

# NEWSLETTER

FEBRUARY 2012

## Corporate & Commercial Newsletter

Welcome to our first Corporate & Commercial newsletter

The newsletter will be distributed quarterly and will contain topical articles on legal issues and developments, as well as news of our team.

This quarter we have included articles on the following:

- the impacts of carbon tax, including for consumers like you and ourselves
- ASIC's changes to financial requirements for responsible entities
- a Cornwall Stodart 'Success Story': 'RSEA – A complex transaction'.

Last week we distributed an alert on the (now commenced) *Personal Property Securities Act 2009* (PPSA). Now that the PPSA regime has commenced, it's time to get moving - or risk losing any interests you have in personal property. Please [click here](#) for the full article.

Please don't hesitate to contact us if you would like more information on any topic, whether covered in this newsletter or not.

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### Planning for the carbon tax

In less than five months, the Australian government's controversial carbon pricing scheme will commence (please refer to our [earlier alert](#) for more information). Yes, we're going to have a carbon tax. No, you may not like it. But one thing is certain, it will happen and we will have to deal with it.

By now, businesses should have identified their carbon exposure and developed a carbon management plan to assist them in safeguarding against increased costs and generating new income streams.

For those businesses that haven't, **NOW** is the time to act.

All businesses will be affected by the carbon tax in one way or another. While only 500 businesses (Australia's largest polluters) are expected to be directly liable under the scheme, the introduction of a carbon price on 1 July 2012 will increase the cost of carbon intensive inputs like electricity, petroleum and gas that are used by most businesses.

### So, what is the rationale behind the carbon tax and why do we need it?

Australians generate more carbon pollution per person than any other developed country. Most of this pollution stems from our high use of



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electricity, which is mainly generated by burning coal. Some of our most prosperous industries such as mining, farming, deforestation and transport, also contribute.

The main policy rationale behind the carbon tax is to reduce Australia's carbon pollution. The government believes that the best way to achieve this objective is to place a price on carbon.

While the carbon price is not a tax on households or small businesses, they will be impacted through the pass through of costs. As large companies pay more to burn fuel, so too will consumers for everyday essentials like electricity and gas.

This pass through of costs is fundamental to the effectiveness of the government's policy rationale, which is focussed on bringing about behavioural change in consumers like you. It is hoped that as prices increase, consumers and businesses will take action to avoid such costs and that this will eventually lead to a decline in their carbon pollution.

## How do I determine the impact on my business?

### Liable entities

Around 500 of Australia's largest polluters will be faced with direct costs of the carbon price; that is, the obligation to buy and surrender carbon permits. Covered sectors include: stationary energy; waste; rail; domestic aviation and shipping; industrial processes; fugitive emissions; and from July 2014, heavy on-road vehicles.

Businesses in covered sectors need to determine whether they are directly liable under the scheme. For those businesses that are covered by the scheme, it is necessary for them to resolve how to deal with this new liability. For large corporate groups, this requires a consideration of how to allocate liability among various entities in the group.

It is also important for liable entities to determine whether costs associated with the scheme can be passed on to consumers (see below).

### Other entities

For the vast majority of businesses that are not liable entities, the relevant impact will be indirect and will depend on two main factors:

- the amount of energy used in everyday processes and within the supply chain; and
- the ability to pass on increased costs to consumers.

The more energy intensive the supply chain, the greater the cost imposed.

Businesses that rely heavily on carbon intensive inputs will be forced to pay more for these products. In turn, these businesses will need to develop mechanisms to cope with their increased costs.

Some businesses may choose to reduce their usage of carbon intensive inputs, while other businesses may try to pass these costs on to their consumers.

## So, all I have to do is increase my prices in line with my increased costs and my business will be okay?

Wrong.

Businesses should not assume that increased costs can be automatically passed on to consumers.

### Existing contracts

The ability to pass on costs will depend heavily on the wording of existing contracts.

Contracts should be thoroughly reviewed to determine whether they provide for costs to be passed on.

Fixed price contracts are unlikely to provide for the pass through of costs. However, some contracts may contain clauses that indirectly permit carbon cost pass through. Businesses may seek to rely on price review, change in law, change in tax, carbon price or material change clauses to pass on costs. However, these clauses are not an absolute safeguard and their effectiveness will depend on their individual wording and interpretation and their ability to operate under the carbon price scheme. For example, as the carbon pricing scheme is not a 'tax' per se, but an emissions trading scheme, some change in tax clauses may not be of assistance.

### New contracts

When preparing new contracts, it is essential to consider carbon pass through.

Businesses should determine the materiality of their carbon costs and determine what costs are to be passed on to consumers.

Clauses should be carefully drafted to ensure that they cover all costs imposed under each carbon price scheme (there are many) and do not result in price gauging (pricing goods much higher than is considered reasonable or fair).

### The role of the ACCC

Businesses should also be aware of the risks of passing on costs to their consumers and the role of the ACCC in policing this process.

