Law Council
OF AUSTRALIA
Business Law Section

General Manager
Financial Systems and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600
Via email: smallptycompanies@treasury.gov.au

31 August 2015

Dear Sir or Madam,

Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses

Enclosed are two separate submissions in response to Treasury's Consultation Paper on "Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses". The submissions have been prepared by the SME Business Law Committee and the Corporations Committee of the Business Law Section of the Law Council of Australia respectively..

In lodging the two separate submissions, the Business Law Section acknowledges that the Committees have differing views in relation to the Consultation Paper. However, the Business Law Section considers that it is appropriate to lodge the differing views of the two Committees for the assistance of Treasury.

If you have any questions in relation to the submissions, please contact either the Chair of the SME Business Law Committee, Coralie Kenny, on 0408 919 082, or the Chair of the Corporations Committee, Bruce Cowley, on 07-3119 6213, as appropriate.

Yours faithfully,

John Keeves, Chairman
Business Law Section

enc.

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Dear Sir/Madam,

Consultation Paper dated August 2015 on 'Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses' (*CSEF Paper*)

Introduction

The Law Council of Australia is the peak national body representing the legal profession in Australia.

The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (***SME Committee***) makes this submission in response to the Consultation Paper dated August 2015, released by Treasury.

The SME Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (***SMEs***) in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs.

Please note that the SME Committee's submission may differ from those made by other Committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs.

Other Submissions

The Corporations Committee of the Business Law Section of the Law Council of Australia (***Corporations Committee***) is also lodging a submission on the CSEF Discussion Paper.

On 12 November 2013 the Corporations Committee lodged with the Corporations and Markets Advisory Committee (***CAMAC***) a Submission (***the CAMAC Submission***) to the CAMAC Discussion Paper on CSEF of September 2013. On 6 February 2015 each of the Corporations Committee and the SME Committee lodged with Treasury Submissions in

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response to the Discussion Paper dated December 2014 on 'Crowd-sourced Equity Funding'.

SME Committee Position

The SME Committee notes that fundraising on-line is also done through receipt of small gifts or donations to start ups and innovators or persons or entities with projects or causes that require monetary support. These gifts are not made in return for an issue of any equity (or debt) interest and it appears the donors are not concerned to participate in any success or growth of the enterprise, although some of these enterprises do provide the donors with a service or reward, such as an opportunity to meet the innovator or the receipt of a sample good or service.

Aside from such money raising enterprises having to ensure they are not misleading or deceptive with regard to consumers (donors) or fraudulent, there is currently no regulatory structure that applies to them because no equity or debt interests are issued to donors. As no interest issues to donors, the legislation on anti-hawking and disclosures does not apply.

Clearly there are opportunities for unscrupulous operators to take advantage of the generosity of consumers (donors) in this unregulated environment and the risk accepted by donors would be dependent on each donor's appetite and funding ability.

The SME Committee considers that this 'online donation' funding should also be looked at by government given how accessible this method is both to willing donors and to unscrupulous operators.

With regard to CSEF, the SME Committee recognizes that in order for SME start ups and innovators to be able to access equity funding of small amounts from large numbers of investors, particularly through social media forums, which is the basis behind crowd-sourced funding, changes need to be made to the existing legislation, particularly to the Corporations Act 2001 (Cth).

The existing corporate legislation was drafted to provide regulatory relief for small numbers of investors through restricting the number of shareholders in proprietary companies to less than 50. Where there are more than 50 shareholders, which takes the entity into the public company domain, complex and costly disclosures are required to protect investors (subject to some carve outs which don't assist crowd sourced funding). Likewise, offers to large numbers of small value investors through a trust is also regulated by similar legislation that covers governance and disclosure requirements designed to protect investors.

In the following Submission responses, the SME Committee will be limiting its comments to those issues which it believes are relevant for SME businesses and for which the SME Committee has knowledge.

Responses

The SME Committee responds to the Consultation Questions asked in the Consultation Paper as follows:

Appropriateness of the shareholder limit

1. Should the law be amended to increase the permitted number of non-employee shareholders in a proprietary company and what would be an appropriate limit?

