

CORPORATIONS LAW  
SIMPLIFICATION PROGRAM

OFFICERS AND RELATED PARTY TRANSACTIONS

PROPOSALS FOR SIMPLIFICATION

TASK FORCE  
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Simplification Task Force  
Attorney-General's Department  
Robert Garran Offices  
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## OFFICERS AND RELATED PARTY TRANSACTIONS

### PROPOSAL FOR SIMPLIFICATION

This proposal covers the provisions in the Corporations Law concerning:

- Officers (Part 3.2)
- Related party transactions (Part 3.2A).

As foreshadowed in the Plan of Action for Stage 3, the Task Force has not reviewed the fundamental policy for those provisions which were recently amended following extensive consultation.

Because of their close relationship with the officers and related party provisions, the rules on oppression and civil penalties will be rewritten as part of this project. The Task Force does not propose to review the policy underlying these provisions, but welcomes comments on them.

#### Officers

The proposal will:

- Give proprietary companies the option of not appointing a company secretary
- Allow the ASC to disqualify a person from managing a company if:
  - The person has been an officer of a corporation that has left creditors unsatisfied because it was mismanaged, and
  - The person's conduct in relation to a corporations justifies their disqualification
- Require directors of all companies to disclose material personal interests they have in the affairs of the company
- Rewrite the existing statutory duty for officers to act honestly.

#### Related party transactions

The proposal will:

- Take into the Law a definition of control based on the one used in the accounting standards
- Make it clear that shareholder approval is not required where shares issued or options granted to directors form part of their reasonable remuneration
- Simplify the rules for shareholder approval of related party transactions.

#### Benefits of the proposal

The proposal will:

- Give greater flexibility for the management of proprietary companies and avoid the need for a person to be appointed both a director and secretary for a 1 person company
- Enhance the power of the ASC to disqualify from managing companies a director or executive officer of a corporation which has left creditors unpaid in circumstances where their conduct requires disqualification in the public interest
- Clarify the existing officers' duty to act honestly
- Require greater disclosure of directors' conflicts of interest
- Clarify the scope of the remuneration exception in Part 3.2A
- Allow the reasonableness of an indemnity given, or insurance premium paid, to be assessed without regard to other benefits given to the director.

THE PROPOSAL - OFFICERS

Proposal	Issues for consideration
<p><u>Company secretaries</u></p> <p>1. (a) As at present, a public company must appoint a company secretary.</p> <p>(b) A proprietary company need not appoint a company secretary.</p> <p>(c) For proprietary companies which do not appoint a company secretary, each director will be responsible for the obligations the Law currently places on company secretaries.</p> <p>Disqualification of directors</p> <p>2. Sections 229, 599 and 600 will be replaced by the following rules:</p> <p><i>ASC disqualification – company failures</i></p> <p>3. The ASC may disqualify a person from being a director or managing a company for up to 10 years if it is satisfied that:</p> <p>(a) they were a director or executive officer of a corporation:</p> <p>(i) which was deregistered by the ASC under proposed subsection 601AB(1) (to be inserted by the draft Second Corporate Law Simplification Bill) due to a failure to lodge documents in the preceding 18 months, with creditors not being fully paid</p> <p>(ii) which is or has been under administration</p> <p>(iii) which has executed a deed of company arrangement</p> <p>(iv) which was wound up with creditors not being fully paid</p> <p>(v) which has ceased to carry on business because of its inability to pay its debts</p> <p>(vi) about which a liquidator has lodged a report under subsection 53391) concerning the company’s inability to pay its debts</p> <p>(vii) for which a receiver or receiver and manager has been appointed</p> <p>(viii) which has entered into a compromise</p>	<p>(a) Should it also be optional for public companies to appoint a company secretary?</p> <p>(b) Alternatively, should only listed companies be required to appoint a company secretary?</p> <p>(a) Would a longer maximum period of disqualification be more appropriate?</p> <p>(b) Should there be a minimum disqualification period of 2 years?</p> <p>(c) Should (vii) be limited to cases where a receiver or receiver and manager has been appointed to the whole or substantially the</p>

