CORPORATE PRACTICES AND THE RIGHTS OF SHAREHOLDERS

GOVERNMENT RESPONSE

TO
THE REPORT BY

THE HOUSE OF REPRESENTATIVES
STANDING COMMITTEE
ON LEGAL AND CONSTITUTIONAL AFFAIRS

Report tabled: 28 November 1991

Government Response tabled: 27 December 1992

GOVERNMENT RESPONSE TO THE REPORT OF THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON LEGAL AND CONSTITUTIONAL AFFAIRS ON CORPORATE PRACTICES AND THE RIGHTS OF SHAREHOLDERS

Background to the Report

The reference relating to Corporate Practices and the Rights of Shareholders was first given to the House of Representatives Standing Committee on Legal and Constitutional Affairs by the then Attorney-General, the Hon Lionel Bowen, in October 1989.

2. The Committee received approximately 80 submissions and conducted public hearings in Canberra, Sydney and Melbourne. Submissions were received from a broad range of interested parties including banking corporations, chartered accountants, State/Territory law societies and law firms, academics and, importantly, representatives of shareholders. The work of the Committee and the participation of these individuals and groups is gratefully acknowledged by the Government.

The Government's Corporate Law Reform Program

3. The Report of the Committee has come at a time when the Government is well placed to reflect on its achievements in the area of reform of companies and securities regulation in Australia. It has now been almost 2 years since the Australian Securities Commission (ASC) commenced operations as the sole regulator of the new national scheme for corporate regulation. The Government believes that the ASC has made considerable gains not only with respect to its enforcement activities but also with respect to its role of disseminating corporate information throughout Australia and thereby contributing to the efficiency of our capital markets.

4. Following the establishment of the ASC, the Government embarked on an extensive law reform program which is still in progress. This reform program commenced with the Corporations Legislation Amendment Act (No.1) 1991 which contained long overdue reforms relating to the consolidation of accounts for corporate groups and insider trading. These reforms were basic to the achievement of an acceptable quality of disclosure and injected a new element of certainty and reliability into the accounts of our major companies. The amendments to the insider trading provisions largely implemented the Standing Committee's Report entitled 'Fair Shares for All - Insider Trading in Australia' (1989).

5. This Act was followed by the Corporations Legislation Amendment Act (No. 2) 1991 which provided for the introduction of a scrip-lending system and facilitated the move by the Australia Stock Exchange (ASX) to a 5 days after trade security settlement regime and various miscellaneous amendments to the Corporations Law.

6. In addition to these two reform packages, the Government released a Draft Corporate Law Reform Bill for public comment in March 1992 and introduced the Bill into the House of Representatives on 3 November 1992. The Bill contains substantial reforms relating to loans to directors and related party transactions, the framework for insolvency and, directors duties and the rights of shareholders. This reform package also contains proposals which will improve the operation of

Australian securities markets by enabling them to be fully automated in terms of transfer, registration and settlement of securities. This will increase the efficiency of Australia's capital markets, reduce the risk in settlement of share transfers, lead to more certainty for market participants and improve the competitiveness of the ASX.

7. The Government also introduced into the Senate on 26 November 1992 the Corporate Law Reform Bill (No.2) 1992 which will implement an enhanced statutory disclosure regime. The regime is designed to ensure the timely disclosure of all material information to the market.

8. It is important that the Committee's Report be considered in the context of the reform activity outlined above. In this context the Government notes the suggestion at paragraph 4.5.27 of the Committee's Report that the Attorney-General give thought to referring draft exposure bills for the reform of the Corporations Law to the Committee for consideration. The Government has has engaged in extensive public consultation with interested parties on the proposed amendments contained in the Corporate Law Reform Bill 1992 and the Corporate Law Reform (No.2) Bill 1992. It is considered that the 3 month public exposure period for proposed legislation provides a good opportunity for public comment by all interested groups. The Committee could avail itself of this opportunity to comment on a proposed Bill.

Consideration of the Report

9. The Committee's Report covers a wide range of issues of importance to the investing public (i.e. shareholders). As such, the Government believes that the Report makes a significant contribution to the on-going review of corporate laws.

10. The Report covers the following areas:

(a) Controls over market practices, including market manipulation, warehousing and ramping.
- Recommendations 1 to 5

(b) Controls over the acquisition of shares by directors including management buy-outs and analogous situations.
- Recommendations 6 to 11

(c) Disclosure requirements of directors.
- Recommendations 12 to 19

(d) Powers of shareholders in relation to the management of their companies.
- Recommendations 20 to 25

(e) Controls necessary for the protection of shareholders, in particular minority shareholders.
- Recommendations 26 to 30.

11. In light of the corporate law reforms which have already been implemented or which are about to be implemented, it is an appropriate time for the Government to review its reform program and to let the business community digest the reforms which have taken place or which are currently before the Parliament. Accordingly,

the proposals made by the Committee in its Report must be carefully considered to build upon existing reform measures and proposals in the most efficient and effective manner possible. It is noted in this regard that a number of the Committee's recommendations have already been dealt with or are being dealt with as part of the package of reforms mentioned above.

(a) Controls over market practices, including market manipulation, warehousing and ramping.

Recommendation 1

The Committee recommends that adequate resources be provided to the Australian Securities Commission and the appropriate sections of the Australian Stock Exchange to enable suitable monitoring - detection, investigation and enforcement - of securities trading.

12. The Government notes that the resources for the ASC have increased dramatically when compared to the funding provided to its predecessor, the National Companies and Securities Commission (NCSC). Indeed, the Government is providing an extra $210 million for corporate regulation over the first 4 years of the national scheme. This represents a substantial increase in comparison to the funding of the former co-operative scheme. The Government is committed to maintaining the funding for the ASC at a level which will enable it to effectively administer the laws of the Commonwealth relating to companies, securities and the futures industry.

13. The Corporations Law provides as one of the conditions for approval of a stock exchange that the Minister must be satisfied that the business rules of the exchange make satisfactory provision for the monitoring of compliance with, and for enforcement of, the body's business rules (s.769(2)(b)(iv)). The Surveillance Division of the ASX works closely with the Companies and Membership Divisions to facilitate a stock market that is fair and efficient for all market participants. The Surveillance Division monitors market trading in order to detect possible breaches of the ASX's Listing and Business Rules and, where appropriate, reports to the ASC possible breaches of the Corporations Law.

