COMPANIES UPDATE

Related Party Transactions

Australian Securities and Investments Commission releases updated regulatory guide

Introduction

Where a company wishes to enter into a related party transaction, Directors must address how they will meet their obligations under sections 207 to 230 of the Corporations Act 2001 (**Chapter 2E Requirements**), as well as the obvious conflict of interest issues that arise in these cases.

The Australian Securities and Investments Commission (**ASIC**) has recently updated its Regulatory Guide 76 – Related Party Transaction (**Regulatory Guide 76**). Directors should be aware of the criteria set out in Regulatory Guide 76 when considering entering into a related party transaction.

This Companies Update focuses on only two of the issues addressed in Regulatory Guide 76:

1. Assessing whether a related party transaction can be considered at "arms – length".
2. Standards which apply to the information given to shareholders in the notice of meeting seeking shareholder approval to a related party transaction.

Regulatory Guide 76 also states ASIC's views on a number of related matters such as Directors' meetings voting restrictions and the level of information regarding related party transactions that should be given in any disclosure document issued by a company.

Assessing whether a related party transaction can be considered at "arms – length"

Under the Corporations Act 2001 the definition of what is a financial benefit and the entities which may be a related party are broadly defined under the Chapter 2E Requirements. The preliminary issue of determining whether a financial benefit is being given to a related party is not expressly dealt with in this Companies Update.

The ASIC guidance states that a Board, when making an assessment as to whether a related party transaction is on arm's length terms and reasonable in the circumstances, should consider at least the following matters:

(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;

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

(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;

(d) any other options that may be available to the entity; and

(e) expert advice received by the entity on the transaction (if any)." [1]

The above items are the factors that ASIC considers a Board should address when making its assessment. These are not the only factors which a Board may take into account when making its determination that a related party transaction is on an "arm's length" basis and therefore shareholder approval to enter into the transaction is not required.

The "arm's length" exception also requires that a Board consider at all times the circumstances of the transaction when determining whether or not the transaction is on an "arm's length" basis.

Therefore, as part of the procedures for determining whether or not a transaction which provides a financial benefit to a related party, is on an "arm's length" basis, it would be prudent for Directors to make a record evidencing that they have assessed the proposed transaction based on the criteria set out in Regulatory Guide 76.

Standards which apply to the information given to shareholders in the notice of meeting seeking shareholders approval to a related party transaction

Regulatory Guide 76 states that if the Board can not determine conclusively that a transaction falls under any exception under Chapter 2E (including

the "arm's length" exception) then shareholder approval should be obtained. The meeting material must provide members enough information to enable members to decide if the financial benefit to be given to the related party is in the best interests of the company.

Regulatory Guide 76 contains a discussion of those matters which are to be included in order for a company to demonstrate its compliance with the section 219 requirements of the Corporations Act 2001. The notice must include:

- Identity of the related party
- Nature of the financial benefit
- Directors' recommendations (and if a recommendation can not be given why not)
- Directors' interest in the outcome
- Information reasonably required by shareholders to decide whether or not the transaction is in the company's interests
- Valuation of the financial benefit
- Disclosure of a relevant director's total remuneration package
- Related party's existing interest
- Dilution effect of the transaction on existing members' interests

There is no express obligation under the Chapter 2E Requirements for a company to obtain an independent valuation of the financial benefit. Regulatory Guide 76 states that ASIC's view is that companies are encouraged to obtain and give to shareholders an independent expert's report regarding the value of the benefit where the circumstances in (a) to (c) below apply.

(a) "the financial benefit is difficult to value;

(b) the transaction is significant from the point of view of the entity; or

(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."[2]

Conclusion

The ASIC has set out in Regulatory Guide 76 its view on how a company is to meet its Chapter 2E Requirements. Boards will need to be able to demonstrate that as part of their decision making process they have acted in accordance with the guidance provided. In addition where a Board elects to seek shareholder approval the criteria regarding the standard of information to be given to shareholders as set out in Regulatory Guide 76 will need to be followed.

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This fact sheet provides general information only and does not constitute legal advice.

Notes

[1] Regulatory Guide 76 - paragraph 76.70

[2] Regulatory Guide 76 – paragraph 76.104