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Submission on Commonwealth Consultation Paper on *Facilitating crowd sourced equity funding and reducing compliance costs for small businesses*

31 August 2015

1. Introduction

This document, prepared by the firms whose logos appear above, sets out our joint response to, and submissions on, Part 6.4 of the Commonwealth's Consultation Paper on *Facilitating crowd sourced equity funding and reducing compliance costs for small businesses (August 2015).*

We have not conducted any independent empirical study in order to respond to the questions below but draw on our collective experience of working with large and small Australian companies.

We have also set out proposals for amendments to the *Electronic Transactions Act 1999 (Cth)* and its equivalents in State and Territory legislation to ensure that companies obtain the benefit of that legislation. While submissions were not sought on these matters, these proposals are consistent with the Government's "de-regulation" agenda, will make it easier for companies to enter into electronic contracts and will reduce the cost of transactions with companies generally.

2. Consultation questions

2.1 Sole director companies – does the current law cause problems and increase costs?

25	Does the current law cause problems and/or increase compliance costs for sole director/no secretary companies and their counterparties in executing documents? What is the extent of the burden imposed on sole director/no secretary small proprietary companies in terms of time and/or financial cost?

Does the current law cause problems and/or increase compliance costs for sole director/no secretary companies and their counterparties in executing documents?

Yes.

Under the current law, a significant number of small business companies do not enjoy the advantages of execution under section 127 of the *Corporations Act 2001.* These include, for the company, being able to execute a document (including a deed) without using a common seal and being able easily to satisfy counterparties that the document is duly authorised and executed, reducing transaction costs. Section129 of the Act allows counterparties to make a number of important and commercially valuable assumptions about the validity and binding nature of the document, including assumptions as to due execution and due appointment and authority. In effect, the signing party, not the counterparty, takes the risk of these matters of internal management. This is consistent with a long-standing overall legislative policy of encouraging and facilitating dealings with companies.

Section 204A of the Act provides that a proprietary company need not have a company secretary but section 127 and the due execution assumption in section 129(5) are not available in respect of a company with only one director and no company secretary.

Since such a company cannot comply with section 127, both the company, and its counterparties, are denied the benefit of the advantages referred to above. Counterparties dealing with the company cannot rely on the statutory assumptions as to due execution and authority and so must satisfy themselves as to the authority of the director to sign (for example, by reviewing the company's constitution).

Moreover, such a company cannot effectively execute a deed under section 127 without using a common seal. It is increasingly rare for Australian companies to have a common seal, so these companies are effectively precluded from using the protections afforded by sections 127 and 29. In this case, there is no risk borne by the signing counterparty. Clearly as a principle, a sole director should be able to bind the company.

What is the extent of the burden imposed on sole director/no secretary small proprietary companies in terms of time and/or financial cost?

The Consultation Paper notes that there are approximately 167,540 such companies in Australia. Because of the attractiveness of this model for small business, it can be expected that many small businesses operate through such companies.

As they are not able to make use of sections 127 and 129, these companies and their counterparties have to incur additional time and cost to evidence that the document has been validly executed. In banking transactions, the additional cost incurred by the bank is usually passed back to the company. Anecdotal evidence indicates that for banks, these issues can also result in substantial delay of execution of documents because there is often uncertainty as to how to resolve these issues and it is necessary to work out how to resolve them with the company. We know that this is exacerbated when deeds are involved because each State and Territory has slightly different rules in relation to the formalities for execution of those instruments.

Over the whole of the small business sector, it can be expected that the total additional (and unnecessary) costs to these companies and the parties dealing with them are substantial.

2.2 Sole director companies – should the law be changed?

26	Is it appropriate to amend the law to specify that a company with a sole director and no company secretary may execute a document without using a common seal if the document is signed by the director or with a company seal if the fixing of the seal is witnessed by the director? Are there any risks associated with this approach? Are there any alternative approaches?

Is it appropriate to amend the law?

Yes, see above.

Generally, the signature requirements for sole director/no secretary small proprietary companies should align with those for other forms of company.

Since section 204A of the Act provides that a proprietary company need not have a company secretary, the Act should extend the benefits and conveniences of section 127 and 129 machinery to them and their counterparties.

There is nothing about the sole director/no secretary small proprietary company form of incorporation that raises sufficient additional risks to require a more onerous documentation execution regime. To the contrary, third parties should be able to assume that a sole director is, by definition, able to bind the company.

