

Directors' notifiable interests, material personal interests and related parties

Memorandum of Understanding

Executive Summary

1.1 The following relates to the obligations of a director of a listed company to notify the Australian Securities Exchange (ASX) of relevant interests in securities held in the company, and to provide guidance on the meaning of 'related party' of a listed entity in relation to the ASX Listing Rules.

1.2 There are several provisions under the Corporations Act 2001 (Cth) (Corporations Act) that are relevant to these considerations:

- (1) section 205G of the Corporations Act (hereinafter referred to as, section 205G);
- (2) section 228 of the Corporations Act (hereinafter referred to as, section 228); and
- (3) Chapter 2E of the Corporations Act (hereinafter referred to as, Chapter 2E).

1.3 Under section 205G, a director of a listed company is required to notify the ASX of a director's notifiable interests. The ASX must be notified within 14 days of a director's appointment, the listing of the company or any change to a director's notifiable interests occurring.

1.4 ASIC Instrument 2016/881 relieves the director of a listed company from the requirements of section 205G, in cases where the listed company has complied with ASX Listing Rule 3.19A. ASX Listing Rule 3.19A.2A requires that a listed company notifies the ASX of changes in a director's notifiable interests no more than 4 business days after the change occurs. ASX Listing Rule 3.19A.2A requires the notice to include whether the change occurred during a closed period where prior written clearance was required and, if so, whether prior written clearance was provided.

1.5 Accordingly, where a listed company complies with ASX Listing Rule 3.19A, the director will not be required to notify the ASX pursuant to section 205G. However, where a listed company fails to comply with ASX Listing Rule 3.19A, the director will be required to notify the ASX of changes to his or her notifiable interests. A listed company must have arrangements with its directors to ensure compliance with that ASX Listing Rule.

1.6 Breach of section 205G carries a fine of up to A\$6,6601 or imprisonment for 2 years, or both.

1.7 Although a failure to notify the ASX within the specified timeframes under section 205G constitutes a breach of the Corporations Act, ASIC does not typically follow up on minor delays in notification or where rectification of a breach occurs without prompting from ASIC. However, there can be no guarantee ASIC will not take enforcement action where there has been a breach of section 205G. Further, in recent times, ASIC has had a greater focus on enforcement compared to its approach in earlier times.

1.8 Transactions that involve the provision of a financial benefit to a related party may also require member approval under Chapter 2E, unless they fall within a relevant exception.

1.9 For all transactions involving benefits to related parties of directors, directors should be cognisant of their duties to act in good faith and for a proper purpose, and should consider whether they are excluded from attending and voting at meetings because of a material personal interest.

Section 205G of the Corporations Act – disclosure of notifiable interests

2.1 Under section 205G(1), a director of a listed public company is required to notify the ASX of:

- (1) the director's relevant interests in securities of the company or a related body corporate; and
- (2) contracts:
 - a) to which the director is a party or under which the director is entitled to benefit; and
 - b) that confer a right to call for or deliver shares in, debentures of or interests in a managed investment scheme made available by the company or a related body corporate.

2.2 The director must notify the ASX of his or her relevant interests within 14 days of a change occurring. Where a director is newly appointed, they must notify the ASX within 14 days of their appointment (but this does not include a director who retires and is reappointed at the same meeting).

Relevant interests

2.3 Section 205G requires a director of a listed public company to disclose only securities in which he or she has a relevant interest.

2.4 Under the Corporations Act, a person has a "relevant interest" in securities if they:

- (1) are the holder of the securities;
- (2) have the power to exercise, or control the exercise of, a right to vote attached to the securities; or
- (3) have the power to dispose of, or control the exercise of a power to dispose of, the securities.

2.5 Subject to paragraph 2.8 below, this means that a director must either hold the securities or, if the securities are held by some other person, the director must have some control over how the securities are voted on or disposed of.

2.6 Absent of any agreement, arrangement or understanding between a person and the holder of the securities, a person would not ordinarily be considered to have a relevant interest in the shares held by some other person. This includes shares owned and held by a person's spouse or children.

2.7 Therefore, a director would not be required to disclose in an Appendix 3X or 3Y any shares held by the director's spouse or children because the director does not have a relevant interest in these shares (unless the director does control them).

2.8 If a director also controls a company, then the director may also be deemed to hold a relevant interest in any shares held by that company or a subsidiary. Equally, if a director holds 20% of the shares of the company, the director may also be deemed to have a relevant interest in any shares in which the company has a relevant interest.

Relationship with ASX Listing Rules 3.19A and 3.19B

2.9 ASX Listing Rule 3.19A is a separate but complementary requirement to section 205G.

2.10 Under ASX Listing Rule 3.19A, a listed company must notify the ASX of a director's "notifiable interest", no more than 4 business days after; the company's admission, the director's appointment, a change to the director's "notifiable interest" occurs, or the person ceases to be a director.

