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5 February 2016

Dear Dr Dermody,

INQUIRY INTO CORPORATIONS AMENDMENT (CROWD-SOURCED FUNDING) BILL 2015 (CSEF Bill)

Introduction

The Corporations Committee, Business Law Section, Law Council of Australia (**Committee**) appreciates the opportunity to make this submission on the CSEF Bill. While this Inquiry does not seek comments on the CSEF Regulations, the Committee has provided the Government with its comments on those regulations and for completeness and for the benefit of the Senate Economics Legislation Committee, we will incorporate those submissions into this submission.

A Working Party of the Committee has made numerous submissions on the topic of crowd sourced equity funding (**CSEF**) to the now disbanded CAMAC and the Government, on both a confidential and open basis.

The Committee is very supportive of CSEF legislation and has long argued that start-ups and early stage companies needed a simpler legislative regime than that currently provided by the *Corporations Act* 2001 (**Act**), under which they could raise equity capital at a reasonable cost and is therefore generally supportive of the CSEF Bill and looks forward to its passage by Parliament at the earliest opportunity.

General Observations

The Committee makes the following general observations:

1. There have been calls from certain sections of the start-up community to broaden the CSEF Bill to permit proprietary companies to raise funds in the same way as an ***eligible CSF company*** (as defined in @738H of the CSEF Bill) is to be permitted to do so.

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The Committee is opposed to any such extension of the CSEF Bill as it has long been a feature of Australian company law that proprietary companies are restricted in what funds they can raise from the public and to change that now without a full inquiry into the ramifications of doing so would be very undesirable. The Committee does not see the requirement that CSEF only take place via an ***eligible CSF company*** as a material 'barrier to entry' for those persons wishing to take advantage of the CSEF Bill either in terms of cost or operational structure.

2. The Committee is concerned that the CSEF Bill is too complicated to be easily understood by start-ups and early stage companies seeking to take advantage of CSEF and may give rise to too high a regulatory burden for intermediaries to readily embrace the establishment of CSEF platforms.

3. Having seen the CSEF Regulations, it remains unclear to the Committee how the CSEF Bill and CSEF Regulations will interact with other fundraising provisions such as Class Order 02/273 that in part deals with business introduction service operators (**Business Matching Class Order**).

4. On 21 December 2015, the International Organisation of Securities Commissions published a very useful summary of developments concerning CSEF in 23 jurisdictions. The relevant report is entitled "Crowdfunding 2015 Survey Responses Report." The Committee respectively suggests that this report is worth considering as part of this Inquiry.

5. Five Canadian provinces have just implemented their crowdfunding legislation (albeit not uniformly though all provinces) via Multilateral Instrument 45-108, *Crowdfunding*. The Committee respectively suggests that this legislation is also worth considering as part of this Inquiry.

Specific Observations

Complexity of Operations

1. The Committee is concerned that the complexity of the CSEF Bill risks excluding the participation of those very people for whose benefit it is designed. The Committee suggests, at the very least, that a simple guide to the legislation be included at the beginning of the legislation, similar to the small business guide in the Act.

2. The Committee, which consists of experienced corporate lawyers, found the interaction between the CSEF Bill and existing provisions of the Act difficult to interpret, particularly in relation to licensing and disclosure for an offer of securities.

3. The Committee found it difficult to clearly comprehend how existing provisions of the Act, particularly Chapters 6D and 7, as they applied to 'retail clients,' were fully

overridden by the terms of the CSEF Bill with regard to 'general investors'. While the distinction between the definitions of 'retail clients', 'wholesale clients' and 'general investors' was easy to follow, the way in which those definitions give rise to obligations across all aspects of the Act was not immediately obvious. The Committee's main concern here is that it could be hard for participants to understand how all of their respective obligations under the Act may interact.

4. @738H(1)(f) restricts an eligible CSF company from having the purpose of investing in securities or interests in other entities or schemes. The rationale for such a blanket prohibition is unclear (or how 'purpose' is to be determined). The Committee recommends that companies that raise funds from CSEF should not be restricted from investing in other companies (because joint ventures and mergers are reasonably common means by which early stage companies can seek to grow). The Committee is however, supportive of preventing CSEF provisions from being used to develop 'cash boxes' but queries whether a similar approach to regulation as used for holding companies in the Venture Capital Limited Partnership and Early Stage Venture Capital Limited Partnership structures could be adopted with CSEF funding. Such structures may be better reflective of current practice in group structuring.