   Answer

   The SME Committee's position is that the law should be amended. In the Committee's view the appropriate limit on the increased number of shareholders should be a calculation as a consequence of the minimum amd maximim investment amounts considered suitable to enable small business start ups and entrepreneurs to raise sufficient capital to allow their company to commence and gain traction in its activities over a reasonable period of time, while protecting the investors.

   If, for example, CSEF allowed a company (whether proprietary of public) to raise a maximum of $5 million over a 5 year period, and also wanted to set a cap of, say, $10,000 on the amount an investor could contribute, then the company would need to be able to have at least 500 shareholders, each investing the maximum.

   Or do companies with more than 50 non-employee shareholders have a sufficiently diverse ownership base with limited access to information or ability to influence the affairs of the company to justify the greater governance requirements currently placed on them?

   Answer

   Currently, companies with more than 50 non-employee shareholders, that is public companies, do have a sufficiently diverse ownership base, although often with limited access to management information and ability to influence the affairs of the company. The investors tend to be advised as the public company requires the increased governance placed on them as they currently can only raise capital (subject to certain exceptions) with costly regulated disclosure and tend to do so from the public through professional investment intermediaries.

2. What are the benefits and risks? For example, would raising the limit expose risks to shareholder protection?

   Answer

   The SME Committee considers that raising the permitted number of non-employee shareholders for proprietary companies should not raise risks for shareholder protection ability so long as the maximum amount of investment is set at an acceptable level that recognises an amount an investor could be prepared to risk with information receipt less than currently available in a prospectus.

3. Have there been changes to market practice or the broader operating environment such that shareholders and investors now have greater access to management or information about a company's performance?

   Answer

   In essence, the SME Committee notes that although in recent years social media and web-based access to information has changed the environment in which companies conduct their operations, shareholders and investors do not really have any greater

access to management or information about a company's performance than they have had in the past. Information provided to investors remains vetted by management with increased professional messaging resources to ensure the position of the company remains as attracive as possible. The only constraint on this messaging is the obligation not to be misleading or deceptive....which applies for all companies whether public or proprietary.

What are the ways by which management now remains accountable to shareholders or shareholders otherwise have access to information about a company?

Answer

Management remains accountable to shareholders through the disclosure regime applicable to the type of company, and through share price and required reporting regimes, which is also how shareholders obtain information not available through a company's web pages.

4. If the shareholder limit were increased, how should the law treat public companies which become eligible to be registered as proprietary companies but have issued shares under a disclosure document?

Answer

Public companies that become eligible to be proprietay companies but have issued shares under a disclosure document should remain obligated to comply with the information as set out in that disclosure document for those shareholder who invested as a consequence of that disclosure document.

Small scale offerings and other exceptions to the disclosure requirements

5. Should the law be amended to increase the 20 investor limit and/or the $2 million cap? What would be an appropriate limit? Should the $2 million cap be linked to increase in line with the consumer price index (CPI)?

Answer

The SME Committee considers that the small scale offerings limits may prove redundant should a CSEF regime become law. Alternatively, the limits on small scale offerings would need to be aligned to those available under CSEF. If the small scale offerings provisions are to be used to provide for CSEF, then the 20 investor limit and the $2million funding cap would need to be increased as set out on the Committee's answer to Question 1.

6. What are the benefits and risks of increasing the 20 investor limit and/or the $2 million cap? Who would benefit or bear the risk? Could there be unintended consequences from altering these limits, for example in terms of the definition of a sophisticated investor?

Answer

The Committee considers this will depend on which regulatory compliance requirements for public companies are maintained for exempt public companies. So long as the CSEF regime only maintains those requirements necessary to ensure appropriate investor protection in light of investor value loss risk, compliance costs for

the exempt public company itself should reduce so as to become viable compared with current compliance costs.

7. Could other exceptions to the requirement to issue a disclosure document provide benefits to small proprietary companies if amended?

   Answer

   In the Committee's view, so long as limits are imposed as proposed, even if companies use exempt public company structure for regulator arbitrage, the impact would be minimal.