14. The ASX is a self-regulatory private association of brokers and a company limited by guarantee. It is owned by its members and governed by the board elected by its membership. As such, it is not a matter for the Government to determine ASX funding levels nor the manner of allocation of funds. The ASX is funded from three main sources of revenue: listing fees from companies, income from operations (the sale of computer services and a wide range of miscellaneous services provided principally by the research, printing and options divisions) and the payment by member organisations of quarterly operations charges based on their level of activity.

15. Additionally, surplus funds from the National Guarantee Fund (funds not required for investor protection purposes) approved for transfer to the Securities Industry Development Account may be made available to the ASX for securities industry development purposes. The Government has agreed to the release of up to $35 million from the Securities Industry Development Account to fund the establishment by the ASX of a proposed new Clearing House Electronic Subregister System which will enable the securities clearance system to be fully automated, including the registration of transfers. This will assist in the monitoring and

surveillance activities of the ASX. Under the current co-regulatory framework for the regulation of the securities industry, the ASX plays a significant role in the monitoring of securities trading.

Recommendation 2

The Committee recommends that the Australian Stock Exchange take a more active role in relation to the enforcement of the Listing Rules and malpractices in relation to the market of listed securities. To that end, it is further recommended that co-operation between the ASX and ASC be formalised with a view to:

- *the ASC using its existing powers (to obtain testimony and documents) in situations where there is reason to suspect that there has been a breach of the Listing Rules or other market malpractice;*

- *the ASC making information so gathered available to the ASX where it would aid in the enforcement by the ASX of the Listing Rules. The ASX would be subject to duties of confidentiality in respect of the information supplied and, to assist in this, the information would be restricted to the Surveillance and Enforcement Division of the ASX and its legal advisers; and*

- *the ASC, after consulting with the ASX, making announcements, with the benefit of its existing protections, in relation to matters concerning suspected market malpractice or suspected breaches of Listing Rules.*

The Committee further recommends that any necessary amendment of sections 127(4) and 246 of the Australian Securities Commission Act 1989 be made so as to make it clear that:

- *the ASC can co-operate with the ASX in the manner recommended by the Committee; and*

- *the ASC is protected from liability in relation to any announcements which might be made.*

16. The Government appreciates that the ASX in its self regulatory role is in a position of public trust and that, given the complementary roles of the ASC and ASX in the detection and investigation of market malpractice and enforcement of the Corporations Law, it follows that a high degree of co-operation should exist between the two bodies in order to achieve the maximum effectiveness. This recommendation, however, raises significant policy issues concerning the appropriate roles and responsibilities of the two bodies in the overall scheme for the regulation of the securities markets.

17. Traditionally, stock exchanges have been independent private bodies and are not subject to direct Government participation. A scheme of joint administration of the ASX Listing Rules runs counter to the philosophy which underpins the self-regulatory framework for the conduct of securities markets. That philosophy broadly assumes that the Exchange itself will have responsibility for the conduct of the market and the regulation of the behaviour of members by promulgating rules, monitoring behaviour and determining violations subject to a degree of oversight and control by a government body. The Government body in this instance is the ASC.

18. The recommendation would require the extension of the existing class of authorised persons to whom the ASC Chairperson may pass confidential information to include the ASX for the purpose of the ASX enforcing the Listing Rules of the Exchange (s.127(4) of the Australian Securities Commission Act 1989 - hereinafter referred to as the ASC Act), and the extension of the protection against liability for damages provided by s.246 of the ASC Act arising from the recommended publication by the ASC of information concerning suspected market malpractice or suspected breaches of the Listing Rules.

19. The current law formalises the relationship between the ASC and ASX having regard to their different roles in the regulation of the securities market. Under s.774 of the Corporations Law the ASC must be notified of any amendment to the business or the listing rules of an exchange for the purpose of notifying the Minister, who may disallow any such amendment. Section 775 empowers the ASC to prohibit trading in a particular security and s.776 requires the securities exchange to provide assistance to the ASC.

20. The ASX Listing Rules are a most important feature of the scheme for the regulation of publicly listed companies but they are also the private rules of a private body. Primary responsibility for the formulation, promulgation, administration and interpretation of the Listing Rules rests with the ASX. Their application in some instances involves the exercise of extensive discretions. In these circumstances a form of joint enforcement of the Listing Rules by the ASX and the ASC may not be appropriate. In consultation with the ASC and the ASX, the Government will give further consideration to this recommendation, in particular, the suggested establishment of an ASC and ASX liaison committee for the referral of information suggesting the possibility of a false market eventuating. The Government notes that the ASC is to enter into a formal agreement with the ASX on the sharing of information. This agreement will formalise the process of the ASX referring possible serious matters to the ASC for investigation.

21. Measures proposed under the enhanced statutory disclosure regime will promote market transparency and lessen the possibility of a false market eventuating. The Government notes the Committee's stated opposition to giving qualified privilege to the ASX in relation to the publication of information, but after a detailed consideration of the matter in the context of the enhanced continuous disclosure scheme has decided to provide the ASX with express qualified privilege in certain circumstances in order to facilitate the communication of information required to be disclosed to the market. This is provided for in the Corporate Law Reform Bill (No.2) 1992.

Recommendation 3

The Committee recommends that the Corporations Law be amended to give the Australian Stock Exchange the right to institute proceedings under sections 1114 or 777, without having to give undertakings as to damages.

22. In August 1990, the ASX recommended to the Companies and Securities Advisory Committee (CSAC) an amendment to the Corporations Law similar to that now recommended by the Committee - i.e. that where the ASX makes an application to the Court for an order under ss.14 or 42 of the Securities Industry Act (now ss.1114 and 777 of the Corporations Law), the Court should not require the ASX to

give any undertakings as to damages. CSAC recommended against the proposal commenting as follows:

> "The ASX, as a private body, is not answerable for its actions in the same manner as the ASC. A statutory immunity from damages in these circumstances would be most unusual. Also the remedial measures under the Corporations Law ss. 777 and 1114 (Securities Industry Code ss. 14, 42) may be sought by the ASC at the request of the ASX, or otherwise. The legislation can be enforced without the ASX having an immunity. These factors weigh strongly against giving the ASX, in effect, an equivalent or co-regulatory role with the ASC in the enforcement of the Listing Rules."

23. While the Government is in general agreement with CSAC's recommendation it is also conscious of the need to maintain an informed market and the possible negative implications which a damages suit may have on disclosure to the market by the ASX. In this regard it is noted that once the proposed enhanced disclosure scheme, contained in the Corporate Law Reform Bill (No.2) 1992, is implemented the ASC will be better placed to enforce disclosure requirements with the assistance of the ASX. This should lessen the need for the ASX to initiate proceedings itself with the attendant need for it to give undertakings as to damages.