This change is also likely to be of greatest benefit to small businesses as they are most likely to be managed under sole director companies. The compliance costs for these businesses would be reduced by eliminating the need for counterparties to take additional technical and procedural steps to protect themselves against risk and would make these companies easier to deal with.

2.3 Split execution

27	Is there an issue regarding split execution? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost? What are the benefits and risks of specifying in the law that split execution is acceptable?

Is there an issue regarding split execution?

Yes.

Companies, including small businesses, often want to use split execution.

There is a debate as to whether the *Corporations Act 2001* covers split execution.

Section 127(1) provides that a document is validly executed by a company if 2 directors, or a director and a secretary, sign it – even if the company's seal is not used.

Because section 127 does not expressly say that split execution is covered, some lawyers consider that it is not covered, some that it may be and some that it is.[1] There is one court decision on the question but, given the lack of analysis in that judgment, the matter remains unsettled.[2] A very recent text book has come to the conclusion that it is not covered.[3] The definition of "document" which applies to the Act does not assist in resolving the matter either.[4]

If parties or their legal advisers believe split execution is not clearly covered, they will not rely on the important and commercially valuable due execution assumption available under section 129. The counterparty will assume the risks covered by that section, and will be put to the trouble and expense of mitigating those risks in any way it can, thus defeating the purpose of the section.

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1 See N D'Angelo, "*Split executions" and s 127 of the Corporations Act 2001,* Banking and Finance Law Bulletin, 2015 Vol 31 No 4-5, page 89.

2 *Re CCI Holdings Ltd* [2007] FCA 1283.

3 N Seddon, *Seddon on Deeds* (The Federation Press, 2015) at page 69. However, he does not cite *Re CCI Holdings Ltd.*

4 The definition is the one used in the *Acts Interpretation Act 1901* as in force at 1 January 2005.

Section 127 also establishes a statutory exception to the need for a deed to be executed under seal. Doubts about the effect of split execution raise the question as to whether a deed executed in this way is legally effective as a deed even if otherwise properly executed.

What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost?

Debate over split execution imposes unnecessary procedural burdens on business and affects the conduct of business on a daily basis.

The commercial reality today, because of changes in work practices and technology, is that company officers do not all have to be in the same place to run the business. Many businesses take advantage of this. To require officers to be in the one place just to sign a document, or to physically circulate a document, simply imposes unnecessary costs or delays on doing business. This is likely to be particularly relevant where small business is concerned.

It delays or disrupts settlements and financial closings of transactions.

Parties and their legal advisers who are not prepared to interpret the section as covering split executions tend to require proof of the technical and procedural matters that the Act would otherwise allow them to assume. This may involve, for example, a detailed review of the company's constitution, board minutes and delegations to analyse and form a view on the signatories' authority to sign. Where the documents are deeds, parties may be unwilling to proceed on the basis of split execution at all.

It may also result in legal opinions as to the validity and binding nature of the transaction being qualified.

All this leads to frustration, delay and added cost.

What are the benefits and risks of specifying in the law that split execution is acceptable?

Amending the law to expressly state that split execution is acceptable for the purposes of sections 127 and 129(5) would have the following benefits.

- **Split execution is in step with commercial reality**

  This proposal will resolve the debate that currently exists about whether the Act requires both signatories to sign the same physical document. It will ensure that the Act recognises and supports existing commercial practice.

  As outlined above, it will save time and cost, reduce a procedural burden and help speed up the economy.

- **Consistent with policy of reducing red tape**

  Recognising split execution is consistent with Government policy to reduce the regulatory burden on businesses. If section 127 does not cover – or clearly cover – split execution, technical and procedural steps have to be taken to provide proper

protection to contracting parties. This has exactly the same practical effect on businesses as more traditional "red tape" requirements.

Split execution raises no substantial additional risks for the following reasons:

- **The Act already recognises "multiple copies"**

  Several other provisions in the Act provide for multiple copies of a document to be treated as one. These provisions principally relate to internal governance of companies.[5] Recognising "split execution" is consistent with these provisions.

- **Risk allocation not affected**

  By requiring 2 officers of a company to be actively involved in committing the company to a document, section 127 protects shareholders and outsiders. Allowing split executions does not undermine the substance of this protection, but simply makes it less procedurally complex.

2.4 Execution of deeds

28	Is there an issue regarding the execution of deeds by foreign companies? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost? Should the UK approach be adopted in the Corporations Act? Should a similar approach be taken to other bodies corporate? What are the benefits and risks?