Increasing flexibility in capital raising

8. Would increasing the shareholder limit for proprietary companies and/or expanding the small scale offerings exception to the disclosure requirements provide small proprietary companies with sufficient additional flexibility to raise capital?

   Answer

   The SME Committee considers that so long as the proposed caps and thresholds are appropriate to provide investor protection reflective of the value risk, and the appropriate limit on the increased number of shareholders is a calculation as a consequence of the minimum and maximum investment amounts considered suitable to enable small business start ups and entrepreneurs to raise sufficient capital to allow their company to commence and gain traction in its activities, while protecting the investors, increasing the shareholder limit for proprietary companies and/or expanding the small scale offerings exception to the disclosure requirements for public companies should enable small proprietary companies that are start ups or entrepreneurs sufficient additional flexibility to raise the capital they require.

   However, if the funding is to be enabled from the 'crowd', it may be that a minimum value limit needs to be imposed and a larger number of shareholders allowed to enable a small company looking to raise a large amount of money from a large number of very small investors.

Crowd-sourced equity funding

9. Should proprietary companies be able to access CSEF?

   Answer

   It is the position of the SME Committee that proprietary companies should be able to access CSEF in order to enable small business start ups and entrepreneurs to raise sufficient capital to allow their company to commence and gain traction in their activities, while protecting the investors.

   The SME Committee considers that proprietary companies are the most appropriate vehicle for small business start ups and entrepreneurs to look to raise funds through as the compliance obligations for public companies require increased support costs.

Consequently the Committee supports proprietary companies being able to access CSEF, but recognises that without an increase in shareholder number limits, the ability to raise funds would not be improved from the current position.

What are the implications for the corporate law framework of permitting proprietary companies to do so?

Answer

In the SME Committee's view, this does not change the priniciples upon which the Corporate Law framework is based, yet recognises the rapidly changing commercial environment in which companies operate and the public investors' increasing appetite to assist start ups and entrepreneurs, which also currently occurs through unregulated donation funding.

10. If the shareholder limit is not changed for all proprietary companies, should proprietary companies be able to access CSEF?

Answer

The benefit for proprietary companies in accessing CSEF would be lost if shareholder numbers are not increased to allow the raising of sufficient capital to allow a company to commence and gain traction in their activities.

If so, should the shareholder limit be changed specifically for proprietary companies using CSEF? What are the benefits and risks of this approach? Would the benefits outweigh the additional complexity of increasing the shareholder limit for a subset of proprietary companies?

Answer

The SME Committee considers that the number of non-employee shareholders needs to be assessed based upon the proposed caps and thresholds that are appropriate to provide investor protection reflective of the value risk, so that the appropriate limit on the increased number of shareholders is a calculation as a consequence of the minimum and maximum investment amounts considered suitable to enable small business start ups and entrepreneurs to raise sufficient capital to allow their company to commence and gain traction in its activities. The SME Committee considers that the proposed investor funding caps do adequately balance protecting investors and limiting investor choice, by limiting the investment value risk for the proposed 'crowd' investors and thereby should result in the maintenance of investor confidence in CSEF and therefore its sustainability as a fundraising model.

If the shareholder limit were to be increased only for proprietary companies using CSEF, is 100 non-employee shareholders an appropriate cap?

Answer

The Committee does not consider 100 non-employee shareholders to be a sufficient number to enable funding of the amounts proposed. The Committee notes that the number of shareholders contributes to the company's ability to raise capital. If the amount each investor is allowed to invest is capped, as is proposed to limit investment risk, and the total amount a company is allowed to raise is capped for CSEF purposes, then it should not be necessary to cap the number of shareholders; or if that number is to be capped, it should be large, for eg some thousands, to provide for large numbers of small value investors.

For example, to raise $5 million with a cap per investor of $10,000 would require 500 investors. If a minimum investment was set at, say $1,000, then that would require 5,000 investors at that minimum amount.

11. Should any increase in the shareholder limit solely for proprietary companies using CSEF be temporary, based on time and size limits? What are the benefits and risks of this approach?