Recommendation 4

The Committee recommends that the Attorney-General ask the Companies and Securities Advisory Committee for it to report on ways in which the market practices in Australia can be brought into harmony with practices in the United States and the United Kingdom, particularly in relation to short selling and market stabilisation activities.

24. The Government is aware of the need to keep abreast of developments in the regulation of foreign securities markets to ensure that Australia's markets are regulated in a way that achieves an appropriate balance in protecting investors and in facilitating market activity.

25. The Attorney-General will consider the issues involved in this recommendation and possibly refer the issues of short selling and market stabilisation to CSAC for its consideration.

26. The Government is committed to Australia having securities legislation which is effective and efficient. It should, however, be recognised that while the international harmonisation of securities laws is desirable, Australia may in fact have or will implement a best practice from an investor's perspective which may give a lead for other countries to follow.

Recommendation 5

The Committee recommends that the Government takes steps to enable regulatory authorities to be able to co-operate better with overseas regulatory authorities in the detection and investigation of market manipulation practices.

27. The recently enacted Mutual Assistance in Business Regulation Act 1992 (MABR Act) is designed to facilitate this objective by establishing the necessary framework for the development of effective international co-operation between the

national business regulatory agencies responsible for administering and monitoring world securities markets. The MABR Act will enable Australian agencies such as the ASC and the Trade Practices Commission to gather information in aid of requests from equivalent foreign agencies. In turn, Australian regulators will be better placed to seek similar assistance in their own investigations from overseas regulators. The legislation complements the scheme for the obtaining and exchange of information between countries for the purposes of criminal prosecutions which is established by the Mutual Assistance in Criminal Matters Act 1987.

(b) Controls over the acquisition of shares by directors including management buy-outs and analogous situations.

Recommendation 6

The Committee recommends that section 623 of the Corporations Law be amended to require that the notice of meeting be accompanied by a report by an expert stating whether the proposed acquisition of shares is fair and reasonable having regard to the interests of shareholders other than the vendor, purchaser, allottee and their associates.

28. Section 623 permits an acquisition of shares, in excess of the prescribed percentage of shares, in a target company where the acquisition is made by way of an allotment or purchase and the acquisition is approved by a resolution of the target company at a general meeting at which no votes are cast by the allottee or purchaser or by an associate in relation to the shares held. The s.623 acquisition procedure is commonly adopted in circumstances involving management buy-outs (MBO).

29. The Committee notes that in any MBO there is an inherent potential conflict of interest for directors of a target company. During a takeover a director's duty is to act in the best interests of the company as a whole and, in normal circumstances, this includes an obligation to take reasonable steps to obtain the best offer possible for the shareholders of the target. On the other hand, if the directors are involved with the offeror the personal interests of the directors lie in obtaining control at the lowest possible price. There is also some potential for insider trading to occur since any proposal necessarily involves senior executives purchasing securities in the company which they manage.

30. The problems of conflict of interest and inside information in an MBO can be substantially resolved by the disclosure to shareholders of all relevant information possessed by the management interests in the buy-out. In this respect the Committee noted that under former NCSC guidelines, but not the Corporations Law, a notice of a paragraph 12(g) meeting under the Companies (Acquisition of Shares) Act (a s.623 meeting under the Corporations Law) had to be accompanied by an expert's report stating whether the proposed acquisition was fair and reasonable having regard to the interests of shareholders other than the purchaser or allottee. The Committee recommends that s.623 should expressly require that the notice of meeting should be accompanied by an expert's report similar to that required under the former NCSC guidelines.

31. This recommendation (and recommendation 8) are primarily concerned with the circumstances in which the provision of an independent expert's report may enhance the integrity of the takeover process. The Government is concerned to ensure so far as possible that takeover bids are conducted fairly and accepts that the

provision of independent expert reports may enhance the integrity of takeover processes. It notes that there may be grounds for going further and including in an amendment to s.623 other requirements stated in the NCSC Policy Release 116. However, the adoption of the recommendation may have wider implications as the s.623 acquisition procedure may be used in circumstances which may not involve an MBO, and a requirement to obtain an expert's report in some circumstances may be too burdensome on affected companies.

32. CSAC is currently examining the law relating to takeovers. The Government will consider its position on this issue in the light of any recommendations CSAC might make to the Attorney-General.

Recommendation 7

The Committee recommends that section 205(10) of the Corporations Law, relating to the circumstances where a company in general meeting can approve the granting of financial assistance for the acquisition of its own shares, be amended to provide the following further protection:

- *the notice of meeting must be accompanied by a solvency declaration by the company's directors, as would apply in a buy-back of shares; and*

- *a joint and several obligation imposed on both the directors involved in the solvency declaration and the person financially assisted, to indemnify the company, to the extent of the financial assistance given, in the event that the company is wound-up within the 12 months following the giving of the financial assistance.*

33. Section 205 of the Corporations Law governs the circumstances in which a company may give financial assistance for the purpose of, or in connection with, the acquisition by any person of shares in the company. This section was considered by the Committee to be of particular importance for the protection of the company's members and creditors where buy-outs are contemplated.

34. The general prohibition in s.205(1) on the giving of financial assistance is subject to a number of exceptions, the principal exception being s.205(10). This exception allows the giving of financial assistance provided the company authorises the financial assistance by special resolution. Before they vote on the resolution, the members of the company must be provided with a notice setting out, among other things, particulars of the financial assistance proposed to be given and the reasons for the proposal to give that assistance, and the effect that the giving of the financial assistance would have on the financial position of the company and, where the company is included in a group of corporations, the effect that the giving of the financial assistance would have on the financial position of the group.

35. Where the giving of financial assistance is authorised by the members in accordance with s.205(10), a creditor or member of the company, or the ASC, may apply to the Court for an order disapproving of the financial assistance, or ordering the company to purchase the interests of the dissentient members. The Court may not make an order approving of the giving of the financial assistance unless it is satisfied that the company has disclosed to the members all material matters relating to the proposed financial assistance, and that the proposed financial assistance would not, after taking into account the financial position of the company (including

future and contingent liabilities of the company), be likely to prejudice materially the interests of the creditors or members of the company.

36. The Government notes that management buy-outs involving the provision of financial assistance will usually involve transactions between a company and its directors (or companies with which the directors are associated) and that transactions are to be regulated under the proposed Part 3.2A of the Corporations Law entitled "Financial Benefits to Related Parties of Public Companies", which is to be inserted by the Corporate Law Reform Bill 1992.

