



**CHARTERED SECRETARIES  
AUSTRALIA**

*Leaders in governance*

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***Related party transactions and  
Expert reports and independence of experts***

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency. Members of CSA deal on a day-to-day basis with the Australian Securities and Investments Commission (ASIC) and have a thorough working knowledge of the operations of the financial markets, the needs of investors and the Corporations Act.

***General comments***

CSA strongly supports the proper management and disclosure of related party transactions and welcomes guidance from ASIC on ways to achieve this. CSA Members are of the view that the compliance with statutory obligations, in both spirit and the letter of the law, when financial benefit is provided to related parties, is central to a good governance framework.

CSA's comments, as set out in the following pages, support the aims articulated by ASIC in *Consultation Paper 142: Related party transactions* (the paper), and are offered within the context of ensuring that the practical implications of the policy objectives are fully examined. CSA hopes that the practical experience of its Members can assist ASIC in the development of its guidance to public companies to promote better management and disclosure of related party transactions.

An overarching comment on the draft Regulatory Guide is that the obligation on directors is to comply with the law, not the ASIC guidance. The ASIC Regulatory Guide is useful guidance as to which criteria should be considered in assessing related party transactions and the application of the arms' length application, but the test remains whether the transaction is arms' length, not whether directors complied with the ASIC guidance. Although treated with respect by the market, the ASIC guidance does not impose obligations on directors — the obligation remains on directors to satisfy the requirements of the law, irrespective of the guidance.

***The arms' length exception***

CSA Members are of the view that not all companies have in place the necessary controls to ensure a rigorous process is followed in assessing whether the arms' length exception applies

to a proposed related party transaction. CSA considers that implementing such robust processes is essential to an appropriate governance outcome.

However, CSA is also of the opinion that it may not be appropriate to automatically seek member approval for the granting of financial benefit to related parties should companies not be able to take into account all the factors set out by ASIC in the paper (page 12) when deciding if the arms' length exception applies. CSA notes that there are often significant costs involved in seeking shareholder approval and an automatic requirement to seek shareholder approval may result in costs being incurred unnecessarily.

CSA strongly agrees that all the factors nominated by ASIC should be considered, that there should be no 'cherry picking' of those favourable to a decision as to whether a proposed transaction is at arms' length. However, **CSA recommends** that, while all the factors set out by ASIC in the paper should form part of the due diligence process, ASIC's guidance should clarify that it is not required that all those factors be satisfied for the arms' length exception to apply, as not all of them may be applicable in every instance. As noted above, the ASIC guidance does not impose obligations on directors — the obligation remains on directors to satisfy the requirements of the law, irrespective of the guidance.

**CSA strongly recommends** that any guidance in the ASIC Regulatory Guide needs to acknowledge that a one-size-fits-all approach is not appropriate. ASIC's guidance should note that all tests should be considered, but acknowledge that it is for the board of directors to decide if all tests are relevant in the circumstances.

### ***Comparable transaction***

CSA notes that companies may not be able to compare the terms of a proposed overall transaction between parties dealing on an arms' length basis in similar circumstances, as the transaction may be unique and therefore non-comparable. For example, in smaller companies, often family-originated, directors on the board are likely to hold conflicts of interest in relation to proposed transactions. In such instances, an assessment of whether the proposed transaction is at arms' length on the basis of a comparison with similar transactions may not be possible, given that the particular transaction may not have an equivalent.

Similarly, CSA notes that joint ventures where one partner provides goods or services to the joint venture have the potential for conflicts of interest to arise, but there may well be no comparable transaction to review. Other examples where there is no comparable transaction to review include where very specific technical skills are required and only the related entity has the appropriate skills/experience; and transacting with a major shareholder.

**CSA recommends** that ASIC's guidance clarify that companies are not required to take into account comparable transactions between parties dealing on an arms' length basis in similar circumstances before determining if the arms' length exception applies, but should assess if comparable transactions exist that can be reviewed for their relevance in determining whether a proposed transaction is at arms' length.

### ***Bargaining process and robust protocols***

CSA is of the view that companies should have a robust bargaining process in place, as it will assist the directors to structure their decision making.

CSA agrees that consideration of the factors set out by ASIC in the paper should form part of the robust process a public company undertakes to ensure that conflicts of interest are appropriately managed in negotiating and structuring the transaction. However, while consideration of the applicability of these factors should form part of the due diligence process, ASIC's guidance should clarify that not all of them may be applicable in every circumstance.

**CSA recommends** that companies should review the factors set out by ASIC in the paper to assess if they are relevant to their decision-making process, but that ASIC's guidance should clarify that not all factors may be applicable in every circumstance.

***Impact of the transaction on the company***

CSA notes that any assessment of the impact of a proposed transaction on the company needs to include the implications and cost of not proceeding with the transaction as well as an assessment of any benefit it may bring.

Notwithstanding that an assessment needs to be broader than the paper allows, CSA notes that directors already have fiduciary duties to act in the best interests of the company as a whole. Directors are therefore already obliged to consider the implications of the transaction on the financial position of the company.