Proposal	Issues for consideration
<p>or arrangement with its creditors</p> <p>(ix) which has not paid a judgment debt due to a lack of assets,</p> <p>and</p> <p>(b) the corporation was mismanaged, and</p> <p>(c) their conduct in relation to the management, business or property of 1 or more corporations justifies the disqualification.</p> <p>The ASC will not be able to disqualify a person unless it has first given them an opportunity to be heard.</p> <p><i>Automatic disqualification - offences</i></p> <p>4. A person will be automatically disqualified from managing a company for 10 years if they have been convicted:</p> <p>(a) of an offence concerning the management of a corporation punishable by at least 12 months imprisonment</p> <p>(b) of an offence involving dishonesty punishable by at least 3 months imprisonment</p> <p>(c) of an offence against:</p> <p>(i) section 590 (concealment of company property or books)</p> <p>(ii) section 595 (inducement to be appointed liquidator, administrator, receiver etc.)</p> <p>(iii) Part 6.6 (misstatements relating to takeovers)</p> <p>(iv) Division 2 of Part 7.11 (offences relating to securities, including continuous disclosure breaches)</p> <p>(v) Division 2 of part 8.7 (offences relating to futures)</p> <p>(vi) section 1307 (falsification of books).</p> <p>The ASC will be able to reduce the period, but there will be an absolute minimum of 2 years.</p>	<p>whole of the corporation's property?</p> <p>(d) Should (vii) be extended to other controllers?</p> <p>(e) Should it be an alternative to (b) that the manner in which the corporation was managed adversely affected the position of creditors?</p> <p>(f) If a person satisfies paragraph (a) twice in 7 years, should the onus be on them to show that paragraphs (b) and (c) do not apply?</p> <p>(a) Would a longer period of disqualification be more appropriate?</p> <p>(b) Are there any other offences for which automatic disqualification would also be appropriate?</p>

Proposal	Issues for consideration
<p><i>Automatic disqualification – insolvents</i></p> <p>5. A person will be disqualified from managing a company if:</p> <p>(a) they are undischarged bankrupt</p> <p>(b) they have executed a deed of arrangement under Part X of the Bankruptcy Act within the preceding 3 years</p> <p>(d) they have executed a deed of assignment under Part X of the Bankruptcy Act within the preceding 3 years</p> <p>(e) their property is subject to control under section 50 or 188 of the Bankruptcy Act.</p> <p><i>Waiver and review of disqualification</i></p> <p>6. During a period of disqualification, the ASC may allow a person to manage a company with or without conditions. This will not apply to an automatic disqualification because of insolvency.</p> <p>7. The exercise of the ASC’s powers under paragraphs 3 and 6 will be subject to review by the Administrative Appeals Tribunal.</p> <p><u>Directors’ duties</u></p> <p>8. Subsection 232(2) will be amended to provide that an officer of a company must at all times act in good faith in the best interests of the company and for a proper purpose in the exercise of their powers and the discharge of the duties of their office.</p> <p><u>Disclosure of conflicts of interest</u></p> <p>9. Section 231 will be replaced by the following rules:</p> <p>10. (a) A director who has a material personal interest in a matter relating to the affairs of the company must disclose that matter at a meeting of the directors as soon as practicable after the director becomes aware of the relevant facts.</p> <p>(b) The disclosure must be recorded in the minutes of the directors’ meeting.</p>	<p>Should this apply during the first 2 years of an automatic disqualification because of a conviction of an offence?</p> <p>(a) Should the Law clarify the mental element of this duty?</p> <p>(b) Should any changes be made to the rules concerning the disclosure of any indemnity given or insurance premium paid by a company for its officers of an auditor (section 309A)?</p> <p>Should the annual directors’ report to members set out the disclosures made during the reporting period?</p>

## THE PROPOSAL – RELATED PARTY TRANSACTIONS

Proposal	Issues for consideration
<p><u>The control test</u></p> <p>11. (a) For the purposes of Part 3.2A, an entity will control another entity if it has the capacity to determine the outcome of decisions about the entity's financial or operating policies.</p> <p>(b) In determining whether an entity has this capacity:</p> <p>(i) the practical influence the entity can exert (rather than the rights it can enforce) is the issue to be addressed, and</p> <p>(ii) a practice or pattern of behaviour affecting the entity's financial or operating policy is to be taken into account (even if it involves a breach of an agreement or a breach of trust).</p> <p><u>Definition of related parties</u></p> <p>12. The following will be added to the parties who are related parties of a public company for the purposes of Part 3.2A:</p> <p>(a) a grandparent of a director and of their spouse or de facto spouse</p> <p>(b) a grandchild of a director and of their spouse or de facto spouse</p> <p>(c) a brother or sister of a director and of their spouse or de facto spouse</p> <p>(d) any entity controlled by them.</p> <p><u>Scope of liability</u></p> <p>13. A person will not be liable under Part 3.2A if it is proved that they were not aware that the person receiving the financial benefit was a related party.</p>	<p>Should the test for control be in the Law, or should reliance be placed on accounting standards instead?</p> <p>Is there anyone else who should be included as a related party?</p>