37. Proposed Part 3.2A will provide that all financial benefits given by a public company, or by entities controlled by a public company, to related parties of the public company will require the informed approval of disinterested shareholders, unless they fall within a number of excepted types of transactions. The related parties of a public company will include holding companies as well as directors and their immediate relatives. It will therefore include a company controlled by the directors and used as the takeover vehicle in a management buy-out. These provisions should prevent directors installed after a successful management buy-out from using the company's resources to fund their acquisition of the company without the informed consent of the other remaining shareholders.

38. While these amendments do not directly address the issue raised by the Committee, it is considered that the existing provisions of the Law requiring the provision of financial information to shareholders to enable an informed decision by shareholders as to the impact of a proposal for financial assistance for the acquisition of shares, and the proposed amendments to be inserted by the Corporate Law Reform Bill 1992, should obviate the concerns raised. However, the Government will monitor the impact of the proposed changes to the Law for the purpose of assessing if further action is necessary in relation to this matter.

Recommendation 8

The Committee recommends that the Corporations Law be amended so that the requirement for an independent expert's report to accompany a Part B Statement by the Target be extended to situations where a person concerned in the management of the Target was associated with or had a material interest in, the Offeror. For this purpose:

- *the Offeror should be obliged to disclose in the Part A Statement the existence of any such connection;*

- *the Law should be amended to require officers of the Target to declare to the Target whether they have any such connection; and*

- *a material interest should be an entitlement of 5% or more of the Offeror or the holding of securities which, upon conversion, would give rise to such an entitlement.*

The Committee further recommends that the Corporations Law be amended to afford the same protections to Target shareholders in the context of an on-market takeover, with the Part D Statement having to be accompanied by an independent expert's report in all situations where it would have been required in the case of a Part B Statement. Further, the Law should be amended to require that any such Part D

Statement must be sent to all Target shareholders and not just lodged with the Australian Stock Exchange.

39. As noted above in relation to recommendation 6, the Government accepts that an extension of the circumstances in which independent expert reports are required may enhance the integrity of takeover processes. It acknowledges that the current provisions of the Corporations Law may not adequately address the wider issue of management involvement in both the offeror and the target. On the other hand, it is concerned that an extension of the requirement for an independent expert's report to all situations in which any person concerned in the management of the target is associated with, or has a material interest in, the offeror may impose undue burdens on affected companies.

40. CSAC is currently examining the law relating to takeovers. The Government will consider its position on this issue in the light of any recommendations CSAC might make to the Attorney-General.

Recommendation 9

The Committee recommends, in relation to shareholder approved acquisitions, that the ASC consider making a class order under section 730 of the Corporations Law to permit pre-meeting arrangements on the terms identified in paragraph 31 of NCSC Policy Statement No.116.

41. The Government offers no comment on this recommendation other than to note that the ASC is an independent statutory authority and the manner in which it exercises its discretionary powers is a matter for it to determine. The Government has brought this recommendation to the attention of the ASC.

Recommendations 10 and 11

The Committee recommends that, in relation to compulsory acquisition of shares pursuant to a court approved scheme under section 414 of the Corporations Law, the Law be amended to provide that the rights of compulsory acquisition are not available unless the thresholds and their calculations are determined in the same manner as would apply to compulsory acquisition under section 701 of the Law in relation to a takeover.

The Committee recommends that, in relation to the compulsory acquisition of shares pursuant to schemes of arrangement, selective reduction of capital or pursuant to a power inserted in the articles, the Attorney-General ask the Companies and Securities Advisory Committee for it to report on ways in which protection against compulsory acquisition on unfair terms can be made consistently available for minority shareholders.

42. The Committee noted that a number of the provisions of the Corporations Law allow a company's members to agree to the compulsory acquisition of a member's shares by either the company or another person (including another member). It referred in particular to ss.701 and 702 concerning the rights of an offeror following a takeover; s.411 concerning schemes of arrangements between a company and its members; Subdivision J of Division 4B of Part 2.4 concerning selective buy-backs;

s.195 concerning reductions in share capital; and, ss.197 and 198 concerning variations in shareholders' rights.

43. The Committee noted that a number of these provisions were not subject to any provisions restricting interested parties from voting, while other provisions provide some protection by way of procedural requirements under which special majorities or approval by the court is required. The Committee further noted that in some cases the only recourse available to dissenting shareholders is to invoke the general oppression remedy under s.260 of the Corporations Law. The Committee concluded that it is open to a majority shareholder to use its voting power to expropriate minority shareholdings.

44. In relation to the Committee's particular concerns that majority shareholders might use the scheme of arrangement provisions to avoid the dissenting shareholder protections in Chapter 6 of the Corporations Law (concerning takeovers), the Government refers to s.411(17) of the Corporations Law, which provides that the Court may not approve a compromise or arrangement unless it is satisfied that the scheme has not been proposed for the purpose of avoiding the operation of Chapter 6, or the Australian Securities Commission has stated in writing that it has no objection to the scheme.

45. The Government also notes that a review of the buy-back provisions in the Corporations Law has been foreshadowed by the Attorney-General, and the Committee's comments on selective buy-backs will be addressed in the course of the review.

46. More generally, the Government accepts the proposition that technical differences in different parts of the Law should not be able to be exploited to disadvantage minority shareholders and it intends to review all the provisions mentioned by the Committee to see what further changes might be needed to give effect to that proposition.

(c) Disclosure requirements of directors.

Recommendation 12

The Committee recommends that a regime of "continuous disclosure" by Listed Companies should be introduced, implemented and enforced through the ASX Listing Rules.

47. The Government agrees with the Committee that it is essential that there be timely disclosure of relevant information about the financial position and prospects of entities in which Australians invest.

48. However, the Government is not satisfied that an ASX administered disclosure scheme is sufficient and is therefore committed to a legislative scheme. In this regard, the Government has recently introduced into the Parliament the Corporate Law Reform Bill (No.2) 1992 containing an enhanced corporate disclosure scheme which not only provides for ongoing or continuous disclosure of information of interest to investors, but also improves the present system for periodic reporting and the issuing of prospectuses.

49. With the enhanced role envisaged under the scheme for the ASC, legislative requirements will have greater force and effect than stock exchange rules. It is considered appropriate that enforceable obligations with civil and criminal consequences should be contained in legislation rather than in stock exchange rules which form part of a private contract between the exchange and listed entities. In addition, a legislative scheme has the advantage of enabling investors to claim damages against a company which does not comply with the disclosure obligations.

