

***Texts and literature***

*Ford* [9.520]; *ACLPP* [3.2A.0065].

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## [2E.214] Benefit to or by closely-held subsidiary — Annotations to section 214

***Key principles***

Section 214(1) says that member approval is not needed to give a financial benefit if the benefit is given either by a body corporate to a closely-held subsidiary of the body, or by closely-held subsidiary of a body corporate to the body or an entity it (that is, the body corporate) controls. "Closely-held subsidiary" is defined in s 214(2) and (3). According to the EM to the Corporate Law Reform Bill 1992 ([281]), the exemption is intended to apply where there are no minority interests to protect.

As explained below, the "exception" in s 211 is in some respects wider (that is, it confers an "exception" when none is needed) and in some respects narrower than the occasions when s 208 applies to inter-corporate transactions.

Section 208 covers financial benefits given by a public company or an entity controlled by a public company, the word "entity" being defined broadly to include bodies corporate and non-corporate entities such as partners and the trustees of trusts. What is prohibited, in the absence of member approval or an available exception, is for the public company or such an entity to give a financial benefit to a related party of the public company. A related party may be a body corporate, but only in the circumstances identified in s 228(1) (an entity that controls a public company) or s 228(4) (for example, a body corporate controlled by a director of the public company or the director's spouse). That is the context in which the application of s 214 is to be assessed.

*The entity that gives the benefit*

The exception in s 214 is only available for financial benefits given by a body corporate. This is because s 214(1)(a) refers to benefits given by a body corporate, and s 214(1)(b) refers to benefits given by a closely-held subsidiary of a body corporate, a concept confined to bodies corporate by the definition in s 214(2). Therefore a non-corporate entity (such as a trust or partnership) controlled by a public company, although it is prevented from giving certain financial benefits by s 208, cannot take advantage of s 214, and consequently (unless some other exemption is available) member approval is required by s 208. That is important in the case where, say, a director of a holding company derives a benefit from a unit trust controlled by its subsidiary as responsible entity.

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*The entity that receives the benefit*

Section 214 only applies if the benefit is given to a body corporate or an entity controlled by a body corporate, having regard to s 214(1) and the definition of "closely-held subsidiary" in s 214(2). But the giving of such a benefit will not be prohibited by s 208, and therefore an exemption will not be needed, unless the entity that receives the benefit is a related party of a public company. That gives rise to the question: when will a related party of a public company be an entity to which a benefit may be given, under s 214, without shareholder approval?

The answer depends on identifying the categories of related parties of a public company that are bodies corporate or entities controlled by bodies corporate, and applying s 214 to each of those categories.

First, under s 228(1) an entity that controls a public company (called a "parent entity" in the former Pt 3.2A) is a related party of the public company. According to the definition of "entity" in s 9, the parent entity may be a body corporate, a partnership, an unincorporated body, an individual, the single trustee of a trust, or the trustees of a trust that has more than one trustee. Where the parent entity is a body corporate, and it receives a financial benefit from the public company that it controls or from an entity controlled by that public company, s 208 applies to require approval by the members of the public company unless an exemption is available.

Section 214(1)(b) provides an exemption to permit a public company to give a financial benefit to its parent entity if the public company is a closely-held subsidiary of the parent entity and the parent entity is a body corporate. Presumably the underlying policy is that if there are no voting members of a public company other than its parent entity, there is no reason for requiring the public company to obtain member approval before giving a financial benefit to the parent, because the parent entity is the only member that would be able to vote on the proposal. Section 214(1)(b) also permits a controlled entity of a public company to give a financial benefit to the public company's parent entity if both a controlled entity and the parent entity are bodies corporate, the controlled entity is a closely held subsidiary of the public company, and the public company is a closely held subsidiary of its parent entity (so that under s 214(2), the controlled entity is also a closely-held subsidiary of the public company's parent entity).

Second, by the combined operation of ss 228(1) and 228(4), an entity is a related party of a public company if it is an entity controlled by a parent entity of the public company and not controlled by the public company. This is the concept described in the former Pt 3.2A as a "sibling entity". A public company is prohibited under s 208 from giving a financial benefit to its sibling entity unless it obtains member approval or there is an available exemption. Under s 214(1)(b), a public company that is controlled by a parent entity and has a sibling entity may give a financial benefit to the sibling entity notwithstanding s 208, whether the sibling entity is or is not a body corporate, *provided that* the public company is a closely-held subsidiary of its parent entity. An entity controlled by a public company is prohibited by s 208 from giving a financial benefit to a parent or sibling entity of the public company because they are related parties of the public company, in the absence of member approval or an available exemption. Under s 214(1)(b), if the controlled entity of the public company is a closely held subsidiary of the public company's parent entity (which it could only be, according to s 214(2), if the public company was also a closely held subsidiary of the parent entity), the controlled entity is permitted to give a financial benefit to the public company's sibling entity, whether the sibling entity is or is not a body corporate.

Third, by the combined operation of s 228(4) and either s 228(2) or (3), an entity is a related party of a public company if it is an entity controlled by a director of the public

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company or of an entity that controls the public company, or the director's spouse, or a parent or child of the director or spouse. A public company is prohibited by s 208 from giving a financial benefit to such an entity unless it obtains member approval or there is an available exemption. Except in highly unusual circumstances, the exemption in s 214 will not be available where a public company or its controlled entity gives a financial benefit to entity of this kind, even where the entity is a body corporate, and so in the absence of some other exemption, member approval will be needed.

*Closely-held subsidiary*

"Closely-held subsidiary", for the purposes of s 214, is defined in ss 214(2) and (3). A closely-held subsidiary is assumed by the definition to be a body corporate. A body corporate (B) is a closely-held subsidiary of another body corporate (A) if and only if no member of B is a person other than A or A's nominee, or C (a closely-held subsidiary of A) or C's nominee. The definition thus allows for a chain of closely-held subsidiaries.

For the purpose of identifying members of B, one must disregard shares that are not voting shares. The EM to the Corporate Law Reform Bill 1992 says ([281]) that such shares (for example, non-voting redeemable preference shares used as a means of debt financing) "do not effectively dilute ownership of the subsidiary, and the [related party provisions are] not intended to impose extra obligations in such situations". But the exemption is not confined to non-voting shares that do not "dilute ownership". Perhaps a better explanation is that the thrust of Ch 2E is to require certain transactions to be put before members for approval, rather than to protect members from oppression. There is no point in requiring transactions to be put to members for approval if there is only one voting member whose attitude to the transaction is already known, even (apparently) when the transaction will be unfair to non-voting members. That unfairness can be addressed in proceedings under Pt 2F.1.

***Definitions and cross-references***

"Benefit", "body corporate", "financial benefit", "member", and "voting share" are defined in s 9. "Giving a financial benefit" has a meaning affected by s 229.

The related party provisions apply, with modifications, to a registered managed investment scheme (s 601LA) as if s 214 (amongst other provisions) were omitted (s 601LD) (see *ACLPP* [3.2A.0145]).

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

There was an exception to the loans to directors provision in UCA s 125, to permit a subsidiary to make loans and give guarantees and security to its holding company, which was rendered necessary because the holding company might have been treated as a director of the subsidiary under the law at the time. Under the Companies ([Name of State]) Code 1981, s 230, there was an exception for loans, guarantees and securities by a company in favour of a related corporation where the transaction was authorised by resolution of the directors. The CSLRC, in its 1989 Report, rejected a submission that a loan by a company to a related or affiliated company should not be a contravention, if the loan was authorised by directors who had no relevant interest in the borrowing company. The Committee's reason was that any minority interest, however small, was entitled to protection against the company making a loan to another company in which a director had a significant interest.

