ASIC
Australian Securities & Investments Commission

CONSULTATION PAPER 142

Related party transactions

October 2010

About this paper

This consultation paper sets out our proposed guidance to promote better disclosure and governance for related party transactions.

It seeks feedback on our proposals from companies, responsible entities of managed investment schemes, experts, company directors, professional advisers, investors and other stakeholders.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 18 October 2010 and is based on the Corporations Act as at 18 October 2010.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. The examples are not exhaustive and are not intended to impose or imply particular rules or requirements. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on related party transactions. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section E, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 17 December 2010 to:

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What will happen next?

Stage 1	18 October 2010	ASIC consultation paper released
Stage 2	17 December 2010	Comments due on the consultation paper
Stage 3	March 2011	Regulatory guide released

A Background to the proposals

Key points

This consultation paper sets out our proposed guidance to public companies and responsible entities of managed investment schemes on complying with the *Corporations Act 2001* (Corporations Act) where they provide financial benefits to related parties.

It also sets out our proposed guidance for experts who prepare independent expert reports on these transactions.

We have developed these proposals as part of our recent work in reviewing the related party arrangements of public companies and registered managed investment schemes.

Member approval of related party transactions

1 Under Ch 2E of the Corporations Act, public companies must obtain member approval to give a financial benefit to a related party: s208. However, member approval is generally not required for:

(a) transactions that are on arm's length terms (s210);

(b) benefits that are reasonable remuneration or reimbursement of officers' and employees' expenses (s211); and

(c) certain other transactions (s212–215) or financial benefits given under a court order (s216).

2 The objective of the related party provisions in Ch 2E is to protect the interests of members of public companies by requiring member approval of related party transactions where members' interests could be endangered: s207.

3 Similar restrictions apply when a registered managed investment scheme provides a financial benefit to a related party. Part 5C.7 applies the related party provisions in Ch 2E to registered schemes, subject to some modifications to take into account the different features of managed investment schemes. This is in addition to the responsible entities' obligations to act in the best interests of members: s601FC(1).

4 This consultation paper applies to related party transactions of both public companies and managed investment schemes. References to 'public company' or 'company' include the responsible entity of a managed investment scheme. References to Ch 2E also include references to that chapter as modified by Pt 5C.7 to apply to managed investment schemes.

5 ASIC's policy on parts of the related party provisions of the Corporations Act and relief from certain provisions is set out in Regulatory Guide 76 *Related party transactions* (RG 76).

ASIC's proposed guidance

6 We propose to provide guidance to help companies and responsible entities of managed investment schemes comply with their obligations when providing financial benefits to related parties, and to help experts prepare independent expert reports on these transactions.

7 In particular, our proposed guidance covers:

(a) the application of the 'arm's length' exemption from the requirement for companies to obtain member approval for related party transactions (see Section B);

(b) the preparation of independent expert reports on related party transactions (see Section C); and

(c) information that should be disclosed to investors about related party transactions (see Section D).

8 Our proposals are designed to:

(a) ensure that members are given an appropriate opportunity to vote on related party transactions that could endanger their interests;

(b) ensure that members are given sufficient, quality information with which to make an informed decision about how to vote on a proposed related party transaction or whether to invest in a company with existing related party arrangements; and

(c) help companies and responsible entities to comply with their obligations when they provide financial benefits to related parties.

9 We anticipate that the proposed guidance outlined in this paper will be incorporated into RG 76, along with other minor technical changes (e.g. to update legislative references). We also propose to incorporate part of this guidance into Regulatory Guide 111 *Content of expert reports* (RG 111) and Regulatory Guide 112 *Independence of experts* (RG 112).

10 For details of the proposed amendments to RG 111 and RG 112, see the attachments to Consultation Paper 143 *Expert reports and independence of experts: Updates to RG 111 and RG 112* (CP 143). References in this consultation paper (i.e. CP 142) to RG 111 and RG 112 are references to the proposed updated regulatory guides attached to CP 143.

Observations from our recent review

11 Our policy proposals have been developed in light of a review of related party transactions entered into by a number of public companies and registered schemes, almost all of which were listed. This review focused on a broad range of transactions, some for which member approval was obtained and others for which it was not.

12 The transactions reviewed included:

(a) issues of securities to related parties;

(b) agreements to purchase assets from, or sell assets to, related parties;

(c) joint venture and farm-in agreements with related parties;

(d) loans and granting charges to related parties;

(e) agreements for the supply of technical and administrative services by related parties; and

(f) leases of property from related parties.

13 Among other things, our review indicated the following:

(a) Almost all companies we reviewed had general policies on managing conflicts of interest and these tended to be at a very high level.

(b) When considering related party transactions at board level, the majority of companies employed board procedures that were consistent with the Corporations Act provisions on material personal interests (s191–195).

(c) There were varying views and practices about the circumstances in which companies applied the 'arm's length' exception from the obligation to obtain member approval under Ch 2E. For example:

(i) in some cases, companies did not appear to take into account whether directors with a conflict of interest were involved in, or privy to, negotiations with the related party when assessing whether the terms of a financial benefit were 'arm's length'; and

(ii) in many cases, companies appeared to rely on the 'arm's length' exception with insufficient consideration given to the reasons for this, or only by reference to isolated factors without considering all relevant factors.

(d) There was uncertainty about the operation of s228(6), under which proposed directors may be related parties.

(e) Expert advice was often obtained on issues 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 services.

(f) For related party asset acquisition transactions, some experts assessed whether a transaction was 'fair and reasonable' using a simple

'advantages and disadvantages' test. Others assessed 'fairness' and 'reasonableness' as separate components, as required for most control transactions under RG 111.

(g) There were varying degrees of market disclosure about related party transactions, including information about independent director recommendations, alternative transactions and whether the terms are 'arm's length'.

B The 'arm's length' exception

Key points

We propose to provide guidance to help companies and responsible entities decide whether member approval should be sought under Ch 2E for a related party transaction.

This guidance would focus on:

- relevant factors to consider when deciding whether the 'arm's length' exception in s210 applies;
- the need to consider all relevant factors, not just individual factors in isolation; and
- the need to consider seeking member approval in cases of doubt about whether an exception applies.

Legal framework

14 Section 208 provides that for a public company or an entity it controls to give a financial benefit to a related party of the public company:

(a) the public company's members must approve the transaction in the way set out in s217–227; or

(b) the giving of the financial benefit must fall within an exception set out in s210–216.

15 The arm's length exception in s210 provides that member approval is not needed to give a financial benefit on terms that would be reasonable in the circumstances if the public company and the related party were dealing at arm's length, or on terms that are less favourable to the related party than these terms.

Note: The equivalent obligations for registered schemes are set out in Pt 5C.7.

16 The case law on the meaning of 'arm's length' suggests that this phrase refers to a relationship between parties where neither bears the other any special duty or obligation, they are unrelated, uninfluenced and each acts in its own interests.

Note: See *Orrong Strategies Pty Ltd v Village Roadshow Ltd* [2007] VSC 1 (*Orrong*), *Australian Securities and Investments Commission (ASIC) v Australian Investors Forum Pty Ltd & Ors (No 2)* [2005] NSWSC 267 (*ASIC v Australian Investors Forum*) and *ACI Operations Pty Ltd v Berri Limited* [2005] VSC 201 (*Berri*).