    Answer

    An increase in shareholder number limits only for proprietary companies that access CSEF would, in the Committee's view, be quite appropriate given the purpose of CSEF. There would not be any increased complexity other than a proprietary company accessing CSEF by meeting the CSEF disclosure rules, and maintaining appropriate records of investors/shareholders. Benefits would outweigh any additional complexity for those proprietary companies that choose to access CSEF.

    If the increased shareholder limit is temporary, what arrangements should apply when a company is no longer eligible for the higher shareholder limit (owing either to the expiry of the time limit or exceeding the caps on company size)? Should it be required to convert to a public company? Or should it have the option to conform with the general proprietary company obligations, including the non-employee shareholder limit?

    Answer

    The Committee considers that an increase in the shareholder limited for proprietary companies using CSEF should not be temporary. However, if after a period of time (eg 5 years) the company has increased its value to a set level, the CSEF regime perhaps should require the company to convert to a public company and take on the applicable compliance obligations. Alternatively, the Committee acknowledges that such a company should be given the option of repurchasing shares so as to revert to conforming with general proprietary company obligations rather than having to convert to a pubic company.

12. If permitted to access CSEF, should proprietary companies using CSEF be subject to additional transparency obligations when raising funds via CSEF?

    Answer

    The SME Committee's position is that the disclosure obligations for proprietary companies that access CSEF should be the same as that of public companies that access CSEF. The investor protection requirements should be the same and should be kept to the minimum required to enable an investor to be sufficiently informed to make a capped investment without being misled or deceived into doing so.

    These obligations should only apply while the proprietary company accesses CSEF, and, as in the answer to Question 11, should the company after a period of time either revert to the general proprietary company regime or convert to be a public company, those CSEF obligations would cease to apply.

    Do you agree with the proposals for annual reporting and audit? Should these be implemented by requiring proprietary companies that have used CSEF to comply with the obligations of large proprietary companies? Should any other obligations apply?

Answer

The SME Committee's position is that the disclosure obligations for proprietary companies that access CSEF should be the same as that of public companies that access CSEF and that, in both cases, the obligations should be more than currently applies for small proprietary companies but less than for public companies, The Committee considers the obligations of large proprietary companies would be appropriate.

Given the Government has committed to introducing a CSEF framework for public companies that will include certain reporting exemptions, what are the benefits of permitting proprietary companies to use CSEF when they would be subject to additional transparency obligations?

Do you agree that these obligations should be permanent?

Answer

The Committee believes that additional reporting requirements for proprietary companies that access CSEF should be acceptable to enable proprietary companies that are small business start ups and entrepreneurs to raise sufficient capital to allow their company to commence and gain traction in its activities. The benefits of being able to raise capital would outweigh any additional complexity for those proprietary companies that choose to access CSEF.

13. Do you consider that an annual fundraising cap of $5 million, and eligibility caps of $5 million in annual turnover and gross assets, are appropriate for proprietary companies using CSEF? If not, what do you consider would be appropriate fundraising caps and eligibility criteria?

    Answer

    In the SME Committee's view an annual fundraising cap of $5 million, and eligibility caps of $5 million in annual turnover and gross assets are currently appropriate for SME proprietary start ups and entrepreneurs. The Committee suggests that these amounts be increased annually in line with the CPI.

14. Are there any other elements of the CSEF framework for public companies that should be amended if proprietary companies were permitted to use CSEF?

    Answer

    The SME Committee's position is that the disclosure obligations for proprietary companies that access CSEF should be the same as that of public companies that access CSEF. The investor protection requirements should be the same and should be kept to the minimum required to enable an investor to be sufficiently informed to make a capped investment without being misled or deceived into doing so.

    These obligations should only apply while the proprietary company accesses CSEF, and, as in the answer to Question 11, should the company after a period of time either revert to the general proprietary company regime or convert to be a public company, those CSEF obligations would cease to apply.

    In the Committee's opinion obstacles to CSEF that exist under the status quo would certainly drive potential issuers, intermediaries and investors to move to jurisdictions that have implemented CSEF regimes. Further, as 'crowd' sourced funding has developed through social media forums, the jurisdictional location of the platform hosting the 'issue' may not be Australia.