CASAC's 1991 Report acknowledged that loan transactions between related bodies corporate should not be prohibited by the loans to directors provision, and recommended

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an exception to the prohibition on transactions between related or linked bodies corporate and asset transfer transactions with associates, where the transaction was in relation to group bodies corporate (holding companies and wholly-owned or closely held (90% or more) subsidiaries).

The Corporate Law Reform Act 1992, s 243M, limited the exception for related bodies corporate to a case where a body corporate gives a financial benefit to a closely-held subsidiary of that body, or a closely held subsidiary of the body gives a financial benefit to the body or its child entity. The present s 214 is in substantially the same terms.

***Texts and literature***

*Ford* [9.520]; *ACLPP* [3.2A.0070].

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## [2E.215] Benefits to members that do not discriminate unfairly — Annotations to section 215

***Key principles***

According to s 215, member approval is not needed to give a financial benefit if two conditions are satisfied, namely:

(a) the benefit is given to the related party in their capacity as a member of the public company; and

(b) giving the benefit does not discriminate unfairly against the other members of the public company.

As the EM to the Corporate Law Reform Bill 1992 noted ([287]), this provision allows a public company to undertake “shareholder transactions” with its related parties who are not members, so long as the transactions do not discriminate unfairly in favour of one or more related parties (and consequently, against the other members of the public company). Giving a benefit to someone in their capacity as a member requires that the benefit must relate to their position as a member rather than, say, employee or consumer or creditor.

Unfair discrimination against the other members of the company is a concept used in the “oppression” provisions of Pt 2F.1, although there the concept of unfair discrimination applies in respect of any member or members whether in that capacity or in any other capacity. According to the EM to the 1992 Bill ([288]), the “normal operation of different classes of shares” will not infringe s 208, but s 215 does not provide an exemption for shareholder transactions where there has been unfairness in the treatment accorded to members who are not related parties as against those members who are related parties.

According to the EM to the 1992 Bill ([286]), the prohibition in s 208 on a public company giving a financial benefit to a related party extends to transactions with related parties in their capacity as a shareholder of the public company, such as the payment of dividends, rights and bonus issues, and “any privileges made available by the company to its members in their capacity as members (such as discounts for the goods and services provided by the company)”.

***Definitions and cross-references***

“Benefit”, “company”, “financial benefit”, “member” and “public company” are defined in s 9. “Related parties” are defined in s 228. “Giving a financial benefit” has a meaning affected by s 229. Note s 232 concerning unfair discrimination against a member or members of a company whether in their capacity as members or otherwise.

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***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

An exemption for benefits given to members in their capacity as members was introduced by the Corporate Law Reform Act 1992, s 243PA. As explained in the EM for that Bill ([286]), once the loans to directors provisions were expanded to cover the giving of related party benefits generally, it was necessary to protect such benefits as dividends, rights and bonus issues.

Section 243PA was replaced by the present s 215 in the CLERP Act 1999. The reference in the previous provision to discriminating unfairly "either directly or indirectly" was removed. Whereas the former provision referred to discriminating unfairly "in favour of one or more related parties of the public company", the replacement provision referred to discriminating unfairly "against the other members of the public company". Arguably these are not changes of substance.

***Texts and literature***

*Ford* [9.520]; *ACLPP* [3.2A.0075].

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## [2E.216] Court order — Annotations to section 216

***Key principles***

Section 216 says that member approval is not needed to give a financial benefit under an order of the court. The section refers to "court" with a small "c", meaning any court, not merely the "Courts" vested with jurisdiction under the Corporations Act: s 58AA.

The effect of s 216 is to allow any court, by order, to permit the giving of a financial benefit that would otherwise require member approval under s 208. The section would also prevent parties affected by court orders from arguing that they need not comply because to do so would contravene Ch 2E.

No doubt the court would expect counsel to draw its attention to Ch 2E if counsel seeks an order that would require a person to do something otherwise in contravention of that chapter. But the order creates an exemption whether or not the court has considered Ch 2E before making the order.

***Definitions and cross-references***

"Benefit", "financial benefit" and "member" are defined in s 9. The definition of "court" is found in s 58AA.

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

An exemption for benefits given under an order of a court was part of the related party provisions introduced by the Corporate Law Reform Act 1992. The exemption, initially s 243PB, was replaced by s 216 by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.520]; *ACLPP* [3.2.0543], [3.2A.0080].

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**[The next page is 30,141]**

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# Division 3 — Procedure for obtaining member approval [ss 217–227]

## [2E.217] Resolution may specify matters by class or kind — Annotations to section 217

***Key principles***

Sections 217–227 deal with the procedure for obtaining member approval. In summary, where member approval is to be obtained:

(i) approval is required by the members of the public company, whether it is the public company itself or a controlled entity of the public company that is to give the financial benefits;

(ii) the obligations in respect of giving notice of, convening and conducting the meeting, and notifying ASIC, are cast upon the public company (see s 218(1)), even if the financial benefits are to be given by a controlled entity of the public company;

(iii) the public company must prepare a notice of meeting setting out the text of the proposed resolution, complying with s 221;

(iv) the resolution may specify anything either in particular or by reference to class or kind (s 217);

(v) the public company must also prepare an explanatory statement satisfying s 219;

(vi) the public company may also prepare other documents relating to the proposed resolution that will accompany the notice of meeting (s 218);

(vii) the public company must lodge with ASIC, at least 14 days before the notice convening the meeting is given (or such shorter period as ASIC approves), the proposed notice of meeting and explanatory statement, any other document that is proposed to accompany the notice of meeting, and also any other document proposed to be given to the members before or at the meeting by the company, or the related party or an associate of the company or the related party, that could reasonably be expected to be material to a member in deciding how to vote (s 218);

(viii) ASIC may give the company written comments on the documents (s 220);

(ix) any document given to the members before the meeting by the public company, the related party or an associate of either, which can reasonably be expected to have been material to a member in deciding how to vote, must be the same as the document lodged under s 218 (s 222).

(x) the resolution put to the meeting must be the same as the proposed resolution set out in the notice of meeting lodged with ASIC (s 223);

(xi) with certain exceptions, votes on the proposed resolution may not be cast (in any capacity) by or on behalf of a related party to whom the resolution would permit a financial benefit to be given, or an associate of the related party (s 224);

(xii) there are detailed requirements for the taking of a poll on the proposed resolution (s 225);

(xiii) if a related party or their associates vote in contravention of s 224, the resolution is not regarded as passed unless it would still have passed if their votes were disregarded (s 225(1));

(xiv) the public company must lodge a notice with ASIC setting out the text of the resolution within 14 days after the resolution is passed (s 226);

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(xv) the court may declare that these requirements are satisfied if it finds that they have been substantially satisfied (s 227).