17 This meaning of 'arm's length' is supported in recent case law that applies the phrase as it appears in taxation and other legislation.

Note: See *Granby Pty Ltd v Federal Commissioner of Taxation* (1995) 129 ALR 503 (*Granby*), *Trustee for the Estate of the Late AW Furse No 5 Will Trust v FCT* (1990) 21 ATR 1123 (*Furse*) and *Australian Trade Commission v WA Meat Exports Pty Ltd* (1987) 75 ALR 287.

18 While case law in the United Kingdom also explores the meaning of 'arm's length', the exception in s210 is different from the exceptions to the requirement for member approval for similar transactions in other jurisdictions.

19 Specifically, *ASIC v Australian Investors Forum* (at para 456) indicates that in determining the objective standards that would characterise arm's length terms, courts should consider the transaction terms that would result if:

(a) the parties to the transaction were unrelated in any way (e.g. financially, through ties of family, affection or dependence);

(b) the parties were free from any undue influence, control or pressure;

(c) through its relevant decision-makers, each party was sufficiently knowledgeable about the circumstances of the transaction, sufficiently experienced in business and sufficiently well advised to be able to form a sound judgement as to what was in its interests; and

(d) each party was concerned only to achieve the best available commercial result for itself in all the circumstances.

20 In deciding whether the exception applies, the terms on which the financial benefit is given should be compared to the objective range of possible terms that these unrelated, uninfluenced and self-interested parties would reasonably arrive at in the circumstances: see *ASIC v Australian Investors Forum* and *Orrong*.

21 In determining what outcomes unrelated parties would reasonably achieve, the following points should also be considered:

(a) commercial prudence should be applied and expert guidance may be required in considering the terms of the related party transaction (see *ASIC v Australian Investors Forum*) and ascertaining common market practice; and

(b) if the terms of the financial benefit are unusual or extraordinary, or excessively generous, then it is less likely that the terms can be considered 'reasonable' and so would not be arm's length terms for the purposes of s210: see *Orrong, Furse, Re HIH Insurance Ltd (in prov liq) and HIH Casualty and General Insurance Ltd (in prov liq); ASIC v Adler and Others* [2002] NSWSC 171 (*ASIC v Adler*).

Relevant factors for determining the application of s210

Proposal

B1 We propose to provide guidance in RG 76 about factors that companies and responsible entities should take into account in deciding whether this exception applies. We propose that companies should take into account all of the following factors:

(a) how the terms of the overall transaction compare with those of any comparable transactions between parties dealing on an arm's length basis in similar circumstances (see paragraphs 24–29);

(b) the nature and content of the bargaining process, including whether the company followed robust protocols to ensure that conflicts of interest were appropriately managed in negotiating and structuring the transaction (see paragraphs 30–35);

(c) the impact of the transaction on the company (e.g. the impact of dealing on those terms on the financial position and performance of the company) and non-associated members (see paragraphs 36–37);

(d) any other options available to the company (see paragraph 38); and

(e) any expert advice received by the company on the transaction (see paragraphs 39–43).

Your feedback

B1Q1 Do you agree with this proposal? If not, please explain why.

B1Q2 Do you anticipate any difficulties in considering any of these factors?

B1Q3 Do you agree that all of the above factors should be considered, rather than one or more factors in isolation from the remaining factors?

B1Q4 Do you think our guidance should identify other factors that should be taken into account? If so, please explain what factors and why.

Explanation of proposal

22 The following sections explain each of the factors listed in our proposal. We propose that companies and responsible entities should take into account all of the factors that are relevant in the circumstances. Companies should not make an assessment of whether the transaction is on arm's length terms based on a single factor in isolation from each of the other factors.

23 For example, it would be insufficient for a company to make this assessment based only on the nature of the bargaining process without considering other relevant factors, such as comparable transactions and other available options.

Comparable transactions

24 A good indicator of arm's length terms is whether the terms of similar transactions completed in similar circumstances but between unrelated parties in a contract for legitimate commercial bargain are comparable to the proposed related party transaction terms: see *Furse*. Companies should seek to establish the contractual terms that prevail in the open market for similar transactions between unrelated parties. Common experience and usual terms of trade can be taken as a guide: see *ASIC v Australian Investors Forum*.

25 Common sense and commercial prudence should be applied and expert guidance may be required when considering the terms of the related party transaction (see *ASIC v Australian Investors Forum*) to determine the terms on which unrelated parties would contract in the same circumstances.

26 In assessing the terms of the related party transaction, consideration also needs to be given to whether any key provisions such as consideration, warranties, indemnities, term and termination are excessively onerous or excessively generous, such that the terms do not appear to be arm's length in comparison with the terms achieved by other parties on the open market in similar circumstances: see *Orrong*. This assessment should include a consideration of whether the contract or agreement adequately protects the interests of the company giving the financial benefit: see *ASIC v Adler*.

27 Where the terms of the financial benefit are unusual or extraordinary, or excessively generous, then they are less likely to be considered 'reasonable' and therefore not arm's length terms for the purposes of s210: see *Orrong* and *Furse*. We consider that this will also be the case where the circumstances of the transaction are unusual and where the terms are excessively onerous. Extreme or unlikely outcomes should be considered to be unreasonable and therefore not used in the comparison.

28 We also consider that if the terms are unusual, extraordinary or excessively onerous or generous, it is less likely that there will be a transaction that is comparable to the proposed related party transaction.

29 If there is no reliable data about comparable transactions between parties dealing at arm's length, then it will be more difficult to determine the hypothetical reasonable arm's length terms that could be reached by unrelated parties. This raises the issue of how directors can conclude that the transaction is on arm's length terms.

> Note: See Proposal B2 for a discussion about obtaining member approval when it is uncertain whether the exception in s210 applies.

Bargaining process

30 Consideration of the nature and content of the bargaining process, including how the transaction was initiated, structured, negotiated and disclosed to

directors, is also relevant in determining whether the terms of a proposed transaction are arm's length.

31 If the parties have dealt with each other as unrelated parties would normally do, and engaged in a process of real bargaining, it is more likely that the outcome of their dealings can be considered to be arm's length terms: see *Furse* and *Granby*. It is not necessary to show that the parties negotiated on an arm's length basis to decide whether the terms of a proposed transaction are arm's length terms for the purposes of s210 (in fact, due to their relationship, they may not have done so).

32 However, factors relating to how the parties conducted themselves in forming the terms of the transaction will be relevant to assessing whether the outcome of their negotiations reasonably could have been achieved by uninfluenced, self-interested parties in the circumstances. These factors include:

(a) whether the proposed transaction is contractual in nature, including whether it is documented in binding form (see *Orrong*, *ASIC v Australian Investors Forum* and *ASIC v Adler*);

(b) the involvement in the negotiations of professional advisers representing or advising each party (see *Orrong*); and

(c) the nature of the negotiation process, including length and sincerity, whether there was 'hard' or 'real' bargaining (e.g. a disinterested bargaining process that is characteristic of strangers, who are each applying their independent separate wills), and whether any of the terms were negotiated at all (see *Orrong*, *Furse*, *Berri* and *Granby*).

33 If a director of the company has a material personal interest in the related party transaction and has participated in, or been privy to, negotiations with the related party, this aspect of the bargaining process and its potential impact on the terms of the transaction should be taken into account when assessing whether the terms are arm's length.