**CSA recommends** that directors are best placed to determine whether a proposed transaction is in the best interests of the company, given their fiduciary duties already provided for in statute and common law. ASIC's Regulatory Guide should clarify that directors should consider all criteria set out in the Guide, but it is for the board of directors to decide if all criteria are relevant to the circumstances of the transaction, taking into account their fiduciary duties.

***Other options available to the company***

CSA is of the view that consideration of all other options available to the company should form part of the due diligence process undertaken by the company when assessing whether to grant a financial benefit to related parties, and whether the arms' length exception applies.

***Expert advice***

CSA considers that companies should take advice if there is uncertainty as to whether a proposed transaction is at arms' length and fair and reasonable.

***CSA recommendation***

**CSA recommends** that, while all the factors set out by ASIC in the paper should form part of the due diligence process, ASIC's guidance should clarify that a decision as to whether the arms' length exception applies may not take into account all of those factors, as not all of them may be applicable in every instance.

**CSA also recommends** that companies should seek expert advice if they are uncertain as to whether the arms' length exception applies to the proposed transaction and whether it is fair and reasonable, but that directors should determine what is in the best interests of the company and if a proposed transaction should go before members for approval.

**CSA recommends** that, where doubt exists as to whether the transaction is at arms' length and fair and reasonable once expert advice has been sought, the transaction should go to members for approval.

***Independent expert report***

CSA is strongly of the view that ASIC's Regulatory Guide should note that it may be 'prudent' rather than 'necessary' for companies to include a valuation from an independent expert with a notice of meeting for member approval under Ch 2E when an independent expert report is needed.

***Obligation to seek expert report***

CSA is also of the view that it is for the directors, rather than the regulator, to decide if an independent expert report is needed. For example, it could be a simple transaction, such as the transfer of 50 per cent of the Australian and New Zealand assets into a new vehicle, where

independent advice is not required. Or it could be a board of a small company, with only three directors, none of whom are independent and all of whom are involved in the transaction, but the transaction is obvious and just and an independent expert report should not be required in such circumstances.

In such circumstances, directors are able to clearly explain the advantages and disadvantages of the transaction without having to seek an expert report to opine on the transaction. For example, the benefit to the third party may be ancillary to the benefit to the company, that is, there may be a large benefit to the company and a small benefit to one of the directors.

**CSA recommends** that, provided the information put before members is easily understood and sufficient to allow them to make a decision, there should be no requirement to include an independent expert report. That is, CSA opposes a blanket obligation to provide an independent expert report in every instance.

### ***Independence***

CSA notes that the question of the independence of the expert advisers may not be the only relevant factor in assessing the value of the expert advice. For example, in a continuous disclosure matter, a company will seek advice from its legal advisers who may not fit the definition of independent but are technically competent to provide the advice. More importantly, that technical competence is more relevant to the decision making than independence in a continuous disclosure matter.

CSA notes that it may be useful for directors to seek expert advice that is not independent when assessing the overall impact of a proposed transaction, even if that advice is not put before members because it is not independent. Given directors' fiduciary duties, it would be remiss of them not to consider such expert advice if it is relevant to their consideration and decision making.

**CSA recommends** that it is for the directors to judge whether they should rely on expert advice. While directors are to be encouraged to seek expert advice when there is doubt as to whether a proposed transaction is at arms' length, and while guidance is useful, ASIC's Regulatory Guide should not specify that such advice must be independent without regard to the circumstances.

### ***Disclosure***

CSA supports the criteria set out in the paper relating to disclosure; however, CSA is of the view that any requirement for disclosure must be subject to materiality limitations (CSA notes that prospectuses and PDSs are already subject to materiality).

CSA considers that it is reasonable to require an explanation as to why the view was formed that a proposed transaction is commercial. CSA notes that AASB 124 relating to financial statements on related party transactions already requires such disclosure.

**CSA recommends** that the disclosure not be confined to only some parties. CSA notes that an explanation of related party arrangements is relevant to prospective shareholders as well as existing shareholders.

### ***Notices of meeting***

CSA supports directors making a recommendation in a Notice of Meeting about the resolution and why they support it and, if they do not make a recommendation, a statement as to why they do not.

CSA is of the view that the Notice of Meeting should advise members that alternative options were considered but that any explanation as to those alternative options should be provided in a

general fashion rather than in detail. CSA notes that directors already have an obligation to provide information sufficient for an informed decision.

**CSA recommends** that ASIC not be prescriptive in its guidance on how the Notice of Meeting should explain alternative options.

***Conclusion***

In preparing this submission, CSA has sought input from its members through its national policy committees, the Legislation Review Committee and the Corporate and Legal Issues Committee.

CSA would be more than happy to arrange for ASIC to meet with our members to discuss the issues canvassed in this submission.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Doug Gration', followed by a horizontal line extending to the right.

Douglas Gration  
VICE-PRESIDENT