These provisions are similar to but not the same as various other requirements for member approval under the Corporations Act or the ASX Listing Rules (note, in particular, s 200E relating to retirement benefits; s 256C relating to reductions of capital; ss 257C and 257C relating to buy-backs; s 260B relating to financial assistance; s 611 item 7 relating to the acquisition of shares above the 20% threshold; and the various requirements of Ch 10 of the ASX Listing Rules concerning related party transactions). Where approval is needed under one of these other provisions for a transaction that also needs member approval under Ch 2E, separate resolutions will be needed for the Ch 2E approval and for the other approval, and care must be taken to comply with the voting exclusion requirements for each resolution, which will not necessarily be the same. It is usually feasible to obtain the various approvals at the same meeting, but there may be different notice and disclosure requirements for each resolution, which will need to be complied with cumulatively. If the other approval or approvals do not concern the related party transaction, they will need to be obtained at a separate meeting, because s 221(e) says that the notice convening a meeting for the approval of related party benefits must not be accompanied by documents other than those specified, all of which relate to the proposal for the giving of a related party benefit.

Section 217 says that a resolution for member approval of related party benefits may specify any matter either in particular, or by reference to class or kind. That provision was part of the member approval provisions of the original related parties legislation, introduced in s 1992. According to the EM to the Corporate Law Reform Bill 1992 ([292]), the section allows a resolution to specify by class or kind:

- the financial benefits that it permits to be given;
- the related parties to whom it permits financial benefits to be given;
- contracts that it permits to be made; or
- related parties with whom it permits contracts to be made.

The EM illustrates this by saying ([293]) that the resolution could specify "the directors" as a class of related parties to whom it proposes that a financial benefit be given, without naming each director.

***Definitions and cross-references***

Note s 218(1)(a), which requires lodgement with ASIC of the proposed notice of meeting setting out the text of the proposed resolution.

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

Legislation dealing with the member approval procedure was introduced as part of the 1992 reforms, after CASAC in its 1991 Report was critical of the loans to directors provision, for several reasons including the failure of the legislation to guarantee that complete and accurate information would be provided to shareholders in circumstances where their consent was required, and the omission of any provision for exclusion from voting of interested parties. The procedure for member approval was introduced by the Corporate Law Reform Act 1992, and has remained in place since that time without any substantial alteration.

Section 217 is in substance identical with the former s 243S. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2.0543], [3.2A.0090].

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## [2E.218] Company must lodge material that will be put to members with ASIC — Annotations to section 218

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 218(1) requires a public company to lodge with ASIC the proposed notice of meeting setting out the text of the proposed resolution (s 218(1)(a)), the proposed explanatory statement satisfying s 219 (s 218(1)(b)), any other document that is proposed to accompany the notice convening the meeting that relates to the proposed resolution (s 218(1)(c)), and any document described in s 218(1)(d). Section 218(1)(d) identifies any other document proposed to be given to the members before or at the meeting by the public company, the related party, or an associate of either, that can reasonably be expected to be material to a member in deciding how to vote on the proposed resolution.

Section 218(1)(c) requires lodgement of any document that is proposed to accompany the notice convening a meeting that relates to the proposed resolution. If the giving of the related party benefit also requires approval under some other provision, such as under Ch 10 of the ASX Listing Rules or s 260B (financial assistance), a resolution for that purpose will require additional explanatory information, which may accompany the notice convening the meeting because it "relates to" the proposed resolution to approve the related party benefit. Were that not the case, s 221(e) would prevent the material relating to the additional resolution from being put to members at the meeting convened to approve the related party benefit.

"Associate" is defined in ss 11, 15 and 16. The definition includes:

- where the primary person is a body corporate, a related body corporate and the directors and secretaries of the body corporate and the related body corporate; and
- whether the primary person is or is not a body corporate, a person in concert with whom the primary person is acting or proposing to act, and a person with whom the primary person is or proposes to become associated, whether formal or informally, in any other way.

According to the EM to the Corporate Law Reform Bill 1992 ([295]), the intended effect of this provision is that potential beneficiaries will only be able to give to members copies of documents that are lodged with ASIC, and the provision of further documents will prevent the member approval procedure from being effective in relation to the proposed financial benefit.

While the notice convening the meeting, as given, may be different from the draft notice lodged under s 218 in immaterial ways (s 221(a)), particular care must be taken with the drafting of the proposed resolution, because s 223 says that the resolution put to the meeting must be the same as the proposed resolution set out in the notice of meeting lodged under s 218. The question whether additional documents will be given to the members at or before the meeting must also be carefully considered before lodgement with ASIC. This is because under s 222, any document that does not accompany the notice convening the meeting but is given to the members before or at the meeting by the public company, the related party or the associate, and can be reasonably expected to have been material to a member in deciding how to vote, must be the same in all material respects as the document lodged with ASIC under s 218(1)(d).

The documents are to be lodged with ASIC at least 14 days before the notice convening the meeting is given. As the minimum period of notice of meeting of a public company

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is generally 21 days (s 249H), and 28 days in the case of a listed company (s 249HA), there will have to be quite a lengthy period between the initiation of the proposal and the member decision. The law in effect gives ASIC 14 days to consider the documents and decide whether it will comment on them under s 220. However, ASIC has a discretion under s 218(2) and (3) to approve a period of less than 14 days for the period of time to elapse between lodgement with ASIC and the giving of the notice of meeting.

In RG 76 *Related party transactions* ASIC has given guidance as to the matters it will take into account on an application for reduction of the 14 day time period, and in deciding whether to make comments on the documents under s 220. Applicants are required to provide reasons why the application should be dealt with in a shorter period: RG 76.42. ASIC will usually comment if, in its view, the documents do not comply with the requirements for lodgement or the content requirements for the explanatory statement (RG 76.44). It will consider the case law and general principles governing notices of meeting and in particular, whether the documents fully disclose material facts and whether they are clear and unambiguous (RG 76.45; as to full disclosure of material facts, see RG 76.46; and as to the requirement that the disclosure be clear and unambiguous, see RG 76.47).

***Definitions and cross-references***

"Company", "member" and "public company" are defined in s 9. The requirements for notice of the meeting of a public company are in s 249H and (in the case of a public company) s 249HA. "Associate" is defined in ss 10, 11, 15 and 16. Note s 220 as to ASIC's power to comment on a proposed resolution, s 219 as to contents of the explanatory statement, s 221 as to the requirements for notice of meeting, and s 222 as to other material to be put to members. See s 223 as to variation of the proposed resolution. As to ASIC's discretion to shorten the lodgement period, see RG 76 *Related party transactions*.

The Acts Interpretation Act 1901 (Cth) contains a definition of "document" in s 25 and provisions about the reckoning of time in ss 36 and 37.

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 218 is in substance identical with the former s 243U. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0095].

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**[The next page is 30,151]**

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## [2E.219] Requirements for explanatory statement to members — Annotations to section 219

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 219(1) prescribes the required form and content of the explanatory statement in some detail, requiring that the proposed document lodged under s 218 be in writing and set out:

- (a) the related parties to whom the proposed resolution would permit financial benefits to be given; and
- (b) the nature of the financial benefit; and
- (c) in relation to each director of the company:
  - (i) if the director wanted to make a recommendation to members about the proposed resolution — the recommendation and his or her reasons for it; or
  - (ii) if not — why not; or
  - (iii) if the director was not available to consider the proposed resolution — why not; and
- (d) in relation to each such director:
  - (i) whether the director had an interest in the outcome of the proposed resolution; and
  - (ii) if so — what it was; and
- (e) all other information that:
  - (i) is reasonably required by members in order to decide whether or not it is in the company's interests to pass the proposed resolution; and
  - (ii) is known to the company or to any of its directors.