5. The Committee has previously commented that it considered that a self-contained regulatory regime for CSEF would throw up discrepancies in the regulatory environment for capital raising that might be exploited. The above comments bear out these concerns.

AFSL Issues

6. The scope of obligations for intermediaries in relation to the AFSL they are required to hold should be clarified. If the intermediary is required to hold a full AFSL and to comply with all of the obligations imposed on AFSL holders, then the cost and complexity of doing so may be prohibitive for would be applicants. The Committee recommends, as an alternative to this approach, that either a CSEF specific AFSL or simple licence for intermediaries be designed to better reflect the intermediary's principal role as a 'hosting service'. Additional queries have been raised by prospective intermediaries as to their obligations under other legislation (for example, CTF/AML legislation) that may arise if they are required to be AFSL holders. The imposition of significant and costly obligations under CTF/AML Legislation is likely to have a very significant detrimental impact on the participation of prospective intermediaries in crowd sourced equity funding).The Committee is concerned that intermediaries may be reluctant to enter the market and provide CSEF platforms if obligations are placed upon them that are significantly more onerous than those imposed under the Business Matching Class Order.

7. It is neither necessary nor desirable that intermediaries are made 'gatekeepers' under @738Q. ASIC should be the only 'gatekeeper' for CSEF. Prospective

intermediaries are being warned that the burden of the obligations under the proposed legislation may practically make it difficult for them to obtain common business insurances necessary to mitigate the risks of conducting a crowd sourced equity facility.

8. It appears from the explanatory memorandum to the legislation that companies seeking to raise funds through a crowd sourced equity facility may need to be treated as retail clients by an intermediary. This adds a further additional (and unexpected) burden to intermediaries in operating such a facility and is likely to deter prospective intermediaries that seek to provide additional support to companies seeking to raise funds through their facilities.

CSF Offers

9. The CSEF Bill permits the running of a CSF offer and another offer simultaneously. In practice, the Committee would expect that an issuer would more likely run one offer made available to general investors and other investors. The CSEF Bill does not appear to contemplate this, which will add additional cost, expense and inconvenience to an issuer wishing to raise capital under a CSF offer and from investors more broadly. The Committee suggests that it should be possible for an issuer to make one offer of securities. To the extent that such offer complies with the requirements for a CSF offer it can be made to (and be taken up by) general investors. However, the Committee believes that, to the extent that the same offer is made to or taken up by a person to whom an offer of securities can be made without a formal disclosure document pursuant to section 708 of the Act, then amounts raised from such acceptances should not count towards the limits in the amounts able to be raised from a CSF offer that is accepted by general investors. In this way, the CSEF regime would interact with section 708 of the Act much as the personal offers exemption (section 708 (1)-(7) of the Act) currently interacts with the other exemptions from the need for a formal disclosure document under that section.

10. Intermediaries and issuers may face difficulties in managing the content of the communication facility required for a CSF offer. In particular, the Committee questions how intermediaries and issuers are expected to deal with misleading, deceptive or defamatory statements by third parties. @738ZA(7) contemplates regulations that would provide guidance on this issue but the CSEF Regulations are unfortunately silent about this issue. The Committee suggests that intermediaries or issuers be required to monitor posts on the communication facility and required to remove misleading, deceptive or defamatory statements; they should be protected from legal liability for doing so.

11. @738ZG imposes a very restrictive regime on the advertising of a CSF offer. The Committee considers the restrictions to be unreasonable given that the rationale of crowd funding is an approach to the ‘crowd’ for funds, which means wide spread advertising and publicity of an opportunity. The Committee is in favour of a more

relaxed advertising regime that at the very least would permit advertising that identified the name and business of the issuer, the investment opportunity and where prospective investors can access more details about the offer or an offer document both before the offer is open and during the term of the term.