Proposal	Issues for consideration
<p data-bbox="150 226 679 259"><u>Shareholder approval for certain benefits</u></p> <p data-bbox="150 293 400 327"><i>Retirement benefits</i></p> <p data-bbox="150 360 751 539">14. The current section 237 restriction on retirement benefits will be moved into Part 3.2A. As a result, shareholder approval will be required under Part 3.2A if a public company or controlled entity:</p> <p data-bbox="150 573 727 685">(a) gives a financial benefit to a related party in connection with their resignation or retirement</p> <p data-bbox="150 719 201 752">and</p> <p data-bbox="150 786 735 965">(b) the value of the financial benefit exceeds the limit established under subsection 237(6) calculated by reference to the person's length of service and total emoluments paid during the last 3 years.</p> <p data-bbox="150 999 568 1032"><i>Transfer of business or property</i></p> <p data-bbox="150 1066 735 1245">15. Financial benefits given in relation to the transfer of the whole or any part of the business or property of a public company (currently dealt with under paragraph 237(1)(b)) will be dealt with under Part 3.2A.</p> <p data-bbox="150 1279 400 1312"><i>Shares and options</i></p> <p data-bbox="150 1346 751 1503">16. The application of the current rules to shares and options will be clarified, so that the following benefits will be remuneration for the purpose of section 243K:</p> <p data-bbox="150 1536 719 1603">(a) shares issued to a related party who is an officer of the company</p> <p data-bbox="150 1637 727 1749">(b) options granted over unissued shares to a related party who is an officer of the company.</p>	<p data-bbox="778 360 1382 618">Should the limit for the financial benefit be calculated in a different way? Alternatively, should the test in Part 3.2A for officers' remuneration be used so that shareholder approval would only be required if it would not be reasonable for a public company in that company's circumstances to give that benefit?</p>

Proposal	Issues for consideration
<p><i>Gratuities, indemnities and insurance</i></p> <p>17. (a) Subsections 243K(7A) and (7B) will be repealed.</p> <p>(b) Shareholder approval will not be required under Part 3.2A if a public company or controlled entity:</p> <ul style="list-style-type: none"> <li>(i) gives a gratuity to a related party in connection with the person ceasing to be an officer of the company, or</li> <li>(ii) indemnifies a related party against a liability incurred by the person as an officer of the company, or</li> <li>(iii) pays a premium in respect of a contract in insuring a person against a liability incurred by the person as an officer of the company,</li> </ul> <p>and it would be reasonable for a public company in the public company's circumstances to do so.</p> <p>(c) In the case of a gratuity or a contract to indemnify or insure a director the reasonableness is to be assessed when the company gives the gratuity or enters into the contract to provide the indemnity or pay the insurance premium.</p> <p>(d) Whether giving a gratuity or indemnity or paying an insurance premium is reasonable is to be assessed without regard to any other financial benefit given by the company to the person.</p>	<p>(a) Should a company be able to indemnify an officer against a liability for expenses incurred in:</p> <ul style="list-style-type: none"> <li>(i) responding to a claim otherwise than by defending proceedings (eg by engaging in an alternative dispute resolution)?</li> <li>(ii) defending a claim in which the officer is substantially successful?</li> </ul> <p>How would whether the officer has been 'substantially successful' be determined?</p> <p>(b) Should a company be able to pay a premium for a contract insuring the officer for costs incurred in responding to a claim otherwise than by defending proceedings (eg by engaging in alternative dispute resolution)?</p>