Is there an issue regarding the execution of deeds by foreign companies?

Yes.

There is widespread uncertainty in the legal and business communities about how a foreign corporation executes a deed so as to be valid and enforceable as a deed under Australian law.[6] This is particularly the case if the corporation is from a jurisdiction that does not recognise the concept of a deed.

- The common law requires a deed executed by a corporation to be signed, sealed and delivered and witnessed.
- It is not enough at common law to simply to state that the deed is sealed - a seal has to be affixed, attached or impressed on the deed as the party's seal (but a printed circle with the word "LS" or "seal", a wafer seal or simply "(seal)" will all do).
- An agent or attorney signing a deed must be appointed by deed.
- Corporations in some jurisdictions do not have a common seal.

In Australia, some common law requirements in relation to the execution of deeds have been modified by State and Territory legislation and the *Corporations Act 2001*, but these either do not cover foreign corporations or it is unclear whether they do. For example, the requirement to seal deeds physically has been modified by State and Territory legislation

[5] See sections 248A(2), 249A(3), 249D(3), 249N(3), 249P(4), 252B(4), 252L(3) and 252N(4).

but these modifications do not apply to execution of deeds by corporations (presumably because that was left to be dealt with in the *Corporations Act 2001*).

What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost?

In a globalised world, if small companies are trading with overseas counterparties, the cost can be significant. As the Consultation Paper notes, it can be difficult to determine whether a foreign corporation has executed a deed in accordance with Australian law requirements.

- There are occasions in commerce where, for legal reasons, it is important for a document to be drafted and executed as a deed.
- Many foreign jurisdictions do not recognise a distinction between agreements and deeds. Some have no concept of a deed. These include our largest trading partners, the United States, Japan and China.
- So, if a transaction requires such a corporation to enter into a deed:
    - time and effort (often very lengthy, involving explanations of deeds and the requirements of the common law) must be spent in explaining the requirement to the corporation;
    - the corporation may be asked by Australian lawyers to take additional corporate action to execute the deed to comply with common law requirements; and
    - when the document is enforced or a dispute arises, issues of due execution arise and the corporation may argue it did not validly executed a deed, requiring other parties to establish that it did,

  all of which increases cost and causes frustration and delay.
- Determining how a foreign corporation executes a deed in accordance with Australian common law as well as the laws of its place of incorporation (so its directors comply with their own law as well) can give rise to complex legal issues - some of which are not completely reconcilable – again leading to frustration and legal risk for the parties to the transaction and for the directors of the foreign corporation.

Should the UK approach be adopted in the Corporations Act? Should a similar approach be taken to other bodies corporate? What are the benefits and risks?

The UK approach should be adopted because it is simple and is well understood.

A foreign corporation must always execute a document in accordance with laws of its place of incorporation. To require a foreign corporation to comply with procedures specified in the *Corporations Act 2001* (or Australian State or Territory laws) adds another layer of

[6] See *Execution of deeds by foreign corporations* by Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright at https://www.aplma.com/en/documentation/australian-documents (accessible only to AMPLA members).

regulation. It may be difficult for the foreign corporation to reconcile those requirements with the requirements of the laws of its place of incorporation.

The same approach should cover all foreign companies (as defined in the *Corporations Act 2001*).

In an increasingly globalised world, Australian businesses regularly contract with foreign counterparties. Making it easier for foreign corporations to execute documents makes it easier for them to do business with Australian businesses. Adopting the UK approach will make it easier for foreign corporations to execute documents. It will facilitate international trade, and finance and investment, by reducing the cost and complexity of, and legal risk associated with, transactions with foreign companies. It will also remove an impediment to the use of Australian law in transactions, facilitating the export of Australian legal services.

The Act should be amended to provide that a document executed by a foreign company in accordance with the requirements of the laws of the jurisdiction in which the company is incorporated, or by a person authorised under those laws to sign the document on behalf of the company, and that is expressed to be a deed, is taken to be executed as a deed for the purposes of Australian law.

3. Electronic transactions reform

Although these issues are not addressed specifically in the Consultation Paper, one area that impacts significantly on small business is the electronic execution of documents (in particular deeds). Parties are increasingly entering into arrangements via electronic technology, whether simply by exchanging emails, or by signing and circulating documents that are sent as attachments to emails or through one of the proprietary applications like DocuSign.[7] While there is some legislative support for these methods, the law is out of date and leaves much room for doubt. This is another example where commerce has raced ahead of the law.