34 It may also be relevant to consider the public company's bargaining position. This is not only determined by reference to the knowledge and experience the company has, including through its advisers, but also by the relevant circumstances in which the transaction is contemplated. Circumstances include the company's desire and need to complete the transaction.

35 For example, a company in financial distress with no other viable alternatives may agree to more onerous terms or a lower price in order to obtain a loan or a capital injection. However, consideration of a company's bargaining position as one factor alone should not be used as justification for characterising non-arm's length terms as arm's length terms in the circumstances of a very strong or very weak bargaining position.

Impact on company

36 An assessment of whether the terms of a transaction would be reasonable if the company was dealing at arm's length also needs to consider the implications of dealing on those terms on the financial position and performance of the company as well as the implications for the non-associated members. This includes the short-term and long-term implications. When dealing at arm's length, companies acting in their own interests generally have the option not to proceed, or to conduct business in a different way, if the terms do not satisfy their performance expectations.

37 This includes considering whether:

(a) there is a negative effect on the company's financial position or performance that is not balanced by sufficient positive effects, such that the terms would not be reasonable in the circumstances if the parties were dealing at arm's length;

(b) the transaction fits within the company's business plan or impacts on whether the company is able to pursue its business plan; and

(c) the terms are fair, given the expected return on the asset, the risks to which the asset is exposed and the relative liquidity of the asset.

Other options available to the company

38 If the proposed related party transaction is one of a number of alternatives open to the company:

(a) the terms of these alternatives can provide a good comparison for what terms can reasonably be obtained between unrelated parties in the circumstances; and

(b) if the terms of the proposed transaction are less favourable to the related party than the terms of these alternatives, the arm's length exception is more likely to apply.

Expert advice

39 Directors should ensure they have, or have access to, enough knowledge or expertise to assess proposed related party transactions—where necessary, they should obtain appropriate professional and expert advice from any appropriately qualified person: see *ASIC v Australian Investors Forum*.

40 However, directors relying on information, professional advice or expert advice provided by others must make their own independent assessment of the information: see s189. Advice does not replace careful judgement by the directors.

41 Sometimes a public company will obtain an independent expert report on the transaction for some other purpose, such as the ASX Listing Rules.

42 If the report is prepared in accordance with RG 111 and RG 112 and concludes that the transaction is:

(a) 'fair and reasonable'—it is more likely that the transaction is on arm's length terms;

(b) 'not fair but reasonable'—the transaction is less likely to be 'arm's length', absent any other mitigating factors.

Note 1: See Section C for our proposed guidance on independent expert reports for related party transactions.

Note 2: Under RG 111.56 (in Attachment 1 to CP 143), an expert should not take into account any special value of the 'target' to a particular 'bidder' (e.g. synergies that are not available to other bidders) when determining fairness. However, special value may be part of the 'circumstances' relevant to considering whether the terms of the transaction are arm's length. In this situation, companies will need to be mindful that the price an expert has determined to be 'fair' may not include special value and, therefore, may be different from the hypothetical price unrelated parties might agree to in the 'circumstances': see paragraphs 48–50 for comments on the 'circumstances'.

43 The directors, of course, will need to be satisfied that it is appropriate to rely on the expert report, including that the opinion in the report is directly relevant to the decision at hand.

Rationale

44 While the arm's length exception in s210 can be interpreted broadly, it is important that it is applied correctly so that members are given an appropriate opportunity to vote on a proposed related party transaction where the terms of that transaction are not truly arm's length terms.

45 Our proposal aims to provide some certainty about how companies should apply the arm's length exception from the requirement to seek member approval under Ch 2E. Our recent review of the related party arrangements of public companies suggests that there are varying views about both:

(a) the scope of the arm's length exception; and

(b) how to assess whether this exception applies, including what information is relevant to this assessment.

46 For example, our recent review indicated that:

(a) some companies failed to consider whether interested directors had participated in, or been privy to, negotiations with the related party when assessing whether the terms of a related party transaction were arm's length; and

(b) in a number of instances, companies appeared to give insufficient consideration to the application of the s210 exception and often only referred to one of the above factors, rather than other relevant factors.

47 For expert reports, our review showed that in most cases where an independent expert had concluded that the transaction was:

(a) 'fair and reasonable'—many of the proposed factors discussed above for consideration when assessing whether the terms of the transaction were arm's length were present (however, some companies still obtained member approval for s208 purposes); and

(b) 'not fair but reasonable'—member approval was obtained for the purposes of s208.

48 We consider that all the circumstances in which the related party transaction occurs are relevant. To determine whether the exception in s210 applies, a comparison should be made between the terms on which the financial benefit is given and the objective range of possible terms that unrelated, uninfluenced and self-interested parties would reasonably arrive at in the circumstances.

49 The 'circumstances' could include, but are not limited to:

(a) whether there are alternative transactions open to the company that are not with related parties;

(b) prevailing economic conditions and their impact on the parties and their relevant industries; and

(c) any special value to the transaction (e.g. synergies available to the related party that may not be available to other purchasers).

Note: This is separate to the assessment of fair value of consideration by experts that does not take special value into account if it is only available to a particular purchaser: see paragraph 42.

50 When considering the 'circumstances' in which the hypothetical unrelated parties would be transacting, we consider that, generally, all circumstances of the related party transaction that have a bearing on determining the terms are relevant, except for the fact of their relationship. This is because recent case law requires that the related party transaction terms be compared with non-related party transaction terms, and so to include the parties' relationship as part of the 'circumstances' could defeat the purpose of the test. Where the related party is an officer who has an interest in the transaction, companies should consider whether appropriate safeguards and checks are included in the terms of the agreement: see *ASIC v Adler*.

51 The application of aspects of this proposal is illustrated by the following examples.

Example 1

LawsonCo manufactures and sells pencils to wholesalers. It has established standard terms and pricing for its pencils, which have been negotiated through a process of 'hard' or 'real' bargaining with the major wholesalers through professional advisers. The pricing is reviewed on a half-yearly basis to ensure the company remains competitive.

BanjoCo wishes to purchase pencils from LawsonCo. Ms Matilda is a director and major shareholder of BanjoCo. She is also a director of LawsonCo. Therefore, Ms Matilda and BanjoCo are both related parties of LawsonCo. Ms Matilda approaches LawsonCo to negotiate a pencil purchase agreement.

Ms Matilda proposes terms that include a long term of supply to BanjoCo, higher standards of specifications for the pencils and a lower price.

LawsonCo does not accept all of Ms Matilda's proposed terms, citing its standard terms and pricing that it has established. However, it does agree during negotiations to supply pencils for the proposed longer term.

Before entering into the agreement to sell pencils to BanjoCo, LawsonCo's directors (excluding Ms Matilda) consider whether member approval is needed to provide the financial benefit to a related party. The directors take into account:

- comparable agreements that LawsonCo has with its other pencil buyers and wholesalers, including the fact that the standard terms have been used but slightly varied to extend the length of supply;
- the nature of the negotiating process, including that this was minimal and was initiated by the related party director;
- the positive impact that the additional revenue from a new supply agreement, for a longer than usual term, would have on the company's profits;
- the fact that there have been no recent approaches for new supply arrangements other than from Ms Matilda, and meeting this additional supply fits with LawsonCo's existing business strategy and poses no significant opportunity cost; and
- that no expert advice was obtained regarding this proposed transaction.