The first four sub-paragraphs of s 219(1) are reasonably straightforward and are the sorts of things one would expect to be disclosed in an explanatory statement concerning a proposal of this kind. It is material for the members to be told the nature of the financial benefit, the identity of the related parties, the attitude of directors, and whether the directors have an interest in the outcome of the proposed resolution (so that the members can assess whether their attitude might be influenced by their interest). The directors will have been required to disclose their interests to the board under s 191.

The disclosure requirement in s 219(1)(e) is of a different order, a sweeping and comprehensive requirement to disclose all information reasonably required by the members for the purposes of their decision and known to the company or any of its directors. Paragraph (1)(e) is supplemented by s 219(2). According to s 219(2), an example of the kind of information referred to in para (1)(e) is information about what, from an economic and commercial point of view, are the true potential costs and detriments of, or resulting from, giving financial benefits as permitted by the proposed resolution. This includes (without limitation) opportunity costs, taxation consequences (such as liability to fringe benefits tax) and benefits foregone by whoever would give the benefits.

The knowledge referred to in s 219(1)(e)(ii) is knowledge possessed anywhere in the company as well as knowledge of any of the directors in any context. Presumably it is confined to actual knowledge. Compare s 710(1)(b), which is a similar comprehensive disclosure requirement for a prospectus, which extends not only to the knowledge of the company and its directors and also to certain others identified in s 710(3), and extends beyond actual knowledge to information that those persons ought reasonably to have obtained by making inquiries.

Great care must be taken in the preparation of the explanatory statement, particularly to identify all material information held within the company or by any director. The directors

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may consider it prudent to establish a due diligence procedure. As the note to s 219(2) points out, the statutory duties of care and diligence and to act in good faith in the best interests of the corporation are applicable to directors in the preparation of the explanatory statement. The note also refers to s 1309, which creates offences where false and misleading information in relation to a corporation's affairs is made available or furnished to members. To this one should add potential liability for misleading or deceptive conduct under s 1041H, if the proposal relates to a financial product or a financial service.

Apart from potential liability under those provisions, the main consequence of failure to comply with the contents requirements of s 219 is that the member approval may be ineffective. Section 208(1)(a)(i) has the effect that in the absence of an available exception, the public company or entity giving the financial benefit must obtain the approval of the public company's members "in the way set out in" ss 217–227. Consequently if the explanatory statement fails to comply with s 219, the approval has not been obtained "in the way set out in" s 219 and is ineffective for the purposes of s 208(1)(a)(i). Some respite is given by s 221(b), which allows for variation between the proposed explanatory statement lodged with ASIC under s 218 and the explanatory statement accompanying the notice of meeting, provided that the variation is not material. But there is no provision for a supplementary explanatory statement to cure defects in the original document or to disclose new material information, in contrast with the prospectus provisions of Ch 6D, and no power on the part of ASIC to excuse non-contravention.

The only way out, if it is discovered that the explanatory statement does not comply with s 219, is to apply to the court under s 227 for a declaration that the procedural requirements for member approval have been satisfied notwithstanding the non-disclosure. Presumably the issue of a supplementary explanatory statement before the meeting, in sufficient time for members to consider it, would be a factor that the court would take into account.

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***Definitions and cross-references***

"Benefit", "company", "director", "financial benefit" and "public company" are defined in s 9. "Related parties" are defined in s 228, and the giving of a financial benefit has a meaning affected by s 229.

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 219 is in substance identical with the former s 243V. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0095].

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## [2E.220] ASIC may comment on proposed resolution — Annotations to section 220

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 220(1) authorises ASIC to give the company written comments on the documents lodged under s 218, within 14 days after the public company has lodged those documents. Section 220(2) specifically authorises ASIC to consult with the relevant market operator if the company is listed, but s 220(3) makes it clear that ASIC may

choose to consult with anyone else. ASIC is required to keep a copy of the written comments it gives to a company, and those comments are treated for the purposes of record-keeping as if they were a document lodged with ASIC.

ASIC is expressly prevented from commenting about whether the proposed resolution is in the company's best interests: s 220(1). This is presumably because that question should be reserved for determination by the members of the public company, without influence from the regulator.

Chapter 2E does not expressly oblige the company to comply with ASIC's comments. However, under s 221(d), if ASIC has given comments to the public company under s 220, the notice convening the meeting must be accompanied by a copy of those comments. There is no provision for the company to respond to ASIC's comments by revising its documentation. That puts the company in a dilemma, because if it amends the explanatory statement or notice of meeting in response to ASIC's comments (almost certainly material amendments) before sending them to the members, the amended documents will not be the same in all material respects as the documents lodged with ASIC, for the purposes of s 221(a) or (b). Moreover, the company is precluded from amending the proposed resolution itself in any way in response to ASIC's comments, because of the terms of s 223. Perhaps a practical solution to the dilemma is for the company to revise its documents and re-lodge them, starting the process again, while applying to ASIC for a reduction of the 14 day period on the ground that ASIC has already reviewed the documents and the only changes to them have been made to reflect ASIC's previous comments.

The fact that ASIC has given particular comments, or has declined to give comments, does not in any way affect the performance or exercise any of ASIC's functions and powers: s 220(5). That would include ASIC's functions and powers with respect to the commencement of proceedings and the making of investigations.

***Definitions and cross-references***

"Company", "listed", "public company" and "relevant market operator" are defined in s 9. As to ASIC's obligation to keep and maintain a copy of its written comments, see s 1274. RG 76 *Related party transactions* explains ASIC's attitude to making comments under s 220.

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 220 is in substance identical with the former s 243W. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0095].

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## [2E.221] Requirements for notice of meeting — Annotations to section 221

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 221(a) requires the notice convening the meeting to be the same, in all material respects, as the proposed notice lodged with ASIC under s 218. The notice must be accompanied by the following documents, and must not be accompanied by any other documents:

- an explanatory statement that is the same, in all material respects, as the proposed explanatory statement lodged under s 218 (s 221(b)); and
- a document or documents the same, in all material respects, as the document or documents (if any) lodged under s 218(1)(c) (that is, other documents proposed to accompany the notice convening the meeting, that relate to the proposed resolution); and
- a copy of ASIC's comments on the documents, if ASIC has given comments to the public company under s 220.

According to s 221(e), the notice convening a meeting must not be accompanied by any other documents. The practical effect of this is that a meeting convened for the purpose of obtaining member approval to a related party benefit cannot deal with any other business of which notice would be required, unless the material disclosing that proposed business relates to the proposed resolution about related party benefits.

At least 21 days' notice of meeting is required under s 249H, as the meeting is a meeting of members of a public company. If the company is listed, s 249HA requires 28 days' notice.

The notice convening a meeting, the explanatory statement, and any other documents proposed to accompany the notice convening the meeting and relating to the proposed resolution, must be the same, in all material respects, as the documents lodged with ASIC under s 218. In this respect the wording of s 221 allows for some variation between the lodged documents and dispatched documents, but only in non-material matters. But there is no provision for the documents dispatched with the notice convening a meeting to be the subject of further changes.

***Definitions and cross-references***

Note s 218 as to the documents to be lodged with ASIC, and s 220 as to ASIC's comments. As to the notice of meeting for a public company, see s 249H and (for a listed company) s 249HA.

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 221 is in substance identical with the former s 243X. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0095].