Proposal	Issues for consideration
<p data-bbox="150 226 501 259"><u>Shareholder approval rules</u></p> <p data-bbox="150 293 730 510">18. The existing rules for shareholder approval of related party transactions will be replaced by the rules which apply for shareholder approval of a selective capital reduction under the Second Corporate Law Simplification Bill. This will involve:</p> <p data-bbox="150 546 743 763">(a) special resolution passed at a general meeting of the company, with no votes being cast in favour of the resolution by the related part or its associates, or a resolution agreed to by all ordinary shareholders at a general meeting</p> <p data-bbox="150 797 699 869">(b) lodgement with the ASC of documents relating to the approval</p> <p data-bbox="150 902 679 974">(c) disclosure to shareholders of material information.</p>	

## DEVELOPMENT OF THE PROPOSAL – OFFICERS

### Company secretaries

The Corporations Law currently requires the directors of every company to appoint at least 1 company secretary and confers a range of powers on secretaries (for example, executing documents and sending out notice of meetings). The obligations placed by the Law on secretaries include:

- To lodge an annual return with the ASC and pay the annual return fee (section 335)
- If it is a disclosing entity – to lodge with the ASC copies of its financial statements, directors' statements and reports, and auditors' report (section 317A)
- To establish and open a registered office for at least 3 hours on every business day (section 217)
- To lodge with the ASC a notice identifying its officers and setting out their full name, residential address and place of birth, and to lodge a new notice with the ASC within 1 month of any change of these details (section 242).

In order to facilitate the enforcement of these provisions, and the timely collection of lodgement fees, enforcement action can be taken directly against the company secretary (subsection 83(2)).

Although the annual return obligation can operate unfairly if the secretary is unable to force the directors to act, the secretary's position will be improved with the following proposed changes:

- Abolition of key financial data, and
- Separation of the financial statements from the annual return.

The Task force is considering in Stage 2 of the Program whether companies that have not lodged financial statements should be able to lodge an annual return stating that the solvency declaration has not been made. Consideration is also being given to removing the obligation in section 317A for the secretary to lodge annual statements and reports for disclosing entities.

New Zealand has recently repealed the requirement for companies to appoint a company secretary. In Canada, the Federal and Ontario corporations legislation allows the directors to determine whether the corporation will have a secretary (subject to the corporation's constitution).

For proprietary companies, particularly those with only 1 director, the appointment of a secretary seems unnecessary. In many proprietary companies, the director takes on the functions of a secretary. The case for making a secretary optional for public companies is not as strong, having regard to the nature of these companies.

### Disqualification of directors

#### *ASC disqualification – company failures*

The ASC, the Parliamentary Joint Committee on Corporations and Securities and the Victorian Law Reform Committee (VLRC) have all expressed concern about the 'phoenix company' phenomena. The 'phoenix company' phenomena refers to a situation where:

- A company fails without being able to pay its debts, and
- Soon afterwards a second company takes up the business of its predecessor, with the same operators, but disclaims any responsibility for the debts of its predecessor.

In its May 1995 report *Curbing the Phoenix Company*, the VLRC made a number of recommendations which would enhance the ASC's power to disqualify the directors of a phoenix

company from the management of companies. This proposal takes accounts of those recommendations.

Section 600 currently provides a means for the disqualification of directors of phoenix companies. However, section 600 applies only where the person has been a director of 2 companies in relation to which a liquidator has lodged with the ASC a report indicating that the company may not be able to pay its unsecured creditors more than 50 cents in the dollar. Typically, the phoenix company problem arises where a company has no assets, making it unlikely that creditors will have a liquidator appointed to it. Instead, the company is likely to be deregistered by the ASC without a formal liquidation.

Under subsection 601AB(1), to be inserted by the draft Second Corporate Law Simplification Bill, the ASC may deregister a company without a formal liquidation if:

- The company's annual return is at least 6 months late, and
- The company has not lodged any other documents under the Law in the last 18 months, and
- The ASC has no reason to believe that the company is carrying on business.

The proposal will allow the ASC to disqualify a person who has been a director or executive officer of a company that has been deregistered under subsection 601AB(1).

Section 599 currently allows the Court to disqualify a person in certain circumstances. It is proposed that the ASC should have a discretion to disqualify a person in those circumstances. This will allow persons who should not remain as directors to be removed quickly, while at the same time giving them appropriate appeal rights. It also provides the ASC with the necessary powers to carry out its legislative function of monitoring persons involved in managing companies.

The VLRC considered that the ASC should be able to disqualify a person who has been a director of only 1 relevant company. Having regard to the discretionary nature of the ASC's power to disqualify, the Task Force agrees with this recommendation.