50. The enhanced disclosure scheme contained in the Bill preserves and enhances the role of the ASX in ensuring proper disclosure to the market. The role of the ASX in supervising listed entities is an important one. This is reflected by a provision in the Bill which specifically preserves the operation of the ASX business and listing rules. In addition, enhancement of the ASX's role is assisted by a provision which will make it clear that the ASX is protected by qualified privilege in appropriate circumstances where it is carrying out its disclosure and supervisory functions.

51. It is noted that in making its recommendation, the Committee was concerned about the regulatory burden which would be imposed on companies by a legislative scheme as proposed by CSAC. This is a concern which is shared by the Government. In this regard, the Government draws attention to the disclosure scheme now contained in the Bill (No.2) which differs in a number of significant respects from the scheme recommended by CSAC. In particular, there has been a substantial narrowing of the range of entities subject to the statutory system so that it only applies to those entities in which investors have a direct interest because their securities are traded or offered for sale in the marketplace. In essence, it will apply in respect of listed securities and securities offered for sale by way of a prospectus. In addition, the ongoing disclosure obligations have been recast to ensure a less onerous and more cost effective system. The obligations are framed so as not to involve the imposition of 'due diligence' obligations applicable to the issue of a one-off prospectus for raising funds.

Recommendation 13

The Committee recommends that the Listing Rules of the Australian Stock Exchange be re-drafted by those versed in statutory drafting so as to have the Rules expressed in a language and style which both facilitates clear interpretation and increases the ability to enforce such Rules in the courts. The Committee further recommends that the Attorney-General announce that he will disallow, under section 774 of the Corporations Law, any further alterations to the Listing Rules which do not comply with the Committee's recommendation on the matter of style.

52. The Government agrees that the ASX should draft its Listing (and Business) Rules so that they are expressed in a language and style which facilitates clear interpretation and increases the ability to enforce such rules in the courts. However, the ASX is an independent and self-governing private organisation and it is the ASX's responsibility to determine the style of drafting which is most suitable to achieve the objects of the Listing Rules. Further, the Government under the existing power of disallowance conferred by s.774 could not dictate a particular style of drafting to the ASX or require the re-drafting of the entirety of its Listing Rules. The re-drafting of the entire Listing Rules may be an expensive undertaking.

53. The Government is aware of judicial criticism of the drafting of ASX Listing Rules but notes that such criticism is not general. Courts have considered the

application of the Listing Rules on a number of occasions and have been able to give effect to those rules without commenting adversely on their drafting.

54. The ASX is aware of criticisms of the drafting of its Listing and Business Rules and is capable of responding and has responded positively to such criticism. Discussions have taken place between the ASX, the Attorney-General's Department and the ASC for the purpose of avoiding technical deficiencies in the drafting of amendments to the Business Rules of the ASX. Those discussions have resulted in improvements in the presentation of amendments to the Business and Listing Rules.

55. It should be noted that the ASX is currently undertaking a review of the Business Rules that govern the operation of the stockbroking industry, and of sections of the ASX's Articles of Association that apply to members. The review is scheduled to be completed in the 1992-93 year. The purpose of the review is to make the rules easier to understand and administer, and to remove rules that are no longer appropriate.

Recommendations 14 and 15

The Committee recommends that section 777 of the Corporations Law be amended to provide that where the Stock Exchange Listing Rules apply to a listed company, the directors of that company are deemed to be under an obligation to procure the company to comply with the Listing Rules and the directors can be subjected to orders of the court concerning compliance with the enforcement of those Listing Rules.

The Committee recommends that, conditional upon the Stock Exchange Listing Rules being re-drafted in a language and style which facilities clear interpretation and increases the ability to enforce them, section 777 of the Corporations Law should be further amended to provide that the court may, as one of its orders, impose penalties (payable to consolidated revenue) on the directors of a company which has failed to comply with Listing Rules and such failure has been the occasion of the Stock Exchange suspending trading in company's securities. Such amendment would also have to provide protection for, first, directors who are in the process of having the company de-listed and, secondly, the directors should not be subjected to double jeopardy.

56. The Government agrees with the thrust of the Committee's recommendation. Limitations on the extent to which s.777 may be effective to impose obligations to observe the Listing Rules on directors, and provide remedies in respect of a breach of those rules, were highlighted by the decision of the Supreme Court of Queensland in Hillhouse & Ors v Gold Copper Exploration NL & Ors (No 3) (1989) 7 ACLC 332.

57. The Government will consider whether the Corporations Law should provide that the directors of a public-listed company be placed under a duty to take all reasonable steps to ensure, where applicable, that the company complies with the Listing Rules of the ASX. It has been the traditional view that the specific requirements imposed on directors should be set out in the company law statutes. For instance, it would be desirable for actions against directors for related party transactions to be taken by the ASC on the basis of the Corporations Law.

Recommendation 16

The Committee recommends that the provisions of the Corporations Law not impede the prompt application of accounting standards so that the Australian Accounting Standards Board can quickly issue whatever standards are needed at a particular time without having to wait for changes in the Law.

58. The Government agrees with the Committee that the provisions of the Corporations Law should not impede the prompt application of new accounting standards. On its face, the Law does not present any impediment to the Australian Accounting Standards Board (AASB) developing and applying new accounting standards.

59. Nevertheless, there may be occasions when the Board needs to make a standard concerning a matter where the Corporations Law requirements have been overtaken by business and accounting practices. With the reconstitution of the AASB on 1 April 1992 and the decision that the Attorney-General's Department be represented at Board meetings in an observer capacity, measures are now in place for the Government to be kept informed of any legislative difficulties that may arise in connection with the work of the Board.

60. As a consequence, where a legislative problem may impede the making of a new standard, the Government will have early warning of the problem and, through its administration of the National Scheme Laws, can move quickly to remove the impediment.

Recommendation 17

The Committee recommends that the Australian Auditing Standards Board should be given similar recognition in the Corporations Law as the Australian Accounting Standards Board. A unit should be established by the Australian Auditing Standards Board to monitor the compliance with the prescribed auditing Standards.

61. The Government notes the Committee's recommendation that standards issued by the Auditing Standards Board should be given similar status under the Corporations Law to those issued by the Australian Accounting Standards Board (AASB).

62. Standards made by the AASB have the force of law. Companies which fail to comply with them commit criminal offences and significant penalties can be imposed. The AASB is a statutory body and its standards are disallowable instruments.

63. The Auditing Standards Board has only issued one standard (prescribing the basic principles of audit conduct and performance), although it has issued more than 30 Statements of Auditing Practice providing guidance on the application of the standard. The Auditing Standards Board is a private body, funded by the Australian Society of Certified Practising Accountants (ASCPA) and the Institute of Chartered Accountants in Australia (ICAA).