The SME Committee queries whether it would be appropriate for SME Start ups and entrepreneurs to utilise intermediaries looking to assists companies accessing CSEF by providing access to investors through the intermediary's platform. Such an access structure would require the SME Start up or entrepreneur to suffer fees payable to the intermediary. The intermediary industry no doubt is enthusiastic to assist companies that wish to access CSEF but given the objective of raising small amounts (up to $5 million) the fees charged by intermediaries would of necessity be a cost an SME start up or entrepreneur would often choose best not to incur.

The solvency resolution

15. Should the requirement to make a solvency resolution be removed or modified? Is there a more effective way to remind directors of their obligations? For example, would aligning the timing of the resolution with tax or other obligations with fixed timing reduce the regulatory burden?

    Answer

    The SME Committee considers that the requirement for directors of small proprietary companies to make an annual solvency resolution is appropriate and a useful reminder to directors of their obligations to ensure their company does not trade whilst insolvent. The Committee considers that it may be beneficial to align the timing of the making of the resolution with the making of the company's tax return so that the minds of directors can focus on the financial position of the company at the same time.

16. What is the extent of the burden imposed on small proprietary companies to make the resolution, in terms of time and/or financial cost?

    Answer

    The SME Committee from the experience of its members does not consider the making of a solvency resolution to impose any unreasonable time or costs on directors of small proprietary companies.

17. What is the value to directors of the annual solvency resolution in reminding them of their ongoing solvency obligations?

    Answer

    The SME Committee considers the making of an annual solvency resolution to be a very valuable opportunity to remind directors of small proprietary companies of their obligation to not allow the company to trade whilst insolvent.

18. Would removing the requirement to make a solvency resolution be likely to increase rates of insolvency or business failure among small proprietary companies? Would unsecured creditors be exposed to increased risk? Are there other risks associated with removing the requirement?

    Answer

    In the SME Committee's view, removing the requirement to make a solvency resolution would likely increase the risk of insolvency or business failure among small proprietary companies and expose unsecured creditors to increased risk of company failure.

Could the risks be mitigated adequately by ASIC reminding directors periodically (say, annually) of their duty to prevent insolvent trading by the company? Are there other ways to mitigate the risks?

Answer

ASIC could look to mitigate such risks with reminders, but from the Committee's experience, the passing of the directors' resolution of itself focusses directors on the solvency position and valuably reminds them of their obligations in a way the receiving of a reminder from ASIC would not do.

The share register

19. What is the extent of the burden imposed on small proprietary companies to establish and maintain a share register, in terms of time and/or financial cost?

    Answer

    The SME Committee does not consider the time and financial costs for proprietary companies to maintain a share register to be burdensome. It is more a matter of those who manage such companies recognising that they are required to maintain a share register.

20. What is the value to small proprietary companies of maintaining a share register? Would companies need to maintain similar records even if the law did not require them to?

    Answer

    The Committee considers that it is essential for a small proprietary company to maintain a share register so that accounting and tax records can ensure the right people receive dividends and to enable entitlement shareholders to vote to determine appointment of directors and other shareholder decisions.

21. Should the requirement to maintain a share register be removed for small proprietary companies with up to 20 shareholders, given that ASIC's records duplicate the information in the share register of such companies?

    Answer

    The SME Committee does not consider it would be sensible to remove the requirement for small proprietary companies to maintain a share register and would be concerned about small proprietary companies maintaining accurate ASIC records, with no company record with which to reconcile the ASIC records.

    This would become particularly relevant for small proprietary companies that choose to access CSEF.

22. If the requirement were removed for small proprietary companies with up to 20 shareholders:

- how could share ownership be transferred? Could transfer take effect via a different mechanism, such as on notification to ASIC or on acknowledgment from the company?

- how would shareholders be able to ascertain the identity of the other shareholders of a company? Would it be reasonable to require shareholders to obtain the information from ASIC (including paying the required fee)?