The ACCC has been directed by the government to investigate and monitor the impacts of carbon permits on prices in the hope of safeguarding against any 'price exploitation'.

The ACCC will have the power to:



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- issue substantiation notices requiring proof of representations made with respect to the impact of the carbon price and increased pricing;
- issue infringement notices; and
- seek civil or criminal penalties.

What will amount to 'price exploitation' in this area is uncertain and will require a level of judgement; however businesses that exaggerate the impact on the carbon price and increase their costs in an unreasonable or unfair manner will probably face some interference by the ACCC.

As a result, you need to ensure that any price increases that are alleged due to the 'carbon price' can actually be traced back to the carbon price and justified.

The ACCC will also undertake an educational role, including issuing guidelines about how it expects businesses to communicate the

impact of the carbon price on them and how they should reflect the cost of carbon permits in their pricing.

## What else do I need to consider?

### Directors

Company directors have new legal duties under the carbon pricing scheme.

In addition to fulfilling their general duty to act with due care and diligence, company directors have a responsibility to ensure that their companies implement strategies to manage liability under the carbon pricing scheme.

In particular, company directors should ensure that their company:

- understands its liability under the carbon pricing scheme;
- has appropriate measures in place to cope with any increases in costs;
- introduces or considers measures to reduce carbon emissions;
- educates its staff about compliance with the scheme; and
- is aware of its obligations to report and make disclosures about the scheme.

Company directors should consider seeking legal advice and assistance in managing their obligations, as a failure to do so may result in a breach of director's duties.

### Listed companies

Under ASX Listing Rule 3.1, a listed company must immediately disclose to the ASX any information that is expected to have a material effect on the price of its securities. This continuous disclosure obligation is just as applicable to the carbon pricing scheme as it is to any other major transaction or business change.

The carbon pricing scheme is likely to increase the cost of inputs and affect profits. As a result, listed companies will need to ascertain the effect of the scheme on financial forecasts. Similarly, they need to consider the general effect of the carbon pricing scheme on their operations; for example, will all planned projects proceed? Will processes need to be re-evaluated? Will product lines need to change?

Several listed entities have already made disclosures about how they expect the carbon pricing scheme to affect their business (both in positive and negative ways).

Listed entities that have not made disclosures should consider their obligations to do so, because a failure to make appropriate disclosures may attract sanctions under the Corporations Act.

## Maybe it will affect my business after all, what should I do now?

The development of a carbon management plan is critical to the ability of your business to understand its carbon footprint and develop effective systems to safeguard against increased costs and generate new income streams.

A properly formulated plan should enable your business to:

- understand its carbon exposure;
- reduce costs;
- use carbon to leverage and increase revenue streams; and
- develop new revenue streams.

Cornwall Stodart can assist you in developing and implementing a carbon management plan that:

- identifies potential carbon exposure;
- reviews contracts to determine which costs can be passed on to consumers;



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- investigates options to reduce costs such as capital upgrades;
- considers intellectual property issues associated with established and emerging renewable energy technologies;
- identifies available government funding;
- ensures that greenhouse gas reporting mechanisms are operational; and
- ensures that disclosure obligations are met.

## New financial requirements for Responsible Entities

**New financial requirements for Responsible Entities commencing on 1 November 2012 represent a significant additional financial and administrative burden for many Responsible Entities and should not be underestimated. The time to implement a plan to ensure compliance is now. Directors should not rely on a declaration by ASIC that it may, on a case-by-case basis, consider granting temporary relief or a further transition of 12 months where a Responsible Entity can demonstrate extenuating circumstances.**

### The hurricane

Managed Investment Schemes (MIS) have long been plagued by skepticism and doubt. Critics have frequently questioned the structure and level of financial resources available to Responsible Entities to meet operating costs throughout the life of the funds which they manage. Despite these concerns, many funds experienced significant growth in assets under management. In the years leading up to the GFC, there was unprecedented growth in the number of registered schemes in Australia. However, following the collapse of several managed investment schemes across the property, finance

and agribusiness sectors and a freeze on unit redemptions during the height of the GFC, ASIC conducted a review of the legislative framework and, in particular, the financial requirements in place for Responsible Entities. The result was Class Order CO 11/1140.

### The winds of change

The new financial requirements which take effect on 1 November 2012 introduce a new section (912AA) into the *Corporations Act 2001* (Cth). The reforms aim to ensure that Responsible Entities have 'adequate resources to meet operating costs' and that their motives are adequately aligned with investors' interests.

### The long and winding road

The new measures address four key areas that should ensure Responsible Entities have sufficient financial resources and risk frameworks in place to successfully manage schemes:

#### 1. Cash-flow requirements

- Responsible Entities will be required to prepare 12-month cash-flow projections which must be approved at least quarterly by directors. All calculations and assumptions upon which the projection is based must be clearly documented.
- Responsible Entities must update the cash-flow projection when:
  - the cash flows cease to cover the next 12 months; or
  - there is a material change; or
  - the Responsible Entity has reason to suspect that an updated projection would show that they do not have access to sufficient resources to meet their liabilities or do not hold the necessary proportion of Net Tangible

Assets (NTA) in cash or cash equivalents.