64. The question arises whether auditing standards should, in these circumstances, be given the force of law at this stage. While the Government intends to keep this matter under review, any decision to give the force of law to auditing standards would require extensive consultation with the business community.

65. Whether the Auditing Standards Board should establish any special unit to monitor compliance with auditing standards is a matter for the ASCPA and the ICAA. Clearly, the ASC has a role in enforcing auditing standards as does the Companies Auditors and Liquidators Disciplining Board, which can de-register an auditor who has failed to carry out his or her duties adequately and properly.

66. The Government also notes and endorses moves by the accounting profession to establish systems of peer review to monitor compliance with auditing standards.

Recommendation 18

The Committee recommends that section 332(10) of the Corporations Law be amended so that auditors, required by the provision to notify the Australian Securities Commission of malpractices that the audit has revealed, should be obliged to report the matter where they have 'reasonable grounds to suspect' rather than needing to be 'satisfied' that the malpractice has occurred.

67. The Government proposes to consult with industry in relation to this recommendation with a view to bringing forward proposals to meet the Committee's concern.

Recommendation 19

The Committee recommends that, where it is established that the auditors of a company have breached proper auditing standards, the Court should have the power to order that the accounts of that company be audited by an auditor appointed by the Court.

68. The Government will give consideration to the recommended amendment in the course of its on-going program of reviewing and updating the Corporations Law.

(d) Powers of shareholders in relation to the management of their companies.

Recommendation 20

The Committee recommends that there be enacted a business judgment rule in the following terms:

- *A director or officer shall not be liable to pay compensation to a company or suffer the imposition of a penalty in respect of his or her business judgment unless it is made to appear to the relevant court that at the relevant time the director or officer:*

  - *had an unauthorised interest in the transaction of the company to which the judgment relates;*

  - *had not informed himself or herself to an appropriate extent about the subject of the judgment;*

  - *did not act in good faith for a proper purpose; or*

- *acted in a manner that a reasonable director with his or her training and experience could not possibly regard as being for the benefit of the company.*

. *In this section "business judgment" means a lawful judgment made for the conduct of the company's business operations and, without affecting the generality of the expression, includes a judgement as to:*

- *the company's goals;*
- *plans and budgeting;*
- *promotion of the company's business;*
- *acquiring assets and disposing of assets;*
- *raising or altering capital;*
- *obtaining or giving credit;*
- *deploying the company's personnel; or*
- *trading*

but does not include a judgement as to -

- *matters relating principally to the constitution of the company or the conduct of meetings within the company;*
- *appointment of executive officers; or*
- *the company's solvency.*

. *Sub-section (1) does not operate in relation to any other provision of this Act or any other Act or any Regulation under which a director or officer may be liable to make a payment in relation to any of his or her acts or omissions as a director or officer.*

. *In circumstances where, in the absence of this provision, a director or officer would not be liable to pay compensation to the company this provision does not operate or impose any such liability.*

69. In its response to the report of the Senate Standing Committee on Legal and Constitutional Affairs on the "Social and Fiduciary Duties and Obligations of Company Directors", the Government noted that the business judgment rule is one of a number of rules concerning directors developed by the courts in the United States. It indicated that it was not then convinced that it is appropriate to legislate for this one aspect of American jurisprudence concerning company directors' duties. The Government also notes that the American Law Institute, in its recent publication "Principles of Corporate Governance", has proposed that the business judgment rule be developed in the United States through the common law rather than by legislation.

70. The Government also notes that the courts have in the past recognised that directors and officers are not liable for honest errors of judgement: Ford's Principles of Company Law (6th ed., 1992) at pp.528-9. They have also shown a reluctance to review business judgments taken in good faith. Thus, in Harlowe's Nominees Pty Ltd v Woodside 121 CLR 483 at 493, the High Court said:

> "Directors in whom are vested the right and duty of deciding where the company's interests lie and how they are served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts."

71. In addition, the courts have exercised their discretion to excuse directors who have acted honestly and who ought fairly be excused: Re Claridge's Patent Asphalte Company Limited [1921] 1 CH 543. The Corporations Law already includes a provision of this nature (s.1318) and the application of that provision is being extended by the Corporate Law Reform Bill 1992.

72. As indicated, both in its response to the Senate Committee Report and in the explanatory memorandum relating to the Corporate Law Reform Bill 1992, the Government does not propose to legislate for a business judgment rule. Instead, the Government considers that, as is the case in the United States, the development of these principles in Australia is better left to the courts.

Recommendation 21

The Committee recommends that section 592 of the Corporations Law, relating to the rights of creditors to recover personally from a director for a company who has incurred a debt in circumstances where he/she knew or must be taken to have known that the company is insolvent, be amended in the following way:

- *the provision should no longer combine civil and criminal aspects in the one legislative provision. The separate criminal provision should be restricted to fraudulent or dishonest trading whilst insolvent;*

- *for the civil provision, the defence under section 592(2)(a) should be replaced so that it is a defence if the director did not have personal knowledge of the incurring of the debt. However, such defence would cease to be available if the director concerned had not discharged his or her duty of care and skill, particularly in relation to the matters of conferring delegated authority, and monitoring of that authority, on the person who actually incurred the debt;*

- *for the criminal provisions, it would be a defence if the director could show that the particular debt was incurred either without that director's express authority or without that director's implied authority and actual knowledge. However, the defence would be lost if the accused was not able to show that he had, in all the circumstances, discharged his duties, particularly those of care and diligence; and*

- *the civil provision should be amended to allow as an additional plaintiff, the liquidator. If the liquidator exercised his or her rights to take action against the directors, any uncommenced action by an individual post-insolvency creditor would be barred. Monies recovered by a liquidator would form part of the assets of the company but post-insolvency creditors would then rank in the winding-up after retrenchment payments in section 556(1)(h). Monies*

recovered on an individual post-insolvency action would continue to be for the benefit of the successful plaintiff.

73. The Committee referred to the differences in approach to s.592 of the Corporations Law in the decisions in *Metal Manufacturers Limited v Lewis* (1987-1988) 13 ACLR 357, *Statewide Tobacco Services Limited v Morley* (1990) 2 ASCR 405 and *Group Four Industries Pty Ltd v Brosnan* (1991) 9 ACLC 1 and concluded that it is desirable to clarify the uncertainties raised by these decisions. It also referred to the report of the Australian Law Reform Commission on *General Insolvency* , which recommended that s.592 be amended to confer on liquidators standing under s.592 of the Corporations Law.