Are there other situations or circumstances where small proprietary companies with up to 20 shareholders need to have an up-to-date share register?

Answer

In the SME Committee's view, if the requirement were removed for small proprietary companies with up to 20 shareholders, share ownership could be transferred by notification to ASIC and a change on the electronic registry records, as is currently done for listed companies.

Shareholders should be able to ascertain the identity of other shareholders by request, although paying a fee does not seem appropriate to the SME Committee given that the records are for a proprietary company.

Small proprietary companies require an up to date share register for dividend payments and shareholder voting requirements. The SME Committee considers that relying on ASIC to maintain the share registry of small proprietary companies is not appropriate as set out above.

23. Alternatively, should the requirement for small proprietary companies to maintain a share register be modified? If so, how? For example, should small proprietary companies with up to 20 shareholders continue to retain a share register but no longer be required to notify ASIC each time shareholder details change?

Answer

The SME Committee sees no need to modify the requirement for small proprietary companies to maintain a share register or for them to notify ASIC of changes to shareholding. This obligation to notify ASIC should cause them to ensure their share register is maintained as up to date.

24. Would removing/modifying the requirement to maintain a share register be likely to increase the risk of minority shareholder or property rights disputes for small proprietary companies? Are there other risks associated with removing the requirement?

Answer

In the SME Committee's view and from its experience, removing or modifying the requirement for small proprietary companies to maintain a share register will almost certainly increase the risk of minority shareholder or proprietary rights disputes without there being any record of proof as there currently is.

Execution of documents

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?

Answer

From the SME Committee's experience the current law does not cause any problems or increase compliance costs or require increased time or costs for sole director/no secretary companies or their counterparties in executing documents.

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?

    Answer

    The SME Committee considers the suggested amendment to the law would be appropriate.

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?

    Answer

    The SME Committee has no issue with split execution and does not see any additional time or costs would apply. In practice, split execution, as with documents executed in counterpart, is more efficient than having to pass the document around for execution by all signatories on the same copy.

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?

    Answer

    The SME Committee is unable to answer these questions as it has not has experience in the topic.

ASIC forms

29. Could any forms which are used by small proprietary companies and prescribed by the Corporations Act or Corporations Regulations be removed, amended or streamlined to reduce the compliance burden? How much time/money would it save you?

    Answer

    The SME Committee is unable to answer this question.

Other ways to reduce compliance costs

30. Are there any other requirements under the Corporations Act which impose unnecessary compliance burdens on small proprietary companies? What is the extent of the burden in terms of time and/or financial cost? How could the burden be reduced?

Answer

The SME Committee is unable to answer this question.

Further discussion

The SME Committee would be happy to discuss any aspect of this submission.

Please contact Coralie Kenny, the Chair of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully,

John Keeves, Chairman
Business Law Section

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Dear Sir or Madam,

Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses – Consultation Paper August 2015

Introduction

The Corporations Committee of the Business Law Section of the Law Council of Australia (**Corporations Committee**) welcomes the opportunity to make a submission in response to this Consultation Paper (**Consultation Paper**).

This is the third submission made by the Corporations Committee on the vitally important topic of CSEF (the other two being the response to the CAMAC Discussion Paper of September 2013 and the response Treasury's Discussion Paper of December 2014).

The Consultation Paper also raises interesting questions about the nature of the proprietary company and 'red tape' reduction issues that the Corporations Committee acknowledges are worthy of discussion. Our comments follow.

Section 2 Crowd-Sourced Equity Funding Framework for Public Companies

The Corporations Committee agrees that, in principle, the proposed CSEF framework for public companies is an acceptable one (even though our previous submissions may not have been precisely to the same effect).

We make this statement subject to seeing an exposure draft of the legislation as the proposed framework, naturally, is no more than 'bare bones' outline of what is proposed.

The Corporations Committee welcomes the Government's indication that an exposure draft will be released for public comment in the 2015 Spring Session of Parliament. The Corporations Committee considers that it is vitally important for start-ups and emerging companies and therefore the economy that CSEF be legislated for at the earliest possible opportunity.

