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31 August 2015

General Manager
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

**BY EMAIL – smallptycompanies@treasury.gov.au**

Dear Sir / Madam

**FACILITATING CROWD-SOURCED EQUITY FUNDING AND REDUCING COMPLIANCE COSTS FOR SMALL BUSINESS – RESPONSE TO AUGUST 2015 CONSULTATION PAPER**

Thank you for the opportunity to respond to the above Consultation Paper.

Our response addresses the majority of your questions and draws upon the author's 25 years of commercial law experience advising some of the country's leading or otherwise significant commercial, research and development, technology, educational and financing market participants and peak bodies.

On crowd-sourced equity funding, our response references our 25-27 August 2014 submissions to the Financial Systems Inquiry and are not repeated here.

We do hope that you find our response of assistance in your deliberations.

Yours faithfully

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# FACILITATING CROWD-SOURCED EQUITY FUNDING AND REDUCING COMPLIANCE COSTS FOR SMALL BUSINESS

## RESPONSE TO AUGUST 2015 CONSULTATION PAPER

31 AUGUST 2015

| Consultation questions | |
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| **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?*<br>*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?* |
| | To better align with seed, Series A and Series B funding and the early life of a start-up company established as a proprietary company, we recommend that none of the shareholdings of friends (who may opt in as such), family (as to which, see s318 of the *Income Tax Assessment Act 1936*, defining "associate"), professional services providers, substantial trade creditors (i.e., >5% by amount of all trade creditors) and substantial financiers (i.e., >5% by amount of all non-trade creditors) be counted towards a limit on the number of shareholders that a proprietary company may have. The number of shareholders that a proprietary company has on top of shareholders of these classes is, in our submission, of lesser consequence. Either 20 or 50 shareholders in addition to such shareholders may well be specified, but we incline to 20 (*cf.*, for managed investment scheme registration, s601ED of the *Corporations Act 2001* – alignment in calculation and number would enhance business efficiency). Offers to any member of the classes of person we have referred to in answer to this question ought, we submit, be specified in s708 of *the Corporations Act 2001* as not requiring disclosure under Part 6D.2 of the *Corporations Act 2001*. |
| **2** | *What are the benefits and risks? For example, would raising the limit expose risks to shareholder protection?* |
| | It is submitted that the principal benefits of adopting the approach proposed in answer to question 1 are: (1) better alignment to what is happening now in the life of Australian start-up companies; and (2) that a wider class of persons, these persons, who are not considered in determining this limit is of greater practical worth than any specific number. |

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| **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? What are the ways by which management now remains accountable to shareholders or shareholders otherwise have access to information about a company?* |
| | We have elected not to respond to this question. |
| **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?* |
| | The identified issue could be an issue under the *Corporations Act 2001* as it stands. We do not consider that the introduction of, say, a regime for the regulation of crowd-sourced equity funding would markedly heighten the identified issue as being of concern. |
| **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)?* |
| | On the investor limit, please see our response to question 1. On the monetary limit, we support indexation. |
| **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?* |
| | We have elected not to respond to this question. |
| **7** | *Could other exceptions to the requirement to issue a disclosure document provide benefits to small proprietary companies if amended?* |
| | Yes. Please refer to our response to question 1. |
| **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?* |
| | Please refer to our response to question 1. |

| Crowd-sourced equity funding | |
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| **9** | *Should proprietary companies be able to access CSEF? What are the implications for the corporate law framework of permitting proprietary companies to do so?* |
| | As part of the second round of submissions to the Financial Systems Inquiry (the Murray Inquiry), we analysed at length CAMAC's May 2014 report, Crowd Sourced Equity Funding and made submissions of wider import and impact. Apart from a concern as to the ability of investors to exit their investment once made (the plot of *The Wolf on Wall Street* and the events on which it is based provide a salutary lesson), we repeat our submissions there made and invite you to consider them. |
| **10** | *If the shareholder limit is not changed for all proprietary companies, should proprietary companies be able to access CSEF?*<br>*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?*<br>*If the shareholder limit were to be increased only for proprietary companies using CSEF, is 100 non-employee shareholders an appropriate cap?* |
| | Please see our Murray Inquiry submission and our response to question 9. |
| **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?*<br>*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?* |
| | Please see our Murray Inquiry submission and our response to question 9. |
| **12** | *If permitted to access CSEF, should proprietary companies using CSEF be subject to additional transparency obligations when raising funds via CSEF?*<br>*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?*<br>*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?*<br>*Do you agree that these obligations should be permanent?* |
| | Please see our Murray Inquiry submission and our response to question 9. |

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| **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?* |
| | Please see our Murray Inquiry submission and our response to question 9. |
| **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?* |
| | Please see our Murray Inquiry submission and our response to question 9. |
| **Making an annual 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?* |
| | The requirement should remain. It is an effective way to remind directors of their obligations as to solvency, particularly following a lessening of the importance of the amount of a company's issued share capital. |
| **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?* |
| | The burden is small when compared to the benefit to those with whom companies deal. |
| **17** | *What is the value to directors of the annual solvency resolution in reminding them of their ongoing solvency obligations?* |
| | We consider an annual reminder to be of great value. |
| **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?*<br>*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?* |
| | Removal of the requirements could in our view appreciably increase rates of insolvency and risk. |
| **Maintaining a 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?* |
| | In context, we consider the burden to be insignificant. |

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| **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?* |
| | Shares are created and are transferable by registration. Like other species of choses in action transferable by registration, the existence and situs (location) of shares are key and turn on the share register (for companies, see ss176 and 1072F of the *Corporations Act 2001*). The location as a matter of law of shares in a company is of central importance to questions of domestic and international taxation, succession, stamp duty and secured financing. |
| **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?* |
| | ASIC's records are not duplicative of share registration. There is in many cases indeed a difference between the state of a company's share register and the state of ASIC's database as it concerns members of a company. A workable ASIC share register replacement would need elements of the functionality and timeliness of the PPS Register. The introduction of such functionality and timeliness of the necessary breadth would be a major project indeed, in terms of time, cost, money, training and personnel. |
| **22** | *If the requirement were removed for small proprietary companies with up to 20 shareholders:*<br>• *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?*<br>• *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)?*<br>*Are there other situations or circumstances where small proprietary companies with up to 20 shareholders need to have an up-to-date share register?* |
| | The requirement should not be removed. Please refer to our response to question 20. |
| **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?* |
| | No. |
| **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?* |
| | Yes and Yes. Please refer to our response to question 20. |

| Facilitating the execution of documents | |
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| **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?* |
| | Yes it can and unknown. |
| **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?*<br>*Are there any risks associated with this approach? Are there any alternative approaches?* |
| | Yes. We see no risks of consequence. There are alternative approaches but we see an amendment of a type implicit in your question to be the best course. |
| **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?*<br>*What are the benefits and risks of specifying in the law that split execution is acceptable?* |
| | Yes. Co-location of officers of a company has lessened with technological developments in means of communication. Facilitating execution of documents by company officers would heighten business efficiency without undue risk. |
| **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?*<br>*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?* |
| | We do not consider that execution of deeds by foreign companies is an issue of consequence. We do not foresee difficulties arising by the introduction into the *Corporations Act 2001* of provisions that follow the referenced UK approach. |

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| **Completing and lodging forms with the regulator** | |
| **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?* |
| | We have elected not to respond to 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?* |
| | We have elected not to respond to this question. |

Yours faithfully

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31 August 2015