74. The Government has addressed these issues in the Corporate Law Reform Bill 1992 through the proposed insertion into the Corporations Law of a new Division 3 of Part 5.7B entitled "Directors' duty to prevent insolvent trading".

75. Proposed s.588G of the Corporate Law Reform Bill is the key new provision. Under proposed s.588G, insolvent trading is no longer a criminal offence unless it is committed knowingly and with an intent to defraud or dishonestly intending to gain.

76. Proposed s.588G renders a director liable where that director has allowed insolvent trading where he or she suspected, or a director in a like position of a company in that company's circumstances ought to have suspected, that the company was insolvent.

77. There are defences provided. Where through illness or for some other good reason, the director did not take part in the management of the company at the relevant time a director will not be liable. Similarly, a director may escape liability where he or she believed on reasonable grounds that the company was solvent. Such reasonable grounds may exist where the director relies on information provided by a competent and reliable person (either a subordinate or fellow director).

78. Proposed Division 4 of Part 5.7B sets out a regime which gives to the liquidator the primary right to sue directors for the benefit of all unsecured creditors who suffered loss or damage as a result of the directors' actions. But if the liquidator consents to a creditor's taking recovery action, or does not act for a specified time, a creditor would have an individual right of action against the director.

Recommendation 22

The Committee recommends that the Corporations Law be amended to give directors and officers power to rely, in the performance of their duties, on other persons to act or to provide information. Such rule would be in the following terms:

- *a director or officer, when exercising powers or performing duties in that capacity, may accept as correct, reports, statements, financial data and other information prepared, and professional or expert advice given, by any of the following persons to the extent only that the director or officer acts in good faith, after reasonable inquiry when the need for inquiry is indicated by the circumstances and without knowledge that would cause such acceptance to be unwarranted:*

(a) any employee of the company whom the director or officer believes on reasonable grounds to be reliable and competent in relation to the matters concerned;

(b) any professional or expert person in relation to matters which the director or officer believes on reasonable grounds to be within the person's professional or expert competence;

(c) any other director, or committee of directors upon which director did not serve, in relation to matters within the director's or committee's designated authority; and

(d) any audit committee operating in relation to a group of companies.

79. The Senate Standing Committee on Legal and Constitutional Affairs has also recommended in its "Report on the Social and Fiduciary Duties and Obligations of Company Directors" that the companies legislation be amended to provide for, and specifically limit, the extent to which company officers may rely on others.

80. The Government indicated in its response to the Senate Committee's recommendation that it considered the issue is when it is appropriate, in the circumstances of a particular company, for company officers to delegate to other persons, committees or organisations, and rely on reports or opinions prepared by them.

81. The Government acknowledges that it is not, and cannot be, the duty of a director to supervise his co-directors or to acquaint him or herself with every aspect of the company's affairs. Companies must be managed on principles of trust, and beyond obliging directors to act reasonably, it is difficult to provide for these matters in precise detail given the great diversity of companies and their operations, and the need to avoid creating inflexibility in the way in which managements of companies respond to changing needs.

82. The Government notes the following comments by Rogers CJ in *AWA Ltd v Daniels* (1993) 10 ACLC 933 at 1015:

> "A director is justified in trusting officers of the corporation to perform all the duties that, having regard to the exigencies of business, the intelligent devolution of labour and the articles of association, may properly be left to such officers (*Dovey v Cory* [1901] AC 477, 485-486, 492-493; *In re Brazilian Rubber Plantation and Estates Ltd* [1911] 1 Ch 425 at p. 438; *Huckerby v Elliot* [1970] 1 All ER 189, 193, 195). A director is entitled to rely without verification on the judgment, information and advice of the officers so entrusted. A director is also entitled to rely on management to go carefully through relevant financial and other information of the corporation and draw to the board's attention any matter requiring the board's consideration. The business of a corporation could not go on if directors could not trust those who are put into a position of trust for the express purpose of attending to details of management (American Law Institute, *"Principles of Corporate Governments, Analysis and Recommendations "* (sic) pp 175, 176 ...
>
> ... Directors are entitled to rely on the judgement, information and advice of the auditors (cf *In Re Denham & Co.* [1883] 25 Ch. D 752, 766; *Dovey v Cory* [1901] AC 477, 486, 492]".

83. The Government considers that this recent statement of principle reflects the Committee's recommendation. The Government will consider whether any legislative amendment could add to the understanding of the underlying principles which emerges from the AWA case.

Recommendations 23 and 24

The Committee recommends that the Corporations Law be amended to recognise the power of the company in general meeting to give advance authority for specific conduct of a director or officer in relation to a specific transaction, other than conduct which involves an intent to deceive or defraud. The advance authority procedure would operate on the basis that:

- *the disclosure should be such as to make members aware of at least:*

  (a) material details of the transaction;

  (b) any direct or indirect interest of the directors or officers or their associates or their relatives in the transaction;

  (c) the benefits to the company that it will obtain that could not be obtained by a transaction that did not require the authority of the company in general meeting; and

  (d) the circumstances that indicate that without the authority, the director or officer will be in breach of duty and the nature of any liability that could accrue;

- *in a group of companies it should be a general meeting of the holding company that gives approval for directors in subsidiary companies to be authorised. In the case of a partly-owed subsidiary, the members of both the subsidiary and the holding company should give the approval (as for directors' loans);*

- *interested directors, their associates and relatives should not be able to vote. The necessary majority should be that for any ordinary resolution;*

- *the statutory statement of the power of the general meeting to authorise what would otherwise be a breach of duty should be expressed to be subject to section 260 alone; and*

- *if the company goes into liquidation within 12 months after the authority is given and is insolvent, the Court may order that the director or officer in question should be considered to be in the same position as if the authority had not been given.*

The Committee recommends that the Corporations Law be amended to recognise the power of the company in general meeting to release a director or officer from civil liability to pay damages or compensation to the company in respect of a past event. The post-event release procedure should operate on a basis that parallels the procedure for an advance authorisation.

84. The Committee considered that it was desirable to provide in the Corporations Law that the duty of directors should be capable of modification in advance and

breaches exonerated but only by the shareholders in general meeting and only on the basis of adequate disclosures.

