Submission to the Commonwealth Treasury

Exposure Draft
Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014

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Introduction

This submission addresses the proposed changes in the Corporations Legislation Amendment (Deregulation and Other measures) Bill 2014. The aim of this submission is to provide an informed debate on the critical issues raised by the Bill.

If any of the responses require further explanation, please contact Dr Marina Nehme at the UNSW Australia, Faculty of Law at m.nehme@unsw.edu.au.

General Observations

The Corporations Legislation Amendment (Deregulation and Other measures) Bill 2014 aims to improve the operation of the *Corporations Act 2001* (Cth), and alter certain provisions that may impose unreasonable burden on businesses.[1]

The observations made in this submission can be summarised in the following manner:

- Support the abolition of the '100 member rule'; and
- Support the change regarding dividend;
- Recommend clarification of the definition of the 'solvency test'.

100 Member Rule

The proposal to repeal the '100 member rule' isn't a novel one. It has been raised and discussed at length in the past decade. [2] The most compelling reasons for which this issue is raised time and time again are:

- There is no 'degree of parity between five per cent of votes and 100 members.'[3] The arbitrariness of the 100 member rule was highlighted by Windeyer J in *NRMA v Snodgrass*[4] when his Honour noted that it is 'extraordinary that in a company… with about 2 million members a general meeting can be summoned by requisition of 100 members, namely one in every 20,000 or 0.005 percent.' In the continuum of

[1] Explanatory Memorandum, Corporations Legislation amendment (Deregulatory and Other Measures) Bill 2014, 1.

[2] Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on Matters arising from the Company Law Review Act 1998*, 1999 noted that the 100 shareholder threshold was "administratively complex and uncertain"; the Companies and Securities Advisory Committee, *Shareholder participation in the Modern Listed Public Company: Final Report*, June 2000, 9 recommended that the 5% of share capital be the sole criterion for member initiated general meetings; the *Corporations Amendment Regulation 2000* altered the 100 member rule to 5% of shareholders but was repealed by the Senate in June 2000 and further, unsuccessful amendment attempts were made by virtue of the *Corporations Amendment Bill (No. 4) 2002* (Cth) and the *Corporations Amendment Bill (No. 2) 2006* (Cth).

[3] New South Wales Young Lawyers, *Response to the Eposure Draft Bill for Consultation – Corporations Amendment Bill (No. 2) 2006,* 2006, 4.

[4] [2001] NSWSC 76, [10].

proprietary and listed/unlisted public companies, the 100 member rule is arbitrary as it is unlikely to be relied on in the case of a proprietary company (see membership requirements under s 113(1) of the *Corporations Act 2001* (Cth)) or it may be misused by a bare minority (in the case of a public company that has millions of shareholders).

- The repeal of the 100 member rule will bring s 249D in line with s 249F and thereby ensure consistency in the *Corporations Act 2001* (Cth).

- The cost of complying with requests made by a small proportion of shareholders is substantial.

Consequently, this submission supports the removal of the 100 member rule to call a general meeting.

Dividend

The payment of dividend characterises the return on investment by shareholders of the company.[5] For a long period of time, the principles governing the payment of dividend were based on the English system which required that dividend should only be paid out of profit. The application of such a test however was problematic. One of the major concerns related to the fact that the word 'profit' was not defined. Further, the guidance from the court decisions regarding the meaning of 'profit' was deemed outdated, complex and not in line with the current accounting standards.[6]

To remedy these concerns, in June 2010, the test for the determination of the payment of dividend was altered. Section 254T(1) now states:

> A company must not pay a dividend unless:
> (a) the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend; and
> (b) the payment of the dividend is fair and reasonable to the company's shareholders as a whole; and
> (c) the payment of the dividend does not materially prejudice the company's ability to pay its creditors.

Consequently, there was a move away from the profit test. For dividend to be paid, all the requirements in s 254T(1) must have been complied with. However, the current test has been subject to criticism. For example:

- One question that may be raised relates to whether or not the new provision requires the accounting standards to be applied at the time of payment in addition to the time

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[5] Kris Arjunan and Chee Keong Low, 'Dividends: A Comparative Analysis of the Provisions in Hong Kong and Australia' (1995) 5 *Australian Journal of Corporate Law* 455, 455.

[6] Wai-Meng Chan, S Susela Devi, Sai-Leong Lee and Kok-Thy Ng, 'Convergence to International Financial Reporting Standards (IFRS): The Need to Tighten the Rule on Divisible Profit' (2010) 4(17) *African Journal of Business and Management* 3588, 3591.

when the financial results are signed off on. If that is the case, what accounts should be relied on at the time of payment of the dividend? Should these accounts be audited?[7]

- The meaning of creditor under s 254T(1)(c) has raised some queries. Is the reference to company's 'creditors' a "reference to the persons who would be entitled to prove in a hypothetical winding up"?[8]

- When considering s 254T(1)(b), the following question may be raised: what would constitute fairness to the members? For instance, if a company refuses to pay dividend to members as it wishes to preserve cash and raise its capital, would this be deemed as unfair to shareholders?[9] Determining the answer to this question is important as studies have highlighted that retail shareholders may influence which dividend policy the company is going to adopt.[10]

The introduction of a pure solvency test for the payment of dividend may remedy the criticism that the current test faces. However, the solvency test may still raise certain question. One of the key questions is the following: How will the solvency of a company be assessed? Will it be assessed based on the test under s 95A of the *Corporations Act 2001* (Cth)? The current Bill is silent regarding this matter.

The solvency test for the payment of dividend is adopted in New Zealand.[11] Under the companies Act 1993 (NZ), solvency is assessed based on two limbs:[12]

- The liquidity limb which requires that the company is able to pay its debt as they become due in the normal course of business (similar to the test under s 95A of the *Corporations Act 2001* (Cth)); and
- Balance Sheet limb which requires that the value of the assets of the company exceed the value of the liabilities of the company (including contingent liability).

It may be beneficial for such a test to be adopted in Australia as it will ensure greater protection to creditors as the test will not just be reliant on the cash flow test.

Dr Marina Nehme

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[7] Jason Harris, Anil Hargovan and Michael Adams, *Australian Corporate Law* (Lexis Nexis, 3rd ed, 2011), 644.
[8] *In the Matter of Centr Properties Limited and CPT Manager Limited in its Capacity as Responsible Entity of Centro Property Trust* [2011] NSWSC 1171 (5 October 2011), [48].
[9] Harris, Hargovan and Adams, above n 3, 644.
[10] King Fuei Lee, 'Retain Minority Shareholders and Corporate Reputation as Determinant of Dividend Policy in Australia' (2010) 18(4) *Pacific-Basin Finance Journal* 351.
[11] *Companies Act 1993* (NZ), s 52.
[12] *Companies Act 1993* (NZ), s 4.