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As for the proposed legislation, some (but not all) of the key issues that the Corporations Committee considers will need to be addressed are:

1. Will an issuer have to commit to raising a nominated sum of money?
2. Will the issuer be able to change that sum (upwards or downwards) after the offer has opened?
3. When during the period of an offer will the intermediary be able to release funds raised or alternatively, be obliged to return them to investors?
4. When will an intermediary be able to deduct its fees and costs both where the offer is successful or where funds are returned to investors for whatever reason?
5. What is the extent of the prohibition on an intermediary providing investment advice?
6. The regulatory requirements for an intermediary to obtain an AFSL (the Corporations Committee considers the requirements should not be too onerous and should not encourage issuers and intermediaries to engage in regulatory arbitrage by setting up in New Zealand).

Section 4 Increasing Flexibility in Capital Activity and Section 5 Extending Crowd-Sourced Equity Funding to Proprietary Companies

General Observation

Given that CSEF as the model for injecting flexibility (both legal and commercial) in fund raising for 'smaller enterprises' has been under active consideration for an extended period of time and that there has been considerable public consultation about it, the Corporations Committee is surprised to see that the Government is now consulting about a potential further adjustment to this model that would involve changes to the nature and structure of proprietary companies.

The Corporations Committee's view is that there should be no changes to proprietary companies along the lines suggested by the Consultation Paper in sections 4 and 5. The 'standard' proprietary company should not be able to access CSEF.

The distinction between public companies and proprietary companies in Australian company law is long standing and is justifiable for sound legal, commercial and consumer protection reasons. Proprietary companies are 'closely held' entities for the most part and it is for this precise reason that they have been relieved of the obligations imposed on public companies as to financial reporting, disclosure and accountability generally. Permitting them to access funds from the public (outside of what they can do under section 708 *Corporations Act* 2001 (**Act**)) would run counter to this reasoning.

The addition of a CSEF framework is an appropriate step forward to provide further flexibility in the fundraising area and should be given a chance to operate for at least 2 years to see if it has ameliorated most, if not all, of the concerns raised by those persons who contend that the proprietary company structure is too restrictive as an 'entrepreneurial vehicle' before further changes to company structures and the rules that apply to them are considered.

If the Government considers that a review is required of corporate structures in Australia, then the Corporations Committee considers that a 'root and branch' review of that issue would be more appropriate than raising the issue through the Consultation Paper.

Given our general observation, we will only respond to certain of the consultation questions posed in sections 4 and 5 as follows:

1. **Question 3** – whether the non-employee shareholder limit is left at 50 or increased to 100 (or some other figure), the Corporations Committee is unaware of any changes to market practice or the broader operating environment such that shareholders and investors now have greater access to management or information about a company's performance.

   The difficulties non-controlling shareholders and investors have in obtaining information from controllers who either engage in 'bad conduct' or who simply lack the skills to perform in accordance with their statutory duties are as prevalent as always.

2. **Question 5** – as a stand-alone issue, the Corporations Committee considers that the small scale offering rule could be updated by increasing the investor limit to 50 (from 20) and by increasing the amount to $5 million (from $2 million) (the $5 million sum would then match the limit that currently applies to those operating under ASIC Class Order 02/273 (Business Introduction or Matching Services)). These numbers should be reviewed periodically. Consideration should also be given to whether the definition of 'personal offer' should be changed or abolished.

   However, the Corporations Committee considers that any change to the small scale offering rules would need to dovetail and be consistent with the CSEF legislation and therefore reserves its final position on this issue for the time being.

Section 6 Reducing Compliance Costs for Small Proprietary Companies

The Corporations Committee supports all efforts to reduce red tape for companies, particularly as imposed by the Act. Again, as a general observation, the Corporations Committee encourages the Government to undertake a broader review of the Act to see what red tape reductions can usefully be made other than the three issues identified in the Consultation Paper.

6.2 Making an Annual Solvency Resolution

Questions 15 to 18

The Corporations Committee does not consider that the requirement that small proprietary companies make an annual solvency declaration imposes any material burden on them in terms of time or cost.