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**[The next page is 30,161]**

## [2E.222] Other material put to members — Annotations to section 222

***Key principles***

See the summary of the member approval provisions at [2E.217].

If the company, the related party to whom the financial benefit is to be given, or an associate of either of them, proposes to give a document to members of the public company before or at the meeting that can reasonably be expected to be material to a member in deciding how to vote on the proposed resolution, the public company is required to lodge that document with ASIC as well: s 218(1)(d).

Section 221 does not require that the notice convening a meeting must be accompanied by any such document. However, under s 222, if the documents did not accompany the notice convening a meeting but are given to the members before or at the meeting by the public company, its related party or the associate of either of them, and they can reasonably be expected to have been material to the member's decision, the documents must be the same in all material respects as documents lodged with ASIC under s 218(1)(d).

According to the EM to the Corporate Law Reform Bill 1992 ([299]), this provision is intended to ensure that any documents circulated by the public company, the potential beneficiaries of the resolution and their associates are the same in all material respects as the documents lodged with ASIC under s 218. If the resolution is contested, the company, the related party and their associates are placed at a disadvantage because s 222 prevents them from responding to circulars sent to members by their opponents.

Note that the definition of "document" in s 25 of the Acts Interpretation Act 1901 has the effect of extending the scope of s 222 to electronic communications such as emails.

***Definitions and cross-references***

"Company", "member" and "public company" are defined in s 9. "Associates" are defined in ss 10, 11, 15 and 16. "Document" is defined in the Acts Interpretation Act 1901 (Cth), s 25. "Related parties" are defined in s 228 and "giving a financial benefit" has a meaning affected by s 229.

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 222 is in substance identical with the former s 243Y. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0095].

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## [2E.223] Proposed resolution cannot be varied — Annotations to section 223

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 223 requires that the resolution adopted by the members must be the same as the proposed resolution set out in the proposed notice lodged with ASIC under s 218. Consequently there is no scope for altering the wording of the proposed resolution

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between the time of lodgement with ASIC and the dispatch of the notice convening the meeting. If the wording is thought to be defective, it will be necessary to start the process again by lodging corrected documents with ASIC.

A motion to amend the proposed resolution at the meeting cannot be entertained because, if the meeting accepts the amendment, the process fails to comply with s 223 and is ineffective in the absence of a court order under s 227.

***Definitions and cross-references***

Compare s 223 with s 221, which allows for non-material variations between documents lodged with ASIC under s 218 and the documents dispatched to convene the meeting.

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 223 is in substance identical with the former s 243ZA. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0095].

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## [2E.224] Voting by or on behalf of related party interested in proposed resolution — Annotations to section 224

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***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 224(1) says that a vote on a resolution to approve a related party benefit must not be cast (in any capacity) by or on behalf of a related party of the public company to whom the resolution would permit a financial benefit to be given, or associate of that related party. Subject to one exception, this provision overrides anything else in the Corporations Act or any statute or general law of a State or Territory, or anything in the constitution of a body corporate: s 224(9). The exception is that Pt 1.1A permits the laws of the States and Territories to operate concurrently notwithstanding s 109 of the Constitution.

"Associate" is defined in ss 11, 15 and 16. The definition includes:

- where the primary purpose is a body corporate, a related body corporate and the directors and secretaries of the body corporate and the related body corporate; and
- whether the primary person is or is not a body corporate, a person in concert with whom the primary person is acting or proposing to act, and a person with whom the primary person is or proposes to become associated, whether formally or informally, in any other way.

By s 224(7), a vote is cast on behalf of an entity if, and only if, it is cast:

(a) as proxy for the entity; or
(b) otherwise on behalf of the entity; or
(c) in respect of a share in respect of which the entity has:
  (i) power to vote; or
  (ii) power to exercise, or control the exercise of, a right to vote.

This last provision picks up the wording of the definition of "relevant interest" in

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s 608(1)(b), but it is not accompanied by the provisions of s 608 which establish that the power to control the exercise of the right to vote is to be interpreted very broadly, such as s 608(2).

If a vote is cast in contravention of these provisions, the related party or associate (as the case may be) contravenes s 224(6), whether or not the proposed resolution is passed. The contravention does not affect the validity of the resolution (s 224(8)), provided that the resolution would still have been passed even if the contravening votes were disregarded (s 225(1)).

There are three exceptions to the prohibition on voting contained in s 224(1). The first is that s 224(2) permits a vote to be cast by a related party (for example, the chairman of directors) as a proxy appointed by a written instrument that specifies how the proxy is to vote on the proposed resolution, and the vote is not cast on behalf of a related party or associate. The second exception, under s 224(3), is that the regulations may prescribe cases where s 224(1) does not apply, but they have not yet done so. The third exception (s 224(4)) allows ASIC to permit a related party or associate to vote.

ASIC's power is to declare by writing that s 224(1) does not apply to a specified proposed resolution; or that it does not prevent the casting of a vote on a specified proposed resolution, by a specified entity, or on behalf of a specified entity. ASIC is permitted to act only if it is satisfied that the declaration will not cause unfair prejudice to the interests of any member of the public company: s 224(4). The wording of s 224(4) (especially "proposed resolution") implies that the power may only be exercised prospectively before the resolution is put to the meeting.

The EM to the Corporate Law Reform Bill 1992 noted ([3O8]) that in view of this limitation, it was anticipated that the Commission would "not usually" exercise its discretion. Likewise, in RG 76 *Related party transactions*, ASIC says it is unlikely that it will often make such a declaration. However, ASIC says (RG 76.50) that since the definition of "related party" is so broad, a declaration may be made, for example, if the applicant can show:

(a) that the association between the parties was strictly technical; and
(b) no real conflict of interest exists (for example, an associate has no interest in the outcome of the transaction, or the interests of the related party are the same as that of the company or where all the parties are related parties).

What if the exclusion of related parties and their associates means that the corporate decision will be taken by a small minority of dissident shareholders? It is not clear whether ASIC would be prepared to intervene in such a case.

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***Definitions and cross-references***

"Benefit", "company", "financial benefit", and "public company" are defined in s 9. "Associate" is defined in ss 10, 11, 15 and 16.

The related party provisions apply, with modifications, to a registered managed investment scheme (s 601LA) as if s 224 (among other provisions) were omitted (s 601LD). Instead of s 224, s 253E applies in the case of a scheme (see note to s 601LD, and s 601LE), to exclude the responsible entity and its associates from voting if they have an interest in the matter other than as member, although if the scheme is listed, the responsible entity and its associates are entitled to vote on resolutions to remove the responsible entity and choose a new responsible entity. See *ACLPP* [3.2A.0155].

Note ASIC Pro Forma 113 which sets out the form of relief ASIC will grant under s 224(4).

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 224 is in substance identical with the former s 243ZF, except that there is no longer a note about a related party who is not a legal person, and s 229(9) is new. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0100].

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## [2E.225] Voting on resolution — Annotations to section 225

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 225(1) says that if any votes on the resolution to approve related party benefits are cast in contravention of s 224(1), it must be the case that the resolution would still be passed even if those votes were disregarded. The purport of the wording is that the approving resolution is validly passed if it would be carried after prohibited related party votes are disregarded. Provided that is the case, the casting of votes contrary to s 224(1) does not invalidate the resolution: s 224(8).