3.1 Proposal – encourage e-commerce by applying the *Electronic Transactions Act 1999* to the *Corporations Act 2001*

We propose that the *Electronic Transactions Regulations 2000* be amended to remove the disapplication of Part 2 Division 2 of that Act in respect of Part 2B.1 of the *Corporations Act 2001.*

The Commonwealth may wish to discuss this proposal with the States and Territories although there is no corresponding State or Territory legislation.

Benefits. This proposal will facilitate companies and those dealing with them to transact business electronically by allowing the benefits of the electronic transactions legislation to flow though to parties dealing with companies.

[7] For example, see https://www.docusign.com.au/.

3.2 Proposal – encourage e-commerce by clarifying that electronic deeds are permitted

We propose that the *Electronic Transactions Act 1999* and its equivalents in State and Territory legislation be amended to expressly state that deeds may be in electronic form and electronically executed.

The electronic transactions legislation is uniform Commonwealth and State/Territory legislation, and also State/Territory legislation governs the execution of deeds, so these amendments will need to be discussed with the States and Territories.

Benefits. This proposal will further facilitate companies and those dealing with them to transact business electronically.

3.3 Rationale

Existing electronic transactions legislation has limitations

The object of the *Electronic Transactions Act 1999* and its State and Territory equivalents (together, "**electronic transactions legislation**") includes:

- facilitating the use of electronic transactions; and
- promoting business and community confidence in the use of electronic transactions.

However, key provisions of the *Electronic Transactions Act 1999* do not apply to the *Corporations Act 2001*[8] and this presents a significant barrier to achieving this objective.

- The *Electronic* Transactions *Act 1999* does not apply to electronic signatures on documents referred to in section 127 of the *Corporations Act 2001* so those documents do not get the benefit of the *Electronic Transactions Act 1999*.
- As noted above, if a document is signed in accordance with sections 127, s129(5) allows people to make a number assumptions about the validity and binding nature of the document. If electronic execution does not satisfy section 127, these important assumptions cannot be relied on.

While electronic transactions may still be valid under common law rules even when the electronic transactions legislation does not apply, significant uncertainty can arise as the common law is still evolving in this area. This means that many Australian businesses – small and large – cannot be fully confident in entering into electronic transactions with companies.

Deeds in electronic form

The electronic transactions legislation also does not expressly state that deeds may be in electronic form or that they may be executed electronically. Some State and Territory legislation goes further and appears to actively exclude deeds from its operation. At common law, there has traditionally been a requirement that deeds must be physically in the form of paper or parchment. Both at common law and under most State/Territory statutes, the signing of deeds must be witnessed, a concept that has very uncertain

[8] See *Electronic Transaction Regulations 2000* regulation 4, Schedule 1, item 28.

meaning when it comes to electronic execution. Since the electronic transactions legislation does not expressly refer to deeds in electronic form, there is a general view that electronic deeds are not possible.[9]

More and more business is being done online

The growth of online commerce means that businesses increasingly seek to enter transactions online. Electronic signature technology has been developed to facilitate electronic exchanges and signing of documents and new digital management services now offer digital management of document-based transactions. The limitations of the electronic transactions legislation create uncertainties for businesses conducted through companies entering into electronic contracts and so have a negative impact on online commerce.

Risk allocation not affected

Section 129 places the risk of due execution primarily on the party executing a document, by providing that the counterparty can make a number of assumptions.

The *Electronic Transactions Act 1999* also places the risk of signature on the party whose electronic signature is on the relevant document – subject to that party establishing to the contrary. The technology for e-signatures is now sufficiently mature that any such risk is acceptable.

Implications of electronic deeds

While the States and Territories have been dealing with stamp duty on electronic documents for some time, if the electronic transactions legislation is amended to clarify that deeds may be in electronic form, the proportion of dutiable transactions that occur electronically may increase, and so the States and Territories may want to consider this aspect.

It is important that there are clear rules for determining the location of rights and obligations under electronic deeds, as this may affect revenue and other laws (for example, section 28 of the *Insurance Act 1973* which requires insurers to hold assets in Australia equal to the value of their liabilities). We think the simplest approach would be to apply the same rules to electronic deeds as apply to contracts generally, but other approaches might be based on the governing law of the deed, or the location of the last person to execute the document. The traditional deed situs rules should continue to apply to physical deeds.

[9] For example, see N Seddon, *Seddon on Deeds* (The Federation Press, 2015) at [2.28].