The VLRC also recommended that a person should be automatically disqualified from managing a company if they have been involved as a director or manager of 2 companies which have failed in certain circumstances. However, it is questionable whether automatic disqualification would be an appropriate sanction in every case because automatic disqualification could occur in circumstances where:

- There may be no misconduct or incompetence on the part of the director
- The director is not aware of the disqualification.

Moreover, the ASC's power to waive the disqualification makes it difficult to distinguish the proposed automatic disqualification from the ASC's discretion to disqualify. In light of the ASC's discretion to deal with the 1 company situation, it is not considered necessary to have automatic disqualification where there are 2 companies. The Task Force does not therefore support this recommendation.

#### *Automatic disqualification – offences*

The Court will retain its current powers to prohibit a person from managing a corporation where they have breached:

- Certain officers' duties or repeatedly contravened the Law (section 230)
- A civil penalty provision (paragraph 1317EA(3)(a)).

There is no significant change proposed to the grounds for automatic disqualification under current subsection 229(3). Subsection 229(3) applies to persons convicted of indictable offences in relation to the management of a corporation, serious fraud, offences under the civil penalty provisions and certain other offences. The Task Force invites comment on whether there are any other offences for which automatic disqualification would be appropriate.

### *Period of disqualification*

The VLRC recommended that, for an automatic disqualification because of a conviction of an offence, there should be an increased maximum disqualification period of 15 years and a minimum disqualification period of 2 years. However, it was considered that would not be appropriate to disqualify a person for a period as long as 15 years, and that 10 years would be a sufficient reflection of the seriousness of improper conduct by directors.

### *Automatic disqualification – insolvents*

Section 224 provides that the office of company director will automatically be vacated when the director becomes an ‘insolvent under administration’. Under subsection 229(1), an insolvent under administration is prohibited from managing a corporation without the leave of the Court.

At present, a person will be an insolvent under administration if they:

- are an undischarged bankrupt under the Bankruptcy Act, or
- have executed a deed of arrangement under Part X of the Act where the terms of the deed have not been fully complied with, or
- have entered into a composition under Part X where a final payment has not been made under that composition.

A person may be subject to an arrangement or composition under Part X for a very long time, for example, if a deed of arrangement provided for the assignment by a debtor of a remainder interest in property subject to a life estate. If the life tenancy continued for 20 years from the date of the deed, the person would remain disqualified from managing a corporation for that period.

Under the proposal, a person who has entered into an arrangement or composition under Part X will be automatically disqualified for 3 years from managing a corporation. The disqualification should run for 3 years because this is the usual period of bankruptcy.

At present, a person who executes a deed of assignment under Part X will not be disqualified from managing a corporation. Under a deed of assignment, a debtor, with the approval of creditors, assigns for the benefit of creditors, all of the debtor’s property that would be divisible among the creditors if the debtor were to become bankrupt. Deeds of assignment have the same practical effect as bankruptcy, except that the debtor does not have the statutes of an undischarged bankrupt and is not liable to make contributions to their estate from income.

Under section 50 of the Bankruptcy Act, the Court may, if it is shown to be necessary in the interests of creditors, direct a trustee to take control of the property of a debtor in relation to whom a creditor’s petition has been presented. Control continues until a sequestration order is made or the control order is discharged.

Under section 188 of the Bankruptcy Act, a debtor proposing to enter into a deed of assignment, arrangement or composition must give a trustee authority to convene a creditors’ meeting to consider the proposed deed. The debtor’s property comes under the control of the trustee immediately after the authority is given to the trustee. Control continues until the debtor becomes bankrupt, executes a deed of assignment or of arrangement, a composition is accepted by the

debtor's creditors, the debtor dies or the debtor's property is released from control. It seems appropriate that a person whose property is subject to control under section 50 or 188 of the Bankruptcy Act should be disqualified from managing a corporation.

This proposal is in line with the general approach to the disqualification of insolvents in Commonwealth legislation, in particular, the *Superannuation Industry (Supervision) Act 1993*.

#### *Waiver and review of disqualification*

The ASC will be able to waive disqualification with or without conditions.

As at present, the ASC's decisions in relation to the disqualification of directors will be subject to review by the Administrative Appeals Tribunal. Decisions relating to the waiver of a disqualification will also be reviewable.