The directors of LawsonCo decide not to obtain member approval under Ch 2E because they are satisfied that the terms are 'arm's length', after taking into account all of these factors and despite not obtaining expert advice.

If LawsonCo had accepted all of Ms Matilda's proposed terms, this could have involved giving a benefit that was not on 'arm's length' terms. This is because in these circumstances, such an agreement would not be as comparable to other agreements, would not have been produced by a process of real bargaining and could potentially have a negative impact on LawsonCo's financial performance if the pencils could be sold to other wholesalers at the higher, standard price.

Example 2

CashCo Ltd is looking to expand its existing business as a resort operator. One of its directors is CEO and controlling shareholder of AssetCo, which owns a resort in Vanuatu. The CEO of AssetCo suggests to the other directors of CashCo that buying AssetCo would be a good way to expand CashCo's business.

After only giving cursory consideration to the other options, CashCo begins to negotiate the acquisition of AssetCo. It establishes protocols to manage conflicts of interest, which include using separate corporate advisers and lawyers. The CEO of AssetCo is given access to documents showing how much CashCo might be willing to pay for AssetCo. The CEO uses this information to obtain the best possible sale price for the shareholders of AssetCo.

Before entering into a binding agreement to acquire AssetCo, the directors of CashCo consider whether to obtain member approval under Ch 2E. In deciding whether the arm's length exception applies, the directors take into account that the transaction originated from a related party and that the related party, who is interested in the outcome of the negotiations, had access to commercial information not normally available to non-related parties, and that the company had not fully explored other options.

After taking this into account and weighing up all the relevant factors, CashCo decides to make it a condition precedent of the purchase agreement that approval is obtained from its members under Ch 2E.

Seeking member approval where there is doubt

Proposal

B2 We propose to provide guidance in RG 76 that companies and responsible entities should consider seeking member approval under Ch 2E in cases where, having taken into account all of the factors in Proposal B1, there is doubt about whether the transaction is on arm's length terms.

Your feedback

B2Q1 Do you agree with this proposal? If not, please explain why.

Rationale

52 This approach is consistent with the text of Ch 2E and judicial comments on the operation of the related party provisions, which indicate the default position is that the companies should obtain member approval to give a related party benefit unless an exception applies.

53 When there are potential conflicts of interest, directors have a heightened obligation to ensure that the necessary corporate approvals, such as member approval, are obtained: see *ASIC v Adler*.

54 The application of aspects of this proposal is illustrated by the following example.

Example 3

BusinessCo Ltd operates a construction business. It has an existing contractual arrangement with ServiceCo, a related party, under which ServiceCo supplies administrative and advisory services.

BusinessCo proposes to terminate this arrangement. It is entitled to do so without penalty—however, termination of the arrangement may trigger a default under a financing contract that BusinessCo has with another related party, which could cause financial detriment to BusinessCo's business.

To counter the detriment, BusinessCo negotiates a cash payment to ServiceCo to secure its assistance in implementing the proposal. BusinessCo and ServiceCo each appoint separate corporate advisers and lawyers. Protocols are followed to ensure that no directors with an actual or potential conflict of interest have access to confidential information on the negotiations or influence in the decision-making process.

After an in-principle agreement is reached, the directors of BusinessCo consider whether member approval is needed under Ch 2E. The directors take into account the following:

- BusinessCo and its professional advisers are unable to identify any comparable transactions entered into by unrelated parties dealing on arm's length terms;
- the nature of the negotiating process, including that this was minimal, but that negotiations had been conducted through separate professional advisers;
- the impact the cash payment and the default event would have on the company's profits, as well as the potential impact of termination and termination without the cash payment;
- the fact that other alternatives (such as renegotiating the arrangement to be terminated and other methods of minimising the financial detriment) had not been fully canvassed in this case; and
- the fact that expert advice had not been obtained regarding the amount of the financial benefit in the context of this transaction, including whether it is fair and reasonable.

In considering these factors, the directors give particular weight to the fact that no comparable transactions between unrelated parties could be identified. The directors are uncertain about whether the transaction is on arm's length terms and, therefore, decide to seek member approval for the transaction under Ch 2E.

C Independent expert reports

Key points

We propose to provide guidance on independent expert reports for related party transactions covering:

- when an expert report is needed;
- how experts should assess related party transactions; and
- the independence of experts.

When an independent expert report is needed

Proposal

C1 We propose to incorporate guidance in RG 76 that it may be necessary for companies to include a valuation from an independent expert with a notice of meeting for member approval under Ch 2E where:

(a) the transaction is significant from the point of view of the company;

(b) the financial benefit is difficult to value;

(c) the non-interested directors do not have the expertise or resources to provide independent advice to members about the value of the financial benefit; or

(d) the related party transaction is a component of a control transaction for which the company is commissioning an expert report (e.g. for member approval under item 7 of s611).

Your feedback

C1Q1 Do you agree with this proposal? If not, please explain why.

C1Q2 Do you consider there are any particular situations or types of transactions for which an independent expert report should, or should not, be needed?

C1Q3 Are there any circumstances in which you think it would be acceptable for an expert who is not independent to prepare an expert report for members on a related party transaction? If so, please explain the circumstances and why.

Rationale

55 Independent valuation advice on a proposed related party transaction can help investors better understand the proposal and make an informed decision about how to vote. Investors are already accustomed to receiving independent expert reports on related party transactions that require member approval under Chapter 10 of the ASX Listing Rules. However, the ASX Listing Rules only apply to some types of related party transactions.

56 Chapter 10 of the ASX Listing Rules requires entities to obtain member approval to acquire or dispose of a substantial asset from or to a related party, or an associate of the related party. The ASX Listing Rules do not include an arm's length exception and so all transactions of this nature must be approved by members. The ASX Listing Rules also require that members be given an independent expert report that states whether the proposed transaction is fair and reasonable for members whose votes will not be discarded under the voting exclusion rules.

57 While there is no express requirement in Ch 2E for an independent expert report to be sent to members with a notice of meeting, we consider that in some circumstances good practice will dictate that it is appropriate for an independent expert report to be sent to members with the accompanying explanatory material.

58 Under Ch 2E and directors' fiduciary duties, companies have a general obligation to include information about the value of a financial benefit in a notice of meeting for member approval of a related party benefit. This information is important for investors to be able to make an informed assessment about how to vote on a proposed related party transaction.

59 This position is also reflected in our existing guidance in Media Release (04-257MR) *ASIC cracks down on related party disclosure* (10 August 2004), which states that:

(a) the notice of meeting should include a valuation of the financial benefit (including benefits that are equity related, such as the issue of shares, options or convertible notes, or where it involves the sale or purchase of an asset);

(b) the basis of the valuation and the principal assumptions should be disclosed; and

(c) in some circumstances, it may be necessary to provide a valuation by an independent expert.

60 In some cases, a notice of meeting for approval of a related party benefit will include information about the value of the financial benefit in the form of advice from the non-interested directors. However, given the complexities and inherent conflicts of interest involved in many related party transactions,

it is sometimes more appropriate for the company to commission an independent expert to give an opinion on the proposed transaction.