The Corporations Committee, however, is of the view that the requirement adds nothing to the mind set of directors of small proprietary companies as to whether their company is solvent or not. It is another form to complete and sign and then file away.

The Corporations Committee does not consider that the annual solvency declaration is an effective tool in reminding directors of their obligation not to engage in insolvent trading and should be removed. Such removal would have no material, if any, bearing on the rates of insolvency or business failure.

The Corporations Committee does consider that it is very important that directors regularly focus on whether or not their companies are solvent and suggests that ASIC should

consider other more meaningful ways to keep this issue at the forefront of directors' minds than the annual solvency declaration.

6.3 Maintaining a Share Register

Questions 19 to 24

The Corporations Committee does not support the removal of the requirement for a small proprietary company to maintain a share register. Every company must know the identity of its shareholders and would need to have a record of them regardless of whether the law required the keeping of a share register or not. In terms of shareholder disputes, of which there are many relating to small proprietary companies, the state of the share register is often vital in founding various legal actions including an application to correct the register under section 175 of the Act. In some instances, the share register can be another method of checking the accuracy on the ASIC register for that company.

The Corporations Committee does not consider that the requirement that small proprietary companies maintain a share register imposes any material burden on them in terms of time or cost and considers that all changes to the shareholders of any (non-public) company should be notified to ASIC, as is the case now.

Under cover of that position, the Corporations Committee, in principle, supports moves to digital record keeping provided that the highest level of security and privacy for these records can be maintained. The Corporations Committee notes the many instances of confidential data bases being hacked and altered; perhaps until these problems are eliminated, certain paper records, such as the share register, should be maintained as a back-up source of information.

6.4 Facilitating the Execution of Documents

Question 25 – The Corporations Committee is unable to comment on the extent of compliance costs that sole director/no secretary companies and their counterparties face in executing documents but acknowledge that it is a difficulty that should be ameliorated by an appropriate legislative fix.

Question 26 – the Corporations Committee supports this proposal.

Question 27 – the matter of 'split execution' is an issue especially, for banking and finance lawyers who are required by financiers to provide an opinion about due execution of documents. If officers are required to sign at the same time and place, then the flexibility offered by 127 will be unavailable and will inevitably increase the costs of arranging the execution of documents, in certain circumstances.

The Corporations Committee supports amending the Act to make it clear that directors and company secretaries can sign documents at different times and places and that the assumptions in sections 128 and 129 of the Act apply in those circumstances.

As an aside, the Corporations Committee supports the re-introduction of the requirement for non-public companies to lodge their Constitutions with ASIC. In a number of areas, reliance on the indoor management rule, is not always the most prudent or commercially or legally effective way of dealing with issues that arise when dealing with small

proprietary companies, for instance in shareholder and director disputes where knowledge of what the Constitution says or whether one exists can be of vital importance.

Question 28 – the Corporations Committee agrees there is an issue regarding the execution of deeds by foreign companies and supports the adoption of the UK approach in the Act for foreign companies only. The Corporations Committee does not see any risks in adopting this position; there are clear benefits in removing this concern as an issue for foreign companies.

6.5 Completing and Lodging Prescribed Forms with the Regulator

Question 29 – The Corporations Committee does not consider, at this time, that there are any forms that need to be removed, amended or streamlined to reduce the compliance burden on small proprietary companies.

6.6 Other Ways to Reduce Compliance Costs

Question 30 – Within the time available to respond to the Consultation Paper, the Corporations Committee has had insufficient time to canvass its members about this issue. Again, the Corporations Committee considers that this question needs a more considered review of the Act as it applies to small proprietary companies.

At this time however, the Corporations Committee does not have any particular comments to make about reducing unnecessary compliance burdens on small proprietary companies.

Further Discussion

The Corporations Committee would be pleased to discuss our submission. Please contact the Chair of the Corporations Committee, Bruce Cowley by telephone on (07) 3119 6213 or by email at bruce.cowley@minterellison.com should you wish to do so.

Yours sincerely,

John Keeves, Chairman
Business Law Section