#### Directors

##### *Directors' duties*

Subsection 232(2) is generally regarded as an attempt to incorporate into the Law the fiduciary obligations of directors. However, the concept of honesty is not used consistently throughout the Law. In particular, the concept of honesty in subsection 232(2) is different to that used in:

- subsection 1317FA(1), which provides that a person who contravenes a civil penalty provision may be guilty of an offence if they contravene the provision 'dishonestly and intending to gain, whether directly or indirectly, an advantage for that or any other person', and
- subsection 1317JA(2), which provides that a court may relieve a person from criminal liability for contravention of a civil penalty provision if, amongst other things, the person is acting honestly.

It is proposed that subsection 232(2) be rewritten, without changing its meaning, to reflect the fiduciary concept of honesty, and to avoid the inconsistent use of 'honestly' in the Law.

The duty will be rewritten so that officers are required to 'act in good faith in the best interests of the company and for a proper purpose'. This is consistent with the approach taken in cases such as *Marchesi v Barnes* [1970] VR 434 and 438, *Australian Growth Resources Corporation Pty Ltd v Van Reesema* (1988) 6 ACLC 529 at 539, *Residue Treatment & Trading Co Ltd v Southern Resources Ltd (No 2)* (1989) 7 ACLC 1130 at 1152, *CAC v Papoulias* (1990) 8 ACLC 849 at 851, and *Feil v CAC* (1991) 9 ACLC 811 at 817.

In reaching this form of words, the Task force noted that different approaches have been taken to this issue in the United Kingdom, Canada and New Zealand. The United Kingdom does not have a corresponding statutory duty. The Canada Business Corporations Act provides that directors must act honestly and in good faith with a view to the best interests of the corporation (section 134). The New Zealand *Companies Act 1993* provides that directors must act in good faith and in what they believe to be the best interests of the company (section 131(1)), and must exercise their powers for a proper purpose (section 133).

##### *Nominee directors*

The Law does not currently address the position of nominee directors who take into account the interests of their nominator. In 1989 the Companies and Securities Law Review Committee proposed a number of changes to the law concerning the duties of nominee directors. The recommendations would have made it possible for a unanimous shareholder agreement to relax the

duties of a director. They would also have allowed the director of a wholly-owned subsidiary to take into account the interests of the holding company.

The Task Force considered whether a specific rule for nominee directors is desirable. The Task force examined the position of nominee directors in a number of jurisdictions and found that only in New Zealand does the companies legislation make special provision for them. The Australian case law appears to accept that a nominee director is able to take into account the interests of their nominator. The Task Force therefore concluded that it was not necessary to proposed amendments to the Law, and that it would be preferable to allow the case law to evolve over time.

### *Age limits*

Section 228 currently has the effect that the members of a public company must vote annually on the appointment of a director who is 72 or more years old. The Task Force is not proposing to examine this provision because it is under consideration as part of a separate Government initiative looking at age discrimination generally.

### Disclosure of conflicts of interest

As a result of amendment sin 1992 to the rules concerning related party transactions, the Law inappropriately sets a lower standard for the disclosure of conflicts of interest by public company directors than it does for proprietary company directors.

Section 231 requires the director of a proprietary company to disclose, at a directors' meeting, interests in contracts and proposed contracts in which the director either directly or indirectly interested, as soon as practicable after the relevant facts have come to the director's knowledge.

As part of the reform of the related party provisions, section 231 was amended to omit references to public company directors. Section 232A was introduced to address their position. Under section 232A, a director of a public company must not vote on a matter in which the director has a material personal interest and must not be present when the matter is being considered by the board. The board or the ASC may permit the director vote or participate in the board's consideration of the matter. However, the director is not required to disclose that they have a material person interests in a matter before the board.

The proposal will introduce the same disclosure rules for both proprietary and public companies, and require disclosure of matters in which directors have a material personal interest. This test is preferred because the range of matters in which a director may have a conflict of interest extend beyond contracts and proposed contracts.

## DEVELOPMENT OF PROPOSAL – RELATED PARTIES

### The control test

The question whether one entity controls another has been addressed in the draft Second Corporate Law Simplification Bill in relation to the rules concerning an entity acquiring an interest in its own shares. Section 258E will take into the Corporations Law for this purpose a definition of control based on the definition in the accounting standards. The Second Bill also applies this definition for the purpose of the test used to determine whether a proprietary company will be small or large.