61 We also propose to update RG 76 to incorporate our guidance from 04-257MR and other changes to the law and our policy since RG 76 was last issued.

62 We consider this proposal to be consistent with the directors' fiduciary duty of disclosure, which generally requires notices of meeting for approval of asset sales or acquisitions to include the material information necessary for members to assess whether a transaction is for a fair price, and whether the terms and conditions are onerous or disadvantageous: see *ENT Pty Ltd v Sunraysia Television Ltd* [2007] NSWSC 270. The economic and commercial considerations that would often require directors to provide information about the value of the benefit are also addressed in the examples in s219(2) regarding the information on financial benefits that needs to be included in explanatory statements.

63 A transaction can be significant from the point of view of a company for reasons other than the cash amount. For example, a transaction that involves a change of business activities or strategic direction, the replacement of the full board, or substantial dilution may be considered to be significant.

64 Our recent review of related party arrangements confirms that independent expert reports are often commissioned for member approvals under Ch 2E for significant transactions or, in some cases, where benefits are difficult to value. This may be because these transactions require an expert report for the purposes of obtaining member approval under ASX Listing Rule 10.1 or item 7 of s611 of the Corporations Act.

65 The application of aspects of this proposal is illustrated by the following example.

Example 4

BurkeCo proposes to buy all the issued share capital of WillsCo for scrip consideration. Both companies are manufacturers in the outdoor equipment business. The percentage shareholding of BurkeCo's existing shareholders will be substantially diluted as a result of issuing the scrip consideration. As part of the transaction, three WillsCo directors, who are also major shareholders of WillsCo, will become directors of BurkeCo, replacing BurkeCo's existing board. No WillsCo shareholder will have voting power in BurkeCo of more than 20% as a result of the transaction.

The acquisition requires approval by BurkeCo's members:

- for the appointment of three new directors;
- under Chapter 7 of the ASX Listing Rules, as it involves the issue of shares;

- under Ch 2E of the Corporations Act, as BurkeCo is proposing to give a financial benefit (shares) to the shareholders of WillsCo, three of whom are also proposed directors, and therefore related parties, of BurkeCo under s228(6);
- but not under Chapter 10 of the ASX Listing Rules, as the requirement for member approval of transactions with related parties does not apply where that relationship is due to s228(6) (see ASX Listing Rule 10.3); and
- not under item 7 of s611, as no WillsCo shareholder will have voting power in BurkeCo of more than 20%.

As Chapter 10 of the ASX Listing Rules does not apply, an expert report is not required by the Listing Rules. However, in this case, BurkeCo's board decides to provide members with an expert report because the transaction is significant to the company. It is significant because it involves dilution of existing shareholders, the acquisition of a major asset and replacement of the existing board.

How experts should assess related party transactions

Proposal

C2 We propose to provide guidance in RG 111 about the approach an expert should take to assessing a related party transaction when preparing a report for member approval under Ch 2E of the Corporations Act or Chapter 10 of the ASX Listing Rules: see Attachment 1 to CP 143. Our proposed guidance is directed primarily at asset acquisitions and/or disposals, and will cover:

(a) the importance of an expert focusing on the substance of the related party transaction, rather than the legal mechanism;

(b) when analysing whether a related party transaction is 'fair and reasonable', our view that an expert should make a separate assessment of whether the transaction is 'fair' and whether it is 'reasonable';

(c) the meaning of 'fair' in the context of a related party transaction—that is, a proposed transaction is 'fair' if the value of the financial benefit to be provided by the company to the related party is equal to or less than the value of the consideration being provided to the company, and that this comparison should be made on the basis set out in RG 111.10;

(d) the meaning of 'reasonable' in the context of a related party transaction—that is, a transaction is 'reasonable' if it is 'fair', and it might also be 'reasonable' if, despite being 'not fair', the expert believes there are sufficient reasons for members to vote for the proposal; and

(e) factors that an expert might consider in determining whether a transaction is 'reasonable' (see paragraphs 74–76).

Your feedback

C2Q1 Do you agree with this proposal? If not, please explain why.

C2Q2 Should this guidance be extended to expert reports relating to transactions other than asset acquisitions and/or disposals? If so, please explain what other types of transactions you think this guidance should apply to. For example, should this guidance apply to related party underwriting in control transactions, share issues and option issues?

C2Q3 Should our proposed guidance apply where a related party transaction involves member approval under item 7 of s611? If not, please explain why.

C2Q4 Do you anticipate there will be any practical difficulties for experts in valuing the consideration paid and received by the company in related party transactions?

C2Q5 Where the related party transaction is a component of a broader transaction (or series of transactions) and the resolutions for approval of each component are interdependent, should the expert undertake a separate analysis of the related party component? If so, please explain why.

C2Q6 Are there other 'reasonableness' factors that you think should be referred to in our guidance?

C2Q7 Do you consider that any of the proposed 'reasonableness' factors will be impractical to apply? If so, please explain why.

Rationale

66 This proposal aims to:

(a) provide more clarity for independent experts on how to analyse related party transactions; and

(b) improve the quality and consistency of information provided to companies and their members about whether related party transactions are 'fair and reasonable'.

Substance of the related party transaction

67 Experts should focus on the substance and true effect of a related party transaction, rather than its legal form. For example, where a related party transaction is made up of a number of separate components, the expert should consider the effect of the related party transaction as a whole.

Use of the 'fair and reasonable' test

68 When analysing related party transactions that involve an asset acquisition or disposal, experts usually express an opinion on whether the transaction is

'fair and reasonable' from the perspective of non-associated members. This is specifically required where the report is also intended to accompany meeting materials for member approval under ASX Listing Rule 10.1.

69 Our recent review of the related party arrangements of listed companies identified that, in some cases, experts had assessed whether a transaction was 'fair and reasonable' by applying a simple 'advantages and disadvantages' test that is broadly similar to that used when analysing a demerger or for a sale of shares that requires approval under item 7 of s611.

70 We do not think it is appropriate for an expert to analyse a related party transaction using an 'advantages and disadvantages' test because this approach does not clearly indicate to members whether or not the consideration provided to the related party is greater than the consideration received by the company (i.e. whether the transaction is 'fair'). The practical effect of this can be that an expert might still conclude the transaction is 'fair and reasonable' even though the consideration received by the company is manifestly inadequate (e.g. where there are other advantages that outweigh the disadvantage of an unfair price).

71 Our proposal aims to address this shortcoming of some expert reports by providing that the 'fair and reasonable' test should not be applied as a composite test. Experts should instead make a separate assessment of whether the transaction is 'fair' and whether the transaction is 'reasonable'. This proposal is consistent with our policy on the approach experts should apply when analysing control transactions: see RG 111.10 in Attachment 1 to CP 143.

Meaning of 'fair' and 'reasonable'

72 Our approach to defining 'fair' and 'reasonable' in the context of a related party transaction is based on the convention used in control transactions: see RG 111.10 and RG 111.11 in Attachment 1 to CP 143. We recognise that investors are familiar with this convention and, where a related party approval is a component of a broader control transaction on which the expert is also giving an opinion, it is logical for the expert to apply a consistent approach when analysing both the control transaction and the related party transaction.