The remainder of s 225 addresses a different subject, namely the procedure for conducting a vote by poll on the resolution, and recording the outcome. If a poll is duly demanded on the question that the resolution be passed, the public company must make the records of voting by members in person or by proxy prescribed by s 225(3) and (4).

The circumstances in which a poll may be demanded at a meeting of members, and the members' entitlements with respect to proxy voting, are governed partly by the corporate constitution (or replaceable rules) and partly by provisions of the Corporations Act. The relevant provisions are noted in *Definitions and cross-references*, below.

In relation to each member who votes in person, the public company must record in writing the member's name and how many votes the member casts for, and how many against, the resolution: s 225(3). Where a member votes on the resolution by proxy or by representative authorised under s 250D, the public company must record in writing the member's name, and the name of the person by whom the vote is cast by proxy, how many votes the person cast on the resolution as proxy or representative for the member, and how many of those votes are cast for and how many against the resolution: s 225(4). The public company must retain these records for 7 years: s 225(5).

According to the EM to the Corporate Law Reform Bill 1992 ([301]), the effect of s 225(1) is that it will be a condition of giving the benefit that the resolution was passed by a majority of disinterested shareholders. In order to assist with checking compliance with this condition, s 225(2), (3) and (4) provide that will be a further condition that, if a poll is demanded, a record must be kept at the manner in which those shareholders who voted cast their vote.

An offence based on s 225(3), (4) or (5) is an offence of strict liability for the public company (s 225(6)): see [1.CC] *Preliminary notes on the Criminal Code*.

**[The next page is 30,171]**

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***Definitions and cross-references***

As to the statutory right to demand a poll, see ss 250K and 250L and note the replaceable rule in s 250J. As to the rules with respect to appointing proxies and body corporate representatives, see ss 249Y, 249Z, 250A, 250B, 250C and 250D (and for listed companies s 250BA) and the replaceable rule in s 249X.

Chapter 2E applies to a registered managed investment scheme as if s 225(1) were amended by amending "subsection 224(1)" and substituting "section 253E": s 601LD. See *ACLPP* [3.2A.0155].

***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 225 is in substance identical with the former ss 243ZB and 243ZH, except for s 225(6). The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0105].

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## [2E.226] Notice of resolution to be lodged — Annotations to section 226

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 226 requires the public company to lodge notice setting up the text of the resolution, within 14 days after the resolution is passed. This is intended to ensure that there is public access to resolutions passed by public companies under which financial benefits are given to related parties: EM to the Corporate Law Reform Bill 1992, [302].

As s 226 is one of the requirements specified in s 208(1)(a)(i), failure to comply will render the members' approval ineffective to avoid a contravention of ss 208 and 209, in the absence of an available exception or an order of the court under s 227.

***Definitions and cross-references***

"Company" and "public company" are defined in s 9. As to the reckoning of time, see Acts Interpretation Act 1901 (Cth), ss 35 and 36.

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***History and explanatory materials***

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 226 is in substance identical with the former s 243ZC. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

***Texts and literature***

*Ford* [9.550]; *ACLPP* [3.2A.0105].

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## [2E.227] Declaration by court of substantial compliance — Annotations to section 227

***Key principles***

See the summary of the member approval provisions at [2E.217].

Section 227 allows "the Court", on the application of an interested person, to make an order declaring that the conditions prescribed by Pt 2E.1 Div 2 (ss 217–226) have been satisfied, if the court finds that they have been substantially satisfied. The purpose of this provision is to avoid injustices in the case of "technical breaches": EM to the Corporate Law Reform Bill, 1992, [303].

The jurisdiction is given to "the Court", that is to say the Federal Court or the Supreme Court of a State or Territory, or the Family Court of Australia or a State court exercising family law jurisdiction: s 58AA. ASIC does not have the power to cure even technical breaches, either afterwards or in advance, although it can make a declaration under s 224(4) permitting a related party or associate to vote, or approve a shorter notification period under s 218(4).

The court will presumably consider whether the failure to comply creates doubt as to whether the approval of members has been obtained by a vote of fully informed, disinterested members. The wording of s 227(2) implies that the court's power is enlivened only after the resolution has been put to the vote. But if an application is brought, say, under s 1324 to restrain the holding of a proposed meeting because of actual or threatened non-compliance with the member approval requirements, the court is likely to consider whether, if the resolution were put and carried, it would cure the non-compliance by making an order under s 227.

### *Definitions and cross-references*

"Court" is defined in s 58AA.

### *History and explanatory materials*

As to the history of the statutory procedure for member approval, see [2E.217] *History and explanatory materials*.

Section 227 is in substance identical with the former s 243ZD. The wording was amended to its present form by the CLERP Act 1999, without any change of substance.

### *Texts and literature*

*Ford* [9.550]; *ACLPP* [3.2.0543], [3.2A.0110].

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**[The next page is 30,191]**

# Part 2E.2 — Related parties and financial benefits [ss 228–229]

## [2E.228] Related parties — Annotations to section 228

***Key principles***

According to the definition of “related parties” in s 228, there are five categories of related parties, namely controlling entities, directors and their spouses, relatives of directors and spouses, entities controlled by other related parties, and an entity that acts in concert with a related party of a public company.

*Controlling entities*

An entity that controls a public company is a related party of the public company: s 228(1). Under the predecessor of Ch 2E, namely Pt 3.2A, the controlling entity was called a “parent entity”. “Control” is now defined in s 50AA, which is discussed at [2E.208]. An “entity” includes a body corporate, a partnership, an incorporated body, an individual, the trustee of the trust that has only one trustee, and the trustees together of trust that has more than one trustee.

Under s 228(1), if a public company is controlled by entity A which is, in turn, controlled by entity B, both A and B are likely to be related parties of the public company. Since A has (under s 50AA) the capacity to determine the outcome of decisions about the public company’s financial and operating policies and A is controlled by B, then B probably has that capacity in relation to the public company as well. In a vertical relationship there is no reason why there cannot be multiple controlling entities. But if two entities jointly have the capacity to determine the outcome of decisions about a public company’s financial and operating policies, neither of them controls the public company: s 50AA(3). And if two or more entities have some substantial influence over decisions about the public company’s financial and operating policies, or one of them has the capacity to determine the outcome of decisions about (say) financial policies and the other has the capacity to determine the outcome of decisions about operating policies, then again neither would appear to control the public company.

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*Directors and their spouses*

Under s 228(2) the following persons are related parties of a public company:

(a) directors of the public company;
(b) directors (if any) of an entity that controls the public company;
(c) if the public company is controlled by an entity that is not a body corporate — each of the persons making up the controlling entity;
(d) spouses of the persons referred to in paras (a), (b) and (c).

The directors of the public company and the directors of any controlling entity of the public company are related parties of the public company. There is no reason to doubt that in this context, “director” includes a de facto director, that is a person not validly appointed as a director who acts in the position of a director. It would be unacceptable if

a person who acts as a director could avoid the related party provisions that apply to a director by relying on the absence of a formal appointment.