In order to facilitate consistency within the Law, and access to the law, the same definition of control will also be used for the purposes of Part 3.2A.

### Definition of related parties

The following members of the family of a director of a public company are currently related parties of the public company for the purposes of Part 3.2A.

- a spouse or de facto spouse of the director
- a parent, son or daughter of the director or of their spouse or de facto spouse
- a spouse or de facto spouse of a director of a body corporate that controls the company.

Given their close relationship with a director, it is hard to see why the director's grandparents, grandchildren and siblings are not also related parties. The proposal will extend the coverage of Part 3.2A to these persons.

### Scope of liability

Those participating in the transaction will have a good defence if it is proved they were not aware that the person receiving the financial benefit was a related party.

### Shareholder approval for certain benefits

Part 3.2A of the Law currently requires shareholder approval of unreasonable remuneration payments.

#### *Retirement benefits*

Paragraph 237(1)(a) regulates the payment of benefits to an officer in connection with retirement from office. It requires shareholder approval where the amount of the benefit exceeds a sum calculated by reference to the officer's length of service and the total emoluments paid to the officer over the last 3 years of service. Part 3.2A also affects retirement benefits paid to directors of public companies. It requires shareholder approval if it would be unreasonable for the company to pay the benefit. In relation to the directors of public companies, paragraph 237(1)(a) and Part 3.2A represent unnecessary duplication.

It does not seem appropriate for the Law to regulate retirement benefits paid by proprietary companies. For these companies it is sufficient to rely on the general rules concerning disclosure and directors' duties.

The retirement benefits payable to officers (other than directors) is properly a matter for which the directors alone should be responsible.

It has been suggested that it is difficult to assess the reasonableness of financial benefits given in connection with retirement from office. It is therefore proposed to require shareholder approval

under Part 3.2A where the value of the financial benefit exceeds the limit established under subsection 237(6). For a person with less than 3 years service the limit will equal the total emoluments paid by the company to the person. For persons with 3 or more years service the limit increases each year until the 7<sup>th</sup> year to a maximum of 2½ times the emoluments paid to the person during the final 3 years of service.

#### *Transfer of business or property*

Paragraph 237(1)(b) regulates benefits paid to an officer in connection with the transfer of the whole or any part of the company's business or property. It does not seem appropriate that the Law should specifically regulate these transactions. Rather, they should be addressed by directors' duties and Part 3.2A.

#### *Shares and options*

There is some doubt whether section 243K applies to shares and options. It will be amended to ensure that it extends to these forms of remuneration.

#### *Gratuities, indemnities and insurance*

Under subsection 243K(1) a public company may pay remuneration to an officer if it is reasonable in the circumstances to do so. In relation to remuneration paid to directors in the form of gratuities, indemnities or insurance, it is not clear whether the reasonableness of the payment is to be assessed at the time the agreement to pay is entered into, or at the time the payment is made. It is also unclear whether the reasonableness of a payment may be assessed without regard to other benefits payable to the director. It is proposed that whether it is reasonable to pay the gratuity, insurance or indemnity be assessed on its own terms, and at the time the agreement to pay is entered into.

#### Shareholder approval rules

Division 5 of Part 3.2A sets out the rules for obtaining shareholder approval of related party transactions. That Division provides that a company may give a financial benefit if it is permitted by a resolution passed at a general meeting held within 15 months of giving the benefit. At least 14 days before the notice convening the relevant meeting is given, the public company must lodge several documents with the ASC, including a proposed notice of meeting setting out the text of the resolution, an explanatory statement setting out details of the proposed benefit, and any other document proposed to be given to members that can reasonably be expected to be material to a member in deciding how to vote on the proposed resolution. The ASC has an opportunity to comment on the proposed resolution.

The draft Second Corporate Law Simplification Bill sets out a simplified process for the holding of shareholder meetings for approving capital reductions (section 256B) and for giving financial assistance (section 259B). These rules will be applied to the provisions concerning related party transactions in place of the existing complicated provisions in Division 5 of Part 3.2a.

One of the major consequences will be to require a special resolution of disinterested members. This is considered appropriate because of the capacity for a controlling shareholder to cause the company to give a financial benefit advantaging some shareholders over others.