Submission on ASIC Consultation Paper 267

Summary

This submission is made by the Head Office Advisory Team at Herbert Smith Freehills in response to ASIC's Consultation Paper 267. In particular, this submission relates to the remaking of ASIC Class Order 98/1418 (**Existing Class Order**) as *ASIC Corporations (Wholly-owned Companies) Instrument 2016/XX* (**Proposed Instrument**).

Our comments in this submission fall into three categories:

1 comments we have on the changes to the conditions for relief suggested by ASIC in the Proposed Instrument;

2 additional changes we would recommend to the conditions for relief based on our experience; and

3 a summary of our understanding regarding what the changes will mean in practice for companies with existing Deeds of Cross Guarantee.

1 Comments on the Proposed Instrument

1.1 Consistency in definitions

We note the following inconsistencies in definitions between the consultation documents and query whether they should be made consistent?

- The definition of 'ASIC Instrument' in the revised Deed of Cross Guarantee is different to the definition of 'ASIC Instrument' in the revised Assumption Deed. While this does not matter for clause 5.1 of the Deed of Cross Guarantee, query whether it matters for Part 1 of the Schedule to the Deed of Cross Guarantee?
- The definition of 'Wholly-owned Entities' in the revised Deed of Cross Guarantee is different to the definition of 'wholly-owned entities' in the Proposed Instrument (in that it does not carve out a trustee that is not a Group Entity).

2 Additional changes recommended to the conditions for relief

2.1 Timing requirements to meet conditions

A number of conditions of the Proposed Instrument require a wholly-owned entity, or its directors, to undertake certain actions by the end of the relevant financial year (i.e. the balance date) of the company, such as:

- **Paragraph 6(g)** requires the directors of the company to resolve to take advantage of the benefit of the instrument *before the end of the first reliance year*.
- **Paragraph 6(h)(i)** requires the directors of the company to make a solvency statement *before the end of the first reliance year*.

- **Paragraph 6(i)** requires the directors of the company to consider the advantages of the deed of cross guarantee and financial reporting relief and resolve to either remain a party or revoke the deed *at or about the end of the relevant financial year*.
- **Paragraph 6(j)** requires the company to have been a wholly-owned entity at all times in the period from the end of the relevant financial year until the reporting date. For an entity seeking relief for their first reliance year, this means that they must be a party to the deed of cross guarantee *from the end of the relevant financial year*.
- **Paragraphs 6(n) and (p)** impose composition requirements on parties of the deed of cross guarantee *as at the end of the relevant financial year*.

Our view is that the company's reporting date is a more appropriate deadline as it accords with the commercial and practical realities of the financial reporting process. Directors (particularly of smaller companies) may only be in a position to determine whether the company needs to seek relief (for example, determining whether the company is 'small' or 'large' proprietary) once the reporting process is well underway. This is likely to be after the end of the relevant financial year/balance date for that company.

We have seen a number of scenarios where subsidiary companies have been ineligible for financial reporting relief under the Existing Class Order because they had failed to pass the requisite resolutions and join the deed of cross guarantee before the end of the first financial year in which it would have liked to obtain relief. The end result is that the company incurred significant additional costs in preparing its audited accounts for that year.

As a result, our recommendation would be to change the deadline from the end of the relevant financial year/balance date to the date on which consolidated financial reports are lodged with ASIC.

With respect to paragraph 6(j), our recommendation would be to carve out companies that are seeking relief for their 'first reliance year' from paragraph 6(j). A specific provision could then be included that companies seeking relief for the first reliance year need to have joined the deed of cross guarantee by the reporting date (rather than the end of the relevant financial year/balance date). To clarify, the company should be a wholly-owned entity of the Holding Entity at all times in the period from the end of the relevant financial year until the reporting date.

2.2 Opt-out notices

Under the Existing Class Order, if a company which previously relied on financial reporting relief under the class order does not lodge an annual financial report for the first financial year in which it ceased to apply relief (for whatever reason), it must lodge an opt-out notice with ASIC.