73 The approach in RG 111.10 means that any special value (e.g. synergies available to one purchaser that are not available to others) should not be taken into account by experts when determining fairness. However, this is a separate test to the consideration by the company of relevant factors and circumstances when determining whether the transaction is 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 for the purposes of s210: see paragraph 42.

Factors an expert might consider

74 We have proposed some additional guidance to take into account the particular features of related party transactions. For example, in a related party transaction, there is a heightened need for an expert to take into account all material terms of the proposed transaction when valuing the consideration to ascertain whether there are any onerous or overly generous terms that may explain why the financial benefit appears to be worth more or less (as the case may be) than the consideration paid by the related party.

75 Under our proposal, factors that an expert might consider in determining whether a transaction is 'reasonable' include:

(a) the financial situation and solvency of the entity, including the factors set out in RG 111.24, if the consideration for the financial benefit is cash;

(b) opportunity costs;

(c) the alternative options available to the company and their likelihood of occurring;

(d) the company's bargaining position;

(e) selective treatment of any security holder, particularly the related party;

(f) the related party's pre-existing voting power in securities in the company;

(g) any special value of the transaction to the purchaser, such as particular technology or the potential to write off outstanding loans from the target; and

(h) the liquidity of the market in the entity's securities.

76 These factors are not intended to be exhaustive. However, as a general rule, we would expect an expert to take all of these factors into account in making an assessment to the extent they are relevant. Experts should also take into account other factors set out in RG 111.15 (in Attachment 1 to CP 143), particularly in relation to related party transactions that are also transactions of the nature referred to in RG 111.

77 The application of aspects of this proposal is illustrated by the following example.

Example 5

VendorCo Ltd proposes to sell one of its main assets to a related party, AcquirerCo Ltd. VendorCo is preparing a notice of meeting and explanatory statement for the purposes of seeking member approval under Ch 2E and ASX Listing Rule 10.1.

VendorCo engages an independent expert to prepare a report for members on whether the transaction is 'fair and reasonable'. The expert values the asset to be sold to AcquirerCo, as well as the consideration to be received by VendorCo. The expert concludes that the asset is valued at more than the consideration to be paid by AcquirerCo and, therefore, the transaction is 'not fair'. However, the expert concludes that the transaction is 'reasonable' because VendorCo:

- is in breach of its loan covenants and must raise funds urgently;
- has explored all other options for raising funds and found that selling one of its assets is the only practical option to raise funds within the required timeframe; and
- appointed a corporate adviser to undertake a sale process for one of its assets and the offer from AcquirerCo was the best offer it received.

It would not have been sufficient for the expert to assess whether the transaction was 'fair and reasonable' by simply weighing up the advantages and disadvantages of the proposal. VendorCo's shareholders should be given the price-related information in the fairness assessment, as well as the factors considered by the expert to make the transaction reasonable.

Independence of experts

Proposal

C3 We propose to clarify in RG 112 that experts who prepare reports on related party transactions should meet the standards of independence set out in RG 112.

Your feedback

C3Q1 Do you agree with this proposal? If not, please explain why.

C3Q2 Do you anticipate there will be any practical difficulties in experts meeting the standards set out in RG 112 (see Attachment 2 to CP 143) when preparing reports for related party transactions?

Rationale

78 RG 112 does not currently contain an express statement as to whether or not our guidance on the independence of experts applies to expert reports prepared for member approvals for the purposes of Ch 2E. However, our recent review of the related party arrangements of listed companies indicated

that almost all expert reports prepared for the purposes of Ch 2E were prepared in accordance with RG 112.

79 Given the inherent conflicts of interest involved in many related party transactions, we think it is especially important that the opinion of an expert is not influenced by people who have an interest in the transaction. We therefore propose to clarify in RG 112 that experts who prepare reports on related party transactions should meet the standards in RG 112.

D Disclosure about related party transactions

Key points

We propose to provide guidance in RG 76 on the content requirements for prospectuses, Product Disclosure Statements (PDSs) and other disclosure documents where a company or registered scheme has existing related party arrangements, including whether member approval has been obtained.

We also propose to update our guidance in RG 76 on the information that should be included in meeting materials provided when seeking member approval of a related party transaction under Ch 2E.

Disclosure of material information to investors

Proposal

D1 We propose that prospectuses and PDSs (and other disclosure documents, such as scheme booklets and takeover documents offering scrip consideration) should describe:

(a) all related party arrangements, including the value of the financial benefit if it can be quantified;

(b) the nature of the relationship (i.e. the identity of the related party and the nature of the arrangements between the parties, in addition to how the parties are related for the purposes of the Corporations Act or ASX Listing Rules. For group structures, the nature of these relationships should be disclosed for all group entities and related parties involved in each transaction);

(c) whether the arrangement is on arm's length terms, is reasonable remuneration or some other Ch 2E exception applies;

(d) whether member approval for the transaction was sought and, if so, when; and

(e) the policies and procedures that the company or registered scheme has in place in relation to entering into related party transactions and how compliance with these policies and procedures is monitored.

Your feedback

D1Q1 Do you agree with this proposal? If not, please explain why.

D1Q2 Should this proposal be confined to only some arrangements with related parties? If so, which arrangements should it apply to?

D1Q3 Do you anticipate any difficulties in providing disclosure of this nature? If so, please explain why.

D1Q4 Do you consider that other disclosure should be made for related party transactions in prospectuses and other disclosure documents? If so, please explain why.

D1Q5 Should there be a requirement that disclosure in prospectuses and other disclosure documents regarding arm's length terms be more detailed than a statement that the terms are 'commercial'? If so, please explain why, including what level of disclosure you think is appropriate. If not, please explain why.

D1Q6 Do you agree that this proposed guidance should apply to all of the documents suggested (prospectuses, PDSs, scheme booklets and takeover documents offering scrip consideration)?

D1Q7 Do you think disclosure of this nature would assist in achieving the aims described below regarding greater transparency? Please explain your answer.

Rationale

80 We consider that the information about related party arrangements is information that investors reasonably require to make informed decisions about whether to acquire a security or managed investment product. In particular, the nature and extent of related party arrangements that exist for an entity or within a corporate structure is information that we consider investors reasonably require. This is because it can be indicative of certain aspects of an entity's business model, its attitude to related party transactions and how they are managed. This information can also show that some members may have different economic interests in an entity to others (i.e. some members may lend to, or provide other services to, the entity).

81 For this reason, we propose that all related party transactions should be disclosed, rather than only those considered by the company to be material. While this information can be particularly relevant to investors making initial investment decisions regarding an offer contained in a full-form prospectus or PDS, companies and responsible entities preparing transaction-specific prospectuses or PDSs should also consider whether to disclose information regarding related party transactions that have not been disclosed to the relevant financial market operator under their continuous disclosure obligations.

82 Our review of disclosure regarding related party transactions showed that disclosure documents sometimes do not disclose information about various matters, including:

(a) the extent and nature of existing related party transactions for the company or within its corporate structure;

(b) the value of the financial benefit, including its impact on the company;

(c) the identity of the related party and nature of the relationship; and

(d) the terms of giving the financial benefit, other than that 'commercial terms' applied.

83 Our review also indicated that some related party transactions that are not put to members are only disclosed in the annual reports of companies and not in any other disclosure documents, such as loans to or from directors.