There is more doubt as to whether, in this context, "director" includes a shadow director, that is a person not validly appointed as a director but where the directors of the company are accustomed to act in accordance with that person's instructions or wishes. The definition applies unless the contrary intention appears. A note to the definition of "director" in s 9 gives some examples of occasions where the word "director" would not extend to a de facto or shadow director, but Ch 2E is not mentioned. On the one hand, as a matter of policy Ch 2E should extend to a case where financial benefits are given by a public company or its controlled entity to a person in accordance with whose instructions or wishes the directors of the public company are accustomed to act. On the other hand, the wording of some provisions (especially ss 219(1)(c) and (d)) suggests that the drafters contemplated only formally appointed directors. On balance, it is submitted that there is not a sufficient contraindication in Ch 2E to prevent the general definition, including de facto and shadow directors, to apply. A consequence is that "director" in this context includes any person in accordance with whose instructions or wishes the directors are accustomed to act, including a body corporate as well as an individual.

The spouses of directors so defined are also related parties of the public company, having regard to s 228(2)(d). "Spouse" includes a de facto partner within the meaning of the Acts Interpretation Act 1901 (Cth): s 9AA(a).

An example within s 228(2)(c) is a public company controlled by an unincorporated firm of lawyers. Each of the partners of the firm is a related party of the public company, so are their spouses.

*Relatives of directors and spouses*

The parents and children of directors of a public company, and all directors of any entity that controls the public company, are related parties by virtue of s 228(3). So are the parents and children of the director's spouse. So are the parents and children of each non-corporate person making up the controlling entity of a public company (such as the partners of a law firm that controls a public company), and also the parents and children of the spouse of any such person (that is, in our example, of the spouse of each partner). "Child" and "parent" are defined in s 9 by reference to the concept of a child within the meaning of the Family Law Act 1975 (Cth).

*Entities controlled by other related parties*

Under s 228(4), an entity controlled by a related party referred to in any of s 228(1) (parent entity), s 228(2) (directors and their spouses) and s 228(3) (relatives of directors and spouses) is a related party of the public company, unless the entity is also controlled by the public company. The definition of "control" in s 50AA applies for this purpose. An entity controlled by a parent entity of the public company but not itself controlled by the public company was referred to in the predecessor to Ch 2E, namely Pt 3.2A, as a "sibling entity". Section 228(4) renders the sibling entity, but not its directors, a related party of the public company. There is an example of the application of a related party provision to a case involving a sibling entity in the EM to the Corporate Law Reform Bill 1992, [270], discussed in *Ford* [9.510].

Similarly, an entity controlled by a director or spouse or parent or child is rendered a related party of the public company by s 228(4), but the controlling person's co-directors in the controlled entity are not necessarily related parties of the public company although they will be if they act in concert as provided in s 227(7).

An entity controlled by a public company is not a related party, and therefore Ch 2E

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does not prevent the public company from giving a financial benefit to the controlled entity. But under s 208 the controlled entity is prohibited from giving a financial benefit to a related party of the public company.

*Acting in concert*

Under s 228(7), an entity is a related party of a public company if the entity acts in concert with a related party of the public company on the understanding that the related party will receive a financial benefit if the public company gives the entity a financial benefit. As to the meaning of "acting in concert" according to case law, see *Ford* [23.250]. There is an example of the application of the related party provisions to a case involving acting in concert, given in the EM to the Corporate Law Reform Bill 1992 ([268]–[269]) and discussed in *Ford* [9.510].

*Related parties in the past or future*

Under s 228(5), an entity is a related party of a public company at a particular time if the entity was a related party of the public company, of any of the kinds referred to above, at any time within the previous 6 months.

Under s 228(6), an entity is a related party of a public company at a particular time if the entity believes, or has reasonable grounds to believe, that it is likely to become a related party of the public company, of any of the kinds referred to above, at any time in the future. Presumably if the entity is a body corporate, one has regard to the belief of the directors of the body corporate, when acting as a board of directors. It is not necessary for the entity to actually become a related party. The purpose of the provision is to prevent an entity from receiving a financial benefit and then becoming a related party: EM to the Corporate Law Reform Bill 1992, [260].

***Definitions and cross-references***

"Benefit", "Body corporate", "child", "company", "director", "entity", "financial benefit", "parent", "public company", "relative" and "spouse" are defined in s 9. Note that the definitions of "entity" and "public company" are special definitions for the purposes of Ch 2E. "Control" is defined in ss 9 and 50AA. "Giving a financial benefit" has a meaning affected by s 229.

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

The definition of "related party" was part of the radical overhaul of the loans to directors provisions achieved by the Corporate Law Reform Act 1992.

The definition was rewritten in the CLERP Act 1999. The main change was that the language of "parent", "child and "sibling" entities was removed. But that was not a change of substance, because the same outcome is achieved when the legislation speaks of an entity that controls a public company, an entity that is controlled by a public company, and an entity controlled by a related party. There were, however, two changes of substance:

(i) to assess whether an entity is controlled by a director, spouse, parent or child, the law no longer adds together the degrees of influence possessed by two or more such persons, and instead the law looks to whether a particular related party controls the entity (compare former ss 243F(1)(f)(ii) with s 228(4)); and

(ii) the former provision said that for the purpose of ascertaining whether an entity comprising two or more persons believes that it is likely to become an entity that

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would be a related party, the belief of any one of those persons is taken to be the belief of the entity (former s 243F(4)), but there is no comparable provision in the current law.

Additionally, and importantly, the CLERP Act 1999 abandoned the definition of "control" previously found in s 243E. Section 243E said that the question of whether an entity had control over another entity at a particular time was to be determined in accordance with the provisions of the accounting standard that dealt with disclosure in companies' financial statements of information about related parties. The CLERP Act introduced a new test of control, found in s 50AA. According to the EM for the CLERP Bill ([6.123]), the new test was intended to overcome the need for users of the corporations legislation to refer to external material (that is, the accounting standards) to understand their obligations under the legislation. However, the new test for control was said to be based on the accounting standards.

***Texts and literature***

*Ford* [9.500], [9.510] (control); *ACLPP* [3.2.0543], [3.2A.0025].

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## [2E.229] Giving a financial benefit — Annotations to section 229

***Key principles***

There is no definition of "giving a financial benefit" in Ch 2E. Instead, there are some rules of construction for determining whether a financial benefit is given for the purposes of the Chapter (s 229(1)), a list of matters included in the concept of giving a financial benefit (s 229(2)) and some examples of giving a financial benefit to a related party (s 229(3)).

*Rules of construction*

There are three rules of construction in s 229(1). First, one must give a broad interpretation to financial benefits being given, even if criminal or civil penalties may be involved. In other words the normal rule of construction, according to which legislation creating criminal offences or grounds for imposing civil penalties is to be construed strictly, is reversed.

Second, s 229(1) declares that the economic and commercial substance of conduct is to prevail over its legal form. If as a matter of commercial substance a related party of a public company receives a financial benefit in a transaction with the public company or its controlled entity, the statutory language must be held to be satisfied even though the legal form of the transaction is designed to rebut the inference that a financial benefit is given.