#### 2. Net Tangible Asset requirements

- Responsible Entities must hold NTA at the greater of:
  - \$150,000;
  - 0.5% of the average value of scheme property of the registered scheme(s) and investor directed portfolio services (IDPS) that the Responsible Entity operates (capped at \$5 million); or
  - 10% of the average revenue of the Responsible Entity (with no maximum).

#### 3. Liquidity requirement

There are two components to the liquidity requirement:

- Responsible Entities must hold as cash or cash equivalents, the greater of:
  - \$150,000; or
  - 50% of the NTA requirement that is required to be held.
- The NTA required to be held must be in liquid assets.

#### 4. Audit opinion

- The Responsible Entity must lodge with ASIC an audit report made by a registered company auditor for each financial year and any other period that ASIC directs.

### The winner takes all

The new requirements follow a lengthy consultation period and were largely expected by the funds management industry. Despite this, they



will have a significant impact on many existing businesses of Responsible Entities and the capital and liquidity levels that they must maintain. This is likely to shake up the industry by pushing smaller players out and encouraging consolidation at the top end. ASIC hopes this will improve investor confidence and result in greater protection of investor funds.

The changes present a number of challenges for Responsible Entities. They introduce a new level of complexity and greater accountability. Responsible Entities will need to review their financial models and consider whether existing arrangements within group companies (for example, cross guarantees) and other contractual arrangements are appropriate under the new regime.

Cornwall Stodart is ready to assist Responsible Entities to undertake this task.

## RSEA - A complex transaction

*'This was a complex transaction involving a number of parties and stakeholders – and a tight timeframe. Our team, along with KPMG Corporate Finance, worked hard under pressure to complete the transaction on time, and ensure we negotiated and facilitated the successful sale of the majority interests in the specialist mining and construction services company, RSEA Pty Ltd, to Champ Private Equity's mid-market unit, Champ Ventures.'*

**Gid Meltzer**, Partner, Corporate & Commercial

### Enhancing our clients' success

Of our role in the sale, Mr Chizik (Managing Director of RSEA) said: 'Our advisors managed this transaction with proficiency and skill. Cornwall Stodart's proactive and commercial approach was instrumental in facilitating a smooth sale and restructure transaction. With this approach and their proficiency combined, Cornwall Stodart demonstrated the value that experienced and commercially oriented lawyers can bring to a complex transaction.'

### Our client

Our clients were the owners of RSEA, including the Spotlight Group as majority owner and senior executives of RSEA.

## Corporate & Commercial Success Story

RSEA is Australia's largest specialist safety retailer of hard hats, high-visibility wear and site signs. A Melbourne-based business, it services the mining, infrastructure and construction industries, has annual revenues of \$65 million and 17 super stores, 8 hire depots, and 6 distribution centres across Australia and New Zealand as well as an online shop.

### Their ambition

The owners asked us to advise on and undertake the documentation and negotiation of the sale transaction including certain restructure arrangements, which were designed to protect and enhance the interests of the senior managers who retain a minority stake in RSEA along with the buyer, Champ Ventures.

The Spotlight Group's aim was to sell its entire holding in RSEA, while the remaining minority interest holders, including Mr Chizik, wanted to retain a slightly reduced stake in the company following the conclusion of the sale.

### Acknowledgements

We would like to thank Mr Chizik again, not only for being a pleasure to work with, but also for his kind words about our work and for allowing us to include those words in this success story.





## Corporate & Commercial Team Member Profile

### **Gid Meltzer, Partner, Corporate & Commercial**

Gid specialises in corporate and commercial law and taxation. He has over 19 years' experience in a wide range of transactions and disciplines both in private practice and as an in-house counsel and executive of ASX listed companies.

His expertise covers capital raising projects including property, structured debt and equity, financial services, property and managed investment schemes, mergers and acquisitions, private equity acquisitions and divestments, joint venture, supplier and marketing agreements, finance and securitisation transactions and management of governance and compliance projects, including regulatory disclosure obligations of listed / unlisted companies and risk management.

Gid's expertise extends to the implementation of legal advice in a corporate environment and translating company policy and legislation into business strategies to improve awareness, transparency and governance. He has successfully engaged with government, lobbyists, regulators and industry bodies to implement structural and legislative changes at industry and corporate levels.

He also advises on carbon tax and its impacts on businesses of all sizes, as well as on individual consumers. Our Revenue Law team regularly consults with Gid on other taxation related matters. In addition he advises clients on the (now commenced) *Personal Property Securities Act 2009*, including the steps they need to take to secure their interests in personal property.

### Want to republish any of this newsletter?

If you would like to republish any part of this newsletter in your staff newsletter or elsewhere please contact our Marketing team on **+61 3 9608 2168**.

### Disclaimer

This newsletter is intended to provide general information on legal issues and should not be relied upon as a substitute for specific legal or other professional advice.



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