Should a company fail to lodge an opt-out notice in this scenario, the consequence appears to be that the company will no longer be able to reapply for relief in future financial years. This interpretation is consistent with an editorial note that accompanied the Existing Class Order.

We have had clients in the situation where a Wholly-owned Entity ceased to be a 'large' proprietary company at some point in the past (and therefore became ineligible for relief) but that Wholly-owned Entity failed to lodge an opt-out notice within the timeframe specified by the Existing Class Order. The disqualification of obtaining future relief in these circumstances seems significantly disproportionate to the relatively innocuous, and unintentional, failure to lodge an opt-out notice.

If a company has ceased to require relief (for example because it ceased to be a large proprietary company) but has continued to be included in the Holding Entity's deed of cross guarantee note to the accounts up until the point at which it lodges the opt-out notice we cannot see the harm in allowing it to reapply for relief in the future, should it once again become a large proprietary company.

2.3 Notices of disposal

The drafting of Pro Forma 24 "Deed of Cross Guarantee" provides that, where a Group Entity is sold, it will essentially be released from its obligations (and the remaining group entities released from their obligations in respect of that company) provided:

1. the directors of the Holding Entity, upon disposal, certify in writing that the disposal is a bona fide sale and that the consideration for the sale is fair and reasonable; and
2. a copy of that certificate is lodged by the Holding Entity, and by the Group Entity sold, with ASIC; and
3. the Group Entity sold lodges notice of that disposal with ASIC (including details of any Group Entity which is a wholly-owned entity of the Group Entity sold).

Our view is that the above steps should only need to be completed by either the Holding Entity or the Group Entity being sold. Once the Group Entity is sold, the Holding Entity no longer has power to influence the preparation and lodgement of documents on its behalf and we have been faced with situations where, due to a mistake on behalf of the Group Entity sold, the notice of disposal was not lodged with ASIC (and vice versa, from the perspective of the Group Entity being sold).

3 Impact of changes on existing Deeds of Cross Guarantee

As the ASIC wholly-owned companies relief instrument documents are complicated, and a change to one document may impact on the other documents, we have set out, for completeness, our understanding of what the changes 'mean'.

All companies with a current Deed of Cross Guarantee will need to vary that deed to reflect the new Pro Forma 24. If they do not, they will not be able to add new parties to the deed, as 'old' clause 5.1 only allows new parties to join if they are 'eligible for the benefit of the Class Order'. Because the Proposed Instrument has a new name, from 1 January 2017 no company will be 'eligible' for the benefit of the [CO 98/1418] class order.

Finally, as the key definitions have been tweaked (and have in the past caused confusion), we set out below our understanding of those definitions.

- A 'wholly-owned entity' is (roughly speaking) a wholly-owned subsidiary of the Holding Entity that is a party to the Deed of Cross Guarantee and listed as a Group Entity in the Schedule to the Deed (or a wholly-owned subsidiary of the Holding Entity that is added to the Deed by an Assumption Deed). A 'wholly-owned entity' may or may not be seeking relief under the Deed of Cross Guarantee.
- 'Group Entity' means the Holding Entity or a 'wholly-owned entity'.
- The Trustee may or may not be a Group Entity/wholly-owned entity.
- The 'closed group' means all the Group Entities (ie the Holding Entity and each 'wholly-owned entity'). The definition won't include the Trustee if the Trustee is not a Group Entity.

- The ‘extended closed group’ means the closed group and any other entities which are party to the deed and controlled by the Holding Entity. The definition won’t include the Trustee if the Trustee is not a Group Entity. Therefore, companies that are controlled (but not wholly owned) by the Holding Entity can become parties to the Deed of Cross Guarantee. These additional companies:
  - would be parties to the deed, but not listed in the Schedule to the Deed; and
  - are the difference between the ‘closed group’ and the ‘extended closed group’.

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If you should have any questions or comments on the above submission, please do not hesitate to contact either Pricilla or Steven.

Yours sincerely,

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