In *HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253; 41 ACSR 72; [2002] NSWSC 171; BC200200827 (appeal largely dismissed: *Adler v ASIC* (2003) 179 FLR 1; 46 ACSR 504; [2003] NSWCA 131; BC200303670), HIH was a listed public company which controlled HIHC, and Adler was a director of HIH. Adler was the sole director of Pacific Eagle, of which Adler Corporation was the only shareholder. HIHC paid $10 million to Pacific Eagle and some weeks afterwards, Australian Equities Unit Trust was constituted with Pacific Eagle as trustee. Then HIHC was issued with units in the Trust at an issue price of $10 million and Adler Corporation was issued with a small quantity of units. The Trust invested in HIH shares and in some unlisted venture capital investments which it acquired from Adler Corporation. ASIC argued that the payment of $10 million was an interest-free unsecured loan, while the defendants claimed that the payment was held on trust by Pacific Eagle for HIHC, and consequently that the shares in HIH purchased with that money were likewise held on trust for HIHC. Santow J emphasised the breadth of the concept of "financial benefit" under s 229 (at [181]–[182]). He held (at [171]–[183]) that even if the defendants' characterisation of the transaction was correct, so that the money and investments were held by Pacific Eagle on trust for HIHC, nevertheless the transaction involved giving a financial benefit, first because it was intended from the outset that the Adler interests would have a 10% interest in the Trust; and second because Pacific Eagle obtained a financial benefit in a practical sense through having control over the sum of $10 million and the legal title, even if a bare title as trustee, to the HIH shares acquired with that money.

Third, one is to disregard any consideration that is or may be given for the benefit, even if the consideration is adequate (the predecessor provision, s 243G(2)(b), said the consideration was to be disregarded "even if it is full or adequate"). This proposition is important because it means that one assesses whether a transaction involves the giving of a benefit to a related party not on a "net benefit" basis, but looking at the position of the public company or controlled entity and assessing whether it has parted with a financial benefit, even if it may have received consideration from the related party or someone else, and even if the consideration is adequate (or, presumably, more than adequate). The EM to the Corporate Law Reform Bill 1992 ([266]) said that "regard is not to be had to any

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resources or services received by the entity", noting that this question will only become relevant when one comes to consider the availability of exceptions such as the reasonable remuneration exception.

*Giving a financial benefit includes certain matters*

Under s 229(2), giving a financial benefit includes the three cases. First, it includes giving a financial benefit indirectly, for example, through one or more interposed entities. Thus, the public company or its controlled entity cannot avoid Ch 2E by causing some other entity to give the benefit. If the entity giving the benefit is controlled by the public company or by its controlled entity, it is directly precluded by s 208 from giving the financial benefit in the absence of approval by the members of the public company or an available exemption. But even if the entity giving the benefit is not controlled by the public company or its controlled entity, if it can be set on the facts that either of them has given a financial benefit "through" that entity, presumably by causing it to act, then the public company or controlled entity has given the benefit that is directly given by the other entity.

The EM to the Corporate Law Reform Bill 1992 said:

> The use of 'indirectly' in this sense is to be contrasted with the narrow use discussed by Lockhart J in *Trade Practices Commission v Australian Iron & Steel Pty Ltd* 22 FCR 305. It will include, for example, the case where a financial benefit is given by a public company to an entity that is not a related party of the public company, in the expectation that that entity will pass the financial benefit to a related party of the public company.

Second, it includes giving a financial benefit by making an informal agreement, oral agreement or an agreement that has no binding force. As explained at [2E.208], the making of a contract to give a financial benefit is itself the giving of a financial benefit, the benefit being the contractual entitlement. In principle that ought to be so for an informal or oral agreement, provided that the agreement is enforceable as a contract. But s 229(2)(b) goes further, by saying the benefit can be given by making an agreement that has no binding force. Presumably the benefit is the economic or commercial expectation of advantage arising out of the non-binding arrangements.

Third, it includes giving a financial benefit that does not involve paying money (for example by conferring a financial advantage). The idea that giving a financial benefit might be confined to paying money would be contrary to the rules of interpretation in s 229(1), but it is not surprising that, to put the matter beyond doubt, s 229(2)(c) expressly extends the concept to financial advantages not involving payment of money.

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*Some statutory examples of giving a financial benefit to a related party*

Section 229(3) gives the following examples of giving a financial benefit to a related party:

(a) giving or providing the related party finance or property;
(b) buying an asset from or selling an asset to the related party;
(c) leasing an asset from or to the related party;
(d) supplying services to or receiving services from the related party;
(c) issuing securities or granting an option to the related party;
(f) taking up or releasing an obligation of the related party.

The list of examples raises a question about whether the word "financial" adds anything to the concept of benefit. The example suggests that "financial" benefits include benefits relating to property as well as benefits relating to money or finance in a narrower sense. Nevertheless the word "financial" probably has some work to do, so as to exclude benefits that are not quantifiable in money terms at all. For example, if an individual who controls a public company gives the spouse of one of the directors of the company a kiss or hug,

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that might in some contexts be the giving of a benefit, but it is more aptly regulated (if at all) by sexual harassment legislation than by company law. Chapter 2E does not apply because the benefit, it is one, is not “financial”.

The predecessor to s 229(3)(a), s 243G(4)(a), referred to an entity lending another entity money, guaranteeing a loan to the other, or providing security for a loan to the other. That provided a direct link with the loans to directors provisions, which were replaced when Pt 3.2A was enacted in 1992. Now the reference to “giving or providing . . . finance or property” would cover loans, guarantees and the provision of security, but the example is much wider.

The reference in s 229(3)(f) is not matched by the examples in the predecessor provision, s 243G(4). Presumably “taking up” an obligation of the related party means taking over that obligation in substitution for the related party.

***Definitions and cross-references***

“Benefit”, “entity”, and “financial benefit” are defined in s 9. “Related parties” are defined in s 228.

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

Like the definition of “related party”, the concept of “giving a financial benefit” was a central part of the radical overhaul of the loans to directors provisions achieved by the Corporate Law Reform Act 1992.

The section, originally s 243G, was revised in the CLERP Act 1999 without substantial change to become s 229.

***Texts and literature***

*Ford* [9.490]; *ACLPP* [1.2.0368], [3.2.0543], [3.2A.0020]; *Austin, Ford and Ramsay* [15.7].

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# Part 2E.3 — Interaction with other rules [s 230]

## [2E.230] General duties still apply — Annotations to section 230

***Key principles***

There are many statutory and general law provisions capable of overlapping with the related party provisions, especially having regard to the breadth of the concepts in Ch 2E. They include the statutory provisions about termination benefits in Pt 2D.2, financial assistance in s 260A, disclosure of material personal interests to the board under s 191, and the general statutory duties of directors and officers in ss 180–184. There is nothing in the drafting of Ch 2E to suggest that an exemption from its operation under ss 210–216, or member approval under ss 217–227, would relieve anyone from any other obligation under statutory or general law.

However, there are certain duties of directors that have a special importance because of their centrality and the propensity for contravention, in particular the duty not to take advantage of position to gain an advantage, and the duty to act in good faith in the best interests of the corporation in a group context. To put the position of directors beyond doubt, s 230 says that a director is not relieved from any of their duties under the Act (including ss 180 and 184), or their fiduciary duties, in connection with a transaction merely because the transaction is authorised by a provision of Ch 2E or was approved by a resolution of members under a provision of Ch 2E.

***Definitions and cross-references***

"Director" and "member" are defined in s 9.

***History and explanatory materials***

See [2D.207] as regards the history of the statutory provision on loans to directors, and the development of proposals for related party provisions by CASAC.

The predecessor of the present s 230 in the former Pt 3.2A was s 243ZI. That section was redrafted by the CLERP Act 1999 to become the present provision, without a change of substance.

***Texts and literature***

*Ford* [8.140], [9.470], [9.520], [9.570]; *ACLPP* [3.2A.0005], [3.2A.0045]; *Austin, Ford and Ramsay* [15.22].

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