12. @738Y prohibits the making of a CSF offer if the offer document is defective. @738Z provides a defence to a breach of the section only if a person can prove he or she did not know the CSF offer was defective. This is a reversal of the onus of proof. Consistent with the Law Council's long held approach about reversals of the burden of proof, the Committee considers it more appropriate that ASIC be obliged to prove the person's knowledge of or reckless indifference to the document being defective.

13. @738Z does not provide a due diligence defence unlike the Act that contains such provisions for fundraising activities.

Other Concerns

14. The Committee is surprised that offers through licensees (section 708 (10) of the Act) count towards the limits on the amounts of capital that can be raised via CSEF. This should not be the case.

15. @738A describes the object of Part 6D.3A of the CSEF Bill as providing a disclosure regime that can be used for certain offers of securities for issue in "*small unlisted companies*". If by the use of the italicised words, there is an intention in due course to extend CSEF to proprietary limited companies, then, as indicated above, the Committee is opposed to such an extension. The italicised words should be changed to "*small public companies*".

16. @738N provides a maximum offer period of three months. This is a very short time frame especially when compared to the offer period available for other fundraising activities under the Act. This period should be extended to at least a maximum of 12 months so as to avoid the costs of re-issuing a CSF offer every three months, if needed.

17. The Government previously flagged that it would permit intermediaries to invest in issuers raising funds on their funding facilities. This permission should be expressly addressed in the CSEF Bill.

18. The CSEF Bill restricts an investor from investing more than $10,000.00 in any particular issuer. The Committee supports this limitation (provided that it does not limit an investor from investing additional amounts using any of the exemptions found in section 708 of the Act) but notes that this does not prevent an investor from making multiple investments in a range of CSF offers. The Committee understood from a previous Government pronouncement that there would be a cap (mooted to

be $25,000.00 per annum) on the amount an unsophisticated investor could invest in CSF offers. The Committee suggests that this cap be expressly addressed in the CSEF Bill.

19. The Committee notes that the 'joint investor' provision is likely to be difficult to enforce in its present form.

CSEF Regulations

The Corporations Committee makes the following comments on the CSEF Regulations:

1. **Regulation 6D.3A.01** specifies fully-paid ordinary shares as a class of securities for the purpose of @738G(1)(c). Given that start-ups often need to be flexible in the way capital is raised, the Corporations Committee is concerned that mandating that such capital can only be raised by the issue of fully-paid ordinary shares (compared with, say, preference shares, redeemable preference shares, options) is too restrictive.

2. **Regulation 6D.3A.03** specifies the wording of the risk warning to be included in an offer document.
   While the Corporations Committee accepts that a risk warning is appropriate, the proposed risk warning may be counter-productive in that it seeks to cover too many possibilities of risk and loss.
   The Corporations Committee prefers the approaches taken to risk warnings contained, for example, in New Zealand's Financial Markets Conduct Act 2014 or the just released Canadian participating jurisdictions Multilateral Instrument 45-108, *Crowdfunding*.

3. **Regulation 6D.3A.11** specifies the checks a CSEF intermediary needs to make to comply with its gatekeeper obligations under @738Q(1). As the Corporations Committee does not support the imposition of gatekeeper obligations on CSEF intermediaries, it does not support this Regulation.

4. **Regulation 6D.3A.12** specifies what constitutes a reasonable standard in relation to the checks mentioned in the above Regulation. Sub-regulation (5) specifies what criteria determines whether documentation is 'reliable and independent' and sub-regulation (6) states that any database maintained by ASIC is to be treated as reliable and independent documentation. While the Corporations Committee appreciates the thinking behind sub-regulation 6, it notes that information in ASIC's database can also be out of date and inaccurate (query what happens with the database if and when it is sold to a private entity) and may therefore not be reliable and achieve the aims of the sub-regulation.

5. **Regulation 6D.3A.13** specifies the wording of the risk warning that CSEF intermediaries must place on their platforms. As the above wording is the same as that contained in Regulation 6D.3A.03, the Corporations Committee repeats its observations in relation to that Regulation.

Conclusion

If you have any questions in relation to this submission, please contact the Chair of the Corporations Committee, Rebecca Maslen-Stannage via email:
or phone on

Yours sincerely,

Teresa Dyson, Chairman
Business Law Section