84 Where possible, we consider that investors should be given information about the value of the financial benefit in dollar terms. We consider that this information is important to investors' decisions, including information that gives an indication of the proportion of the company's or scheme's revenue, expenses, assets or liabilities that is attributable to related party arrangements. This proposal is consistent with our existing guidance that information about the value of the financial benefit should be disclosed, including the basis for the valuation, the principal assumptions behind the valuation and, in some cases, the opinion of an expert.

> Note: See 04-257MR and Media Release (05-63MR) *ASIC seeks better disclosure for shareholders in related party transactions* (21 March 2005). These media releases relate to notices of meeting and explanatory statements—however, we also consider matters of this type are relevant to other disclosure documents, including prospectuses and PDSs.

85 This proposal describes our overall approach to disclosure of related party arrangements in prospectuses and PDSs. In other regulatory guides, we have set out specific benchmark disclosure requirements, which include benchmarks for related party arrangements. These regulatory guides apply to specific products and/or industry sectors, in conjunction with the overarching requirements of the proposals in this consultation paper.

> Note: For other guidance and proposals on the disclosure of information about related party arrangements in prospectuses and PDSs, see Regulatory Guide 45 *Mortgage schemes: Improving disclosure for retail investors* (RG 45), Regulatory Guide 46 *Unlisted property schemes: Improving disclosure for retail investors* (RG 46), Regulatory Guide 69 *Debentures: Improving disclosure for retail investors* (RG 69), Consultation Paper 133 *Agribusiness managed investment schemes: Improving disclosure for retail investors* (CP 133), Consultation Paper 134 *Infrastructure entities: Improving disclosure for retail investors* (CP 134) and Consultation Paper 141 *Mortgage schemes: Strengthening the disclosure benchmarks* (CP 141).

86 We expect that the disclosure of information in prospectuses and PDSs about related party arrangements will:

(a) promote informed decision-making by investors about companies and registered schemes that have established ongoing arrangements with related parties before undertaking a public fundraising; and

(b) make directors' decisions about whether to enter into related party transactions—and, if so, whether to seek member approval—more transparent.

Note: This proposal is consistent with the prospectus and PDS content requirements in Ch 6D and Pt 7.9.

87 Through this proposal, we seek to encourage greater disclosure about a company's policy on entering into related party arrangements. We consider that this information is also material to investors' decisions and that merely disclosing the existence of relevant committees and protocols may not be sufficient.

88 Table 1 summarises the disclosure obligations that are relevant to related party arrangements for various disclosure documents. Other documents, such as continuous disclosure announcements and financial reports, also require disclosure of information about related party transactions.

Table 1: Summary of disclosure obligations (excluding notices of meeting)

Document	Content requirements relevant to related party arrangements
Prospectus	• All the information that investors and their professional advisers would reasonably require to make an informed decision about the financial position, performance and prospects of the company: s710. • Information about the nature and extent of interests, or amounts paid, given or agreed to be paid or given, to directors, proposed directors or promoters of the company: s711. • All the information that investors and their professional advisers would reasonably require to make an assessment of the effect of the offer on the body (s713), including information excluded from a continuous disclosure notice reasonably required to make an informed decision about the financial position, performance and prospects of the company: s713(5).
Product Disclosure Statement (PDS)	• Any information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product: s1013E.
Offer information statement	• A copy of an annual financial report with a balance date that occurs within the last six months before the offer of securities. The annual financial report must be audited and prepared in accordance with the accounting standards: s715(2). Related party disclosure in accordance with AASB 124 must be included in the annual financial report.
Bidder's statement	• If any securities (other than managed investment products) are offered as consideration under the bid—all material that would be required for a prospectus for an offer of those securities by the bidder under s710–713 (see above). • If any managed investment products are offered as consideration under the bid—all material that would be required by s1013C to be included in a PDS given to a person in an issue situation in relation to those managed investment products (see above).

Document	Content requirements relevant to related party arrangements
Target statement	• All the information that holders of bid class securities and their professional advisers would reasonably require to make an informed assessment whether to accept the offer under the bid.
Scheme booklet	• All the information that is material to the making of a decision by a creditor or member of the body that is known by the directors of the body and has not previously been disclosed to the creditors or members of the body: s412(1)(a).

89 The application of aspects of this proposal is illustrated by the following example.

Example 6

NewCo Pty Ltd is setting up a business as a mineral exploration company. It acquires a tenement from DirectorCo Pty Ltd, a company controlled by Newco's directors. NewCo enters into a 10-year services agreement, under which DirectorCo will provide it with geological and engineering services. NewCo also obtains a loan from one of its directors to fund its exploration activities. NewCo did not obtain member approval under Ch 2E before entering into these arrangements because it was not a public company and so Ch 2E did not apply.

After entering into these arrangements, NewCo converts into a public company, NewCo Ltd, in preparation for floating on ASX. It prepares an initial public offering (IPO) prospectus, which explains, among other things:

- the key terms of all these arrangements, including information relating to the value of the benefits provided to related parties;
- how the entities are related and the scope of related party arrangements that exist within NewCo's corporate structure;
- whether the terms of each of the acquisition, the services agreement and the loan are arm's length;
- that member approval was not sought under Ch 2E because, at the time of entering into these arrangements, NewCo was not a public company and, therefore, Ch 2E and its exceptions did not apply; and
- its policy for entering into related party arrangements, including its procedures for monitoring and ensuring compliance with this policy.

Information about related party arrangements it entered into before it converted to a public company are disclosed in the prospectus because this information is reasonably expected by investors and their advisers to make an informed assessment of the financial position and prospects of the company: see s710. In some cases, this disclosure may also be required under s711.

Notices of meeting

Proposal

D2 We propose to update RG 76 to provide further guidance on the content of notices of meeting and explanatory statements for the approval of financial benefits lodged with ASIC under Ch 2E. This update will reflect how we are currently reviewing these documents in practice and will include guidance on disclosure about:

(a) director recommendations;

(b) alternative options to the related party transaction and the reasons for choosing the related party transaction;

(c) the impact of the transaction on the entity;

(d) valuation of the financial benefit and, where relevant, the expert report; and

(e) the information set out at Proposal D1 about disclosure of material information to investors.

Your feedback

D2Q1 Do you agree with this proposal? If not, please explain why.

D2Q2 Do you think we should provide further guidance on the contents of Ch 2E disclosure documents, and, if so, what extra guidance should we provide?

Rationale

90 Notices of meeting and explanatory statements seeking member approval for related party transactions must provide sufficient information to members to enable them to decide whether or not the financial benefit to be given to a related party is in the interests of the company: s219.

91 We consider that the information set out in Proposal D1 is information that is material to members' decisions about how to vote on a related party proposal and that investors expect to see this information in notices of meeting and explanatory statements.

92 We currently provide guidance on the content of meeting materials for related party approvals in 04-257MR and 05-63MR. These media releases give guidance on various matters for disclosure, including each director's recommendation and their interest in the transaction, valuation and details of the financial benefit, the identity of the related party and the nature of their existing interest in the company.

93 We consider that information about valuation and details of the financial benefit are particularly important to members' voting decisions: see paragraph 84. Where possible, we consider that members should be able to understand the value of the financial benefit and its impact on the company

in dollar terms. We consider that the matters set out in s219(2) indicate the importance of providing members with information about value.