"notifiable interest" is defined as:

- (1) relevant interests in securities of the company or a related body corporate; and
- (2) interests in contracts to which the director is a party or under which the director is entitled to a benefit, and that confer a right to call for or deliver shares in, debentures of or interests in a managed investment scheme made available by the company or a related body corporate.

2.11 Under ASX Listing Rule 3.19B, a listed company is required to make arrangements with its directors to ensure that its directors disclose all the information required by the company to comply with ASX Listing Rule 3.19A. Further, the listed company must enforce the arrangement with the directors. A proforma of that agreement is contained in the guidance notes to the ASX Listing Rules.

2.12 Importantly, unlike section 205G, ASX Listing Rule 3.19A imposes the obligation to notify the ASX on the listed company and not the directors.

2.13 Because the requirements of ASX Listing Rule 3.19A and section 205G are similar, ASIC Instrument 2016/881 provides an exemption to section 205G. Accordingly, where a director reasonably believes that a listed company complies with ASX Listing Rule 3.19A, the director of the listed company will not be required to comply with section 205G.

2.14 On the other hand, if the director does not reasonably believe that a listed company has complied with ASX Listing Rule 3.19A, the director of the listed company will still be required to comply with section 205G. Importantly, in such a case, a failure to notify the ASX of changes in his or her notifiable interests will constitute a breach of section 205G by the director.

Breach of section 205G

2.15 Where a breach of section 205G occurs, the director will be guilty of an offence and liable for a fine of up to A\$6,6606, or imprisonment for 2 years, or both.

2.16 Although a failure to notify the ASX within the specified timeframe (in cases where the listed company has not complied with ASX Listing Rule 3.19A) is a breach of the Corporations Act by the director, ASIC does not typically follow up on minor delays. The longer the delay, the more likely that ASIC will follow up on the breach. Ordinarily, one would not expect ASIC to follow up on a breach where it is rectified prior to ASIC deciding to take any action.

2.17 ASIC Regulatory Guide 193: Notification of Directors Interests in Securities – Listed Companies (June 2008) provides guidance on the approach that ASIC will take when enforcing this provision. In the event that ASIC identifies a breach of section 205G and is considering prosecution, the director will be sent a letter asking the director to explain the reasons for the breach. This explanation will not necessarily enable the director to avoid prosecution, however the information will be taken into account when ASIC is deciding whether to prosecute the director or not. Please note that, in recent times, ASIC has had a more heightened focus on enforcement compared to its approach when that regulatory guide was first issued.

2.18 Where there has been a breach of ASX Listing Rule 3.19A, the ASX will generally send the listed company a letter requesting an explanation for the breach of that Listing Rule. The request and the response of the listed company is posted on the Company Announcements Platform in respect of that listed company.

Section 228 of the Corporations Act – related parties

3.1 The ASX Listing Rules contain a number of provisions relevant to “related parties” of a listed entity, particularly in Chapter 10. Certain provisions of the Corporations Act also apply to “related parties” of public companies, particularly the provisions of Chapter 2E which restricts a public company giving a financial benefit to a related party of a public company (discussed in more detail in paragraph 4 below).

3.2 The ASX Listing Rules define “related party” separately from (though broadly consistent with) the Corporations Act in relation to listed entities.

3.3 Under section 228, a “related party” of a public company includes:

- 1) an entity that controls a public company;
- 2) directors of the public company or of an entity that controls the public company;
- 3) if the public company is controlled by an entity that is not a body corporate, each of the persons making up the controlling entity;
- 4) spouses and de facto spouses of any persons referred to above;
- 5) parents and children of any persons referred to above;
- 6) an entity controlled by a related party referred to above, unless the entity is also controlled by the public company;
- 7) an entity that was a related party of the public company of a kind referred to above at any time within the previous 6 months;
- 8) an entity that believes, or has reasonable grounds to believe, it will become a related party or a kind referred to above at any time in the future; and
- 9) an entity acting in concert with a related party of the public company on the understanding that the related party will receive a financial benefit if the public company gives the entity a financial benefit.

Is a step-child a related party?

3.4 As stated above, “children” of certain persons can be a related party of a listed company. The definition of “child” in the Corporations Act states that “someone is the child of a person if he or she is a child of the person within the meaning of the Family Law Act 1975 (Cth)” (Family Law Act).

8 Section 228(1)-(7) of the Corporations Act.

3.5 The Family Law Act provides that a “child” can include a person’s child, an adopted child, and a child of a marriage or other relationship.

3.6 The Family Law Act provides that a person is the “parent” of a child if they are the biological parents or adoptive parents. Therefore, step-parents are not included within this definition unless they have legally adopted the child. The Family Law Act also defines “step-parent” of a child as a “relative” and as a person who “is not a parent of the child.”