94 Our review of related party transactions showed that there were varying degrees of market disclosure about related party transactions, including information regarding valuation of the financial benefit, independent director recommendations, alternative transactions and whether the terms are arm's length.

95 Table 2 sets out our proposed guidance on the content of meeting materials.

Table 2: Proposed guidance on content of related party meeting materials

Topic	Summary of guidance
Identity of the related party: s219(1)(a)	The related party to receive the financial benefit must be clearly identified, including an explanation of the nature of the related party relationship. We consider that for group structures, the nature of these relationships should be disclosed for all group entities and related parties involved in each transaction. This is regardless of whether some relationships are considered immaterial.
Nature of the financial benefit: s219(1)(b)	Complete details of the financial benefit to be given to the related party must be provided to members. This includes not only details of what the benefit is (both as to nature and quantity), but also the reason for giving the benefit and the basis for giving the particular benefit. For example, if options are to be granted to a director, ASIC expects the following information to be disclosed: • the number of options to be granted to the director; • the terms of the options; • an explanation as to why the options are to be granted, particularly where alternative forms of remuneration or incentive may be required to be expensed by the company in future years; and • an explanation as to why the specified number of options is to be granted and why the specified value of the options was chosen. A company should be careful to disclose the substantive effect of a transaction if necessary to explain the financial benefit. For example, if a company, instead of granting options, proposes to lend a director money to acquire shares in the company but the repayment terms of the loan effectively create an option-like situation, this should be disclosed.

Topic	Summary of guidance
Directors' recommendations: s219(1)(c)	For each proposed related party resolution, each director of the company must either: • make a recommendation about the resolution and state their reasons for it; or • if they do not make a recommendation, state why they do not. If, for some reason, a director is not available to make either of these statements, they must also state why this is the case. Importantly, we consider that detailed reasons for director recommendations should be provided, including a discussion of any alternative options considered. It is not enough simply for a director to state that they approve of the resolution. This is because we consider this information is material to members when deciding how to vote, and in some cases, the omission of this information could be misleading. We also consider it is good practice for directors to avoid making a recommendation for resolutions regarding each other's remuneration as there may be a conflict of interest. The reason for not making a recommendation must be disclosed: s219(1)(c)(ii). For example: • if a proposal to issue options to a non-executive director will mean that the company will no longer satisfy the ASX Corporate Governance Principles and Recommendations (2nd edn)—the reasons supporting the director's recommendation should include an explanation of why the director considers this is appropriate, and a discussion of other relevant options; • if a company's reason for granting options to a director is as an incentive for future performance but the options are in the money—the reasons should address how the director has reconciled these facts; and • if a proposed related party transaction was chosen over other alternative transactions with non-related entities—the reasons for choosing the related party transaction over the alternatives should be explained.
Directors' interest in outcome: s219(1)(d)	Each director must state whether or not they have an interest in the outcome of the proposed resolution. If a director does have an interest in the outcome, they must state what that interest is. If the director's interest in the outcome was considered a material personal interest, this should be disclosed, along with whether the director voted on the transaction. Further, if a director has a material personal interest in the outcome, there should be an explanation as to why the director has not also been included as a related party for the purpose of obtaining member approval.
Other: s219(1)(e)	The explanatory statement must contain all other information that is reasonably required by members in order to decide whether or not it is in the company's interests to pass the related party resolution: s219(1)(e). For transactions with multiple steps and approvals, companies should assess what information is to be disclosed for each step and the information provided should enable a member to understand the transactions as a whole. In preparing this information, the company should keep in mind: • the general requirement that information included in a notice of meeting be presented in a clear, concise and effective manner (s249L(3)); and • the obligations stated at the end of s219—that is, 'sections 180 and 181 require an officer of a corporation to act honestly and to exercise care and diligence. These duties extend to preparing an explanatory statement under this section. Section 1309 creates offences where false and misleading material relating to a corporation's affairs is made available or furnished to members'.

Topic	Summary of guidance
Valuation of the financial benefit	The related party documents must adequately value the financial benefit. This is especially the case where: • the financial benefit is the issue of shares, options or convertible notes; or • it involves the sale or purchase of an asset, such as a mining tenement or an existing business. We consider that an adequate valuation requires the basis of the valuation, and the principal assumptions behind the valuation, to be disclosed. In some circumstances, it may also be necessary to provide a valuation by an independent expert. This will be particularly important where there is a possibility of directors having a conflict of interest in the transaction. Options must be valued in accordance with AASB 2 *Share-based payment* and all material assumptions used in valuing the options must be disclosed. Where a company is purchasing an asset from, or selling an asset to, a related party, it will be necessary to include a valuation. Where a company is purchasing an asset from a related party in exchange for shares, it may be necessary to include both a valuation of the asset and a valuation of the shares. Where relevant, the valuation methodology should be consistent with that required to be adopted in the financial reports of the company.
Disclosure of a relevant director's total remuneration package	Where the financial benefit to be conferred on a related party is a benefit conferred by way of remuneration or incentive, the amount of the total remuneration package must be disclosed to the members. For example, if options are to be granted to a director, the company must provide a proper valuation of those options as well as give members details of other remuneration the director will receive. Members must be able to assess the value of the overall remuneration package the director will receive when taking into account the financial benefit to be conferred. It is not usually sufficient to only include past remuneration of directors. However, if the remuneration a director will receive is not known but is anticipated to be similar to that received in the previous year, it may be sufficient to include the previous year's remuneration and a statement to that effect.
Related party's existing interest	Details of the related party's existing interest in the company should be disclosed. For example, where shares or options in the company are to be granted to a related party, that party's existing interest will be relevant because it allows the members to determine the likely extent of the related party's influence or control if the financial benefit were to be granted.
Dilution effect of transaction on existing members' interests	Where a company intends to provide equity-related financial benefits to a related party, ASIC requires the company to state the possible dilution effects of that issue on the shares held by other shareholders, or provide sufficient information for members to calculate the dilution effect themselves, provided that a statement to the effect that dilution will occur is also made.

E Regulatory and financial impact

96 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

(a) protecting the interests of investors; and

(b) promoting more certainty for businesses about compliance with their legal obligations.

97 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and

(c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

98 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

99 To ensure that we are in a position to properly complete any required RIS, we ask you to provide us with as much information as you can about:

(a) the likely compliance costs;

(b) the likely effect on competition; and

(c) other impacts, costs and benefits,

of our proposals or any alternative approaches: see 'The consultation process' p. 4.

Key terms

Term	Meaning in this document
arm's length exception	The exception, set out in s210, to the requirement for public companies and registered schemes to obtain member approval to give a financial benefit to a related party
ASIC	Australian Securities and Investments Commission
Ch 2E (for example)	A chapter of the Corporations Act (in this example, numbered 2E), unless otherwise specified
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
disclosure document	Includes a prospectus, PDS, profile statement, offer information statement, scheme booklet or takeover document for the offer of securities or managed investment products, as the case may be
IPO	Initial public offering
Pt 5C.7 (for example)	A part of the Corporations Act (in this example, numbered 5C.7)
related party	Has the meaning given to that term in s228 of the Corporations Act
RG 76 (for example)	An ASIC regulatory guide (in this example, numbered 76)
s208 (for example)	A section of the Corporations Act (in this example, numbered 208)
takeover document	A bidder's statement, target statement or explanatory statement for a scheme of arrangement