3.7 Because a step-child is not a “child” for the purposes of the Corporations Act, the step-child of a director of a publically listed company would not be considered to be a related party of the company.

Chapter 10 of the ASX Listing Rules

3.8 Chapter 10 of the ASX Listing Rules applies to certain transactions including issues of securities with persons in a position of influence in relation to the listed entity.

3.9 Many of the restrictions in Chapter 10 of the ASX Listing Rules apply to “related parties” of the listed entity. They also apply to other persons of influence such as persons having a substantial holding of shares in the listed entity.

3.10 It is important to note, however, that while many of the restrictions in Chapter 10 apply to “related parties” of the listed entity, such restrictions often also apply to:

- (1) associates of a related party; and
- (2) any person whose relationship with the listed entity or a related party is such that, in ASX’s opinion, shareholder approval should be obtained.

3.11 Accordingly, a step-child of a related party (though not a related party of the listed entity) could be an associate of a related party or a person whom the ASX decides is effectively an associate of a related party.

3.12 Further, under the ASX Listing Rules, a “related party” of a natural person (i.e. a director) is taken to be an associate of the natural person unless the contrary is established. A “related party” of a natural person is defined in similar (but not identical) terms in the ASX Listing Rules to those which apply to a “related party” of a public company outlined in paragraph 3.3 above, and expressly includes a parent or child of the person or of a spouse or de facto spouse of the person.

3.13 Therefore, where a proposed transaction or issue of securities involves a relative of a director of the listed entity, or a company in which the director has an interest, further investigations must be undertaken to ensure that Chapter 10 of the ASX Listing Rules does not apply to the proposed transaction or issue.

Chapter 2E of the Corporations Act – related party transactions

4.1 When a proposed transaction involves a related party of a public company, thought should be given to whether Chapter 2E applies. Under Chapter 2E, public companies must obtain member approval to give a related party a financial benefit unless a relevant exception applies.

4.2 The meaning of “financial benefit” under section 228(7) is to be interpreted broadly and includes financial benefits that are given indirectly or where the financial benefit does not involve the payment of money, and also where the financial benefit is given pursuant to an informal agreement, oral agreement or an agreement that has no binding force. Examples of giving a financial benefit to a related party include; providing finance or property to the related party, buying or leasing an asset from or selling an asset to the related party, supplying services to or receiving services from the related party, issuing securities or granting an option to the related party, or taking up or releasing an obligation of the related party.

4.3 Member approval is not required for certain transactions or financial benefits including:

- 1) transactions that are on arm’s length terms;
- 2) benefits that are reasonable remuneration or reimbursement of officers’ and employees’ expenses; and
- 3) certain other transactions or financial benefits given under a court order.

4.4 When considering whether the arm’s length exception applies, the company should consider how the terms of the overall transaction compare with those of any comparable transactions on an arm’s length basis, the nature and content of the bargaining process, and the impact of the transaction on the company.

4.5 If giving the financial benefit to the related party does not come within any of the relevant exceptions, member approval must be obtained by using the procedure set out in the Corporations Act. This includes preparing and lodging with ASIC the explanatory materials to be put to members in relation to the proposed transaction. The materials must provide sufficient information for members to decide whether or not the financial benefit to be given to a related party is in the interests of the company, and may require a valuation from an independent expert.

Sections 181 to 195 of the Corporations Act – material personal interest and director’s duties

5.1 Finally, the directors must be aware of their own duties and responsibilities where they have a personal interest in a transaction or matter

5.2 If a director of a public company has a material personal interest in a matter being considered at a directors’ meeting, they must not be present while the matter is being considered at the meeting or vote on the matter. This prohibition does not apply where the interest does not need to be disclosed under section 191 or where the board has passed a resolution that they are satisfied the interest should not disqualify the director from voting or being present in accordance with section 195(2)(b) of the Corporations Act.

5.3 ‘Material personal interest’ is undefined but is taken to mean an interest of some substance or value, rather than merely a slight interest and would include any interest that has the capacity to influence the vote of a director.

5.4 As persons in a fiduciary position, directors have common law duties not to profit from a position of trust or place themselves in a position where duty and interest might conflict. This prevents directors from promoting their personal interest where there is a real and substantial conflict between that personal interest and the interests of the company. Specific duties are set out in sections 181 to 184 of the Corporations Act and include the duty to act in good faith in the best interests of the company and for a proper purpose.

5.5 The objective of the common law and statutory director’s duties are to preclude directors from being swayed by considerations of personal interest and from misusing their position for personal advantage; and both sets of duties apply regardless of whether a proposed transaction receives member approval.

5.6 Whether a director has a material personal interest in a particular transaction, or is at risk of breaching their duties by engaging in or otherwise facilitating the transaction, will depend on the specific circumstance and the directors should, if necessary, seek specific legal advice.