85. The Senate Committee in its "Report on the Social and Fiduciary Duties and Obligations of Company Directors" also recommended that the Corporations Law be amended to set out requirements which must be met for the exoneration of directors from what would otherwise be breaches of their fiduciary duty. In its response to the Senate Committee's report the Government referred to three categories of breach of fiduciary duty: misuse of corporate assets, transactions with the company involving a conflict of interest, and the taking for personal gain of business opportunities which ought to be taken by the company. It also referred to the Senate Committee's observation that:

> "It is difficult to formulate a general rule for disclosure and consent to activities which would otherwise be breaches of fiduciary duty. For some questions the involvement of shareholders is clearly warranted, while for others it would render decision making unnecessarily cumbersome. Different consent regimes may be appropriate for the various fiduciary rules."

86. The Corporate Law Reform Bill 1992 proposes the insertion into the Corporations Law of a new Part 3.2A, entitled "Financial Benefits to Related Parties of Public Companies", which includes a disclosure and consent regime in relation to breaches of duty involving misuse of corporate assets and transactions with the company involving a conflict of interest.

87. The proposed Part 3.2A does not deal with breaches of duty involving the taking for personal gain of business opportunities which ought to be taken by the company. The Government intends to monitor experience with the proposed Part 3.2A before developing complementary proposals in the areas of corporate opportunity and exoneration of existing breaches of duty.

Recommendation 25

The Committee recommends that the ASX Listing Rules be amended to require every listed company to:

- *establish an audit committee, with the chairman and a majority, or all, of the members of the audit committee being non-executive directors: where there are not sufficient non-executive directors on the board to comply with this, the function of the audit committee must be performed by the whole board;*

- *require that the audit committee meet regularly and report to the Board;*

- *require that the audit committee have direct access to the company's auditors (internal and external) and senior management and have the ability to consult independent experts whenever it concludes such to be necessary;*

- *require that the audit committee review financial information to ensure its accuracy and timeliness and the inclusion of all appropriate disclosures;*

- *ensure the existence and effective operation of accounting and financial controls oversee the audit of the company, including nominating the*

auditors, approving the scope of the audit and examining the results to provide a link between the auditors and the board; and

- *undertake such other functions as are allocated to it by the board provided that the extra functions do not compromise its ability to perform its primary function as listed above.*

88. The Government affirms the opinion put in its response to the report by the Senate Standing Committee on Legal and Constitutional Affairs on the "Social and Fiduciary Duties and Obligations of Company Directors" that the establishment of audit committees has the potential to enhance the quality of financial information about Australian companies and alleviate concerns relating to the difficulty of maintaining a proper balance between the wishes of company management and the interests of shareholders and creditors.

89. In its response to the Senate Committee's report, the Government also noted that the Working Group on Corporate Practices and Conduct has recommended that each public company establish an audit committee with a majority of non-executive directors. The Working Group's report offers the opportunity for industry to develop practices concerning the use and establishment of audit committees, especially in the light of the relative lack of experience in the use of audit committees in Australia. The Government also indicated in its response to the Senate Committee report that it proposes to monitor the impact of the Working Group's recommendation before giving consideration to a legislative approach. However, the question whether Listing Rules should mandate the establishment of audit committees for listed companies is in the first instance a matter for the Australian Stock Exchange.

(e) Controls necessary for the protection of shareholders, in particular minority shareholders.

Recommendation 26

The Committee recommends that the Corporations Law be amended to insert a new provision, section 260A, which would provide standing to:

- *any member or former member, of the corporation or a related corporation,*
- *any director or officer, or former director or officer, of the corporation or a related corporation;*

to establish an interest to seek leave of the Court to proceed on behalf of a company without the need to demonstrate the availability of any of the general exceptions to the rule in Foss v Harbottle.

The provision would otherwise be drafted in the same terms as that proposed by the Companies and Securities Law Review Committee at pages 7 and 8 of its report No.12 with the following qualifications;

- *any present or former director or officer who is the defendant in proceedings for which leave was granted shall be entitled to financial assistance from the company in defending such proceedings on the same basis as that provided by the company to the applicant. If no assistance is provided by the company to the applicant then, none would be provided to the defendant, officer or director. Any such assistance is to be regarded as an interest free unsecured loan (permission for which is to be recognised by an amendment to section 234);*

- *in situations where the derivative action is being funded by the company, the Court shall be obliged to be active in case-management by requiring regular reports on steps taken and funds expended on both sides so as to ensure that the shareholders funds are being expended in reasonable manner;*

- *that directors and officers be given a statutory right to indemnity for the costs of a successful defence (in the terms of recommendation 33 of the CSLRC in its report No.10); and*

- *that the Corporations Law be further amended in relation to the company's ability to maintain suitable insurance for directors, such amendments being in accordance with recommendations 26-32 of the CSLRC Report No.10.*

90. The establishment of a shareholders' derivative action involves a number of complex issues requiring the striking of a tripartite balance between the competing interests of the company's directors, its members in general meeting and the personal rights of individual members. A shareholders' derivative action also impacts upon the Committee's recommendation that the company in general meeting be authorised to release a director or officer from liability to the company in respect of a past event, as such a release will usually operate to terminate a derivative action.

91. The Attorney-General has indicated that the Government will be reviewing its corporate law reform program after the enactment of the Corporate Law Reform Bill 1992 and the Corporate Law Reform Bill (No. 2) 1992. That review will consider the priority to be accorded to the Government's consideration of the introduction of shareholders' derivative actions to the Corporations Law.

Recommendation 27

The Committee recommends that:

(a) section 319 be amended to provide that when the Court accedes to a request for access , such access be provided to 'a suitable person', to be determined at the discretion of the Court; and

(b) a person, with standing to seek leave to proceed on behalf of a company, should be able to invoke section 319 in preparation for an application for leave to pursue a derivative action.

92. Section 319 of the Corporations Law enables the court to make an order, upon the application of a shareholder, for the inspection of the company's books by a registered company auditor or a duly qualified legal practitioner on the shareholder's behalf. The Committee considered that s.319 is too restrictive in confining the right

to inspect the company's books to registered company auditors and duly qualified legal practitioners.

93. The Government will consider the Committee's recommendation that the class of persons who might be granted access should be extended, in the course of the Government's on-going program of reviewing and updating the Corporations Law.

94. The extension of the right to inspect a company's books as contemplated by part (b) of this recommendation will be considered in the course of the Government's consideration of the establishment of a shareholders' derivative action.

Recommendation 28

The Committee recommends that the ability of shareholders to force the timely convening of a meeting of shareholders be enhanced by amending section 246 in the following way:

- *the meeting must be held as soon as practicable but in any case, not later than one month after the date of the deposit of the requisition;*
- *if the directors have not convened the meeting within 10 days after the date of deposit of the requisition, the requisitionists are to then have the power to convene the meeting themselves, with the meeting to be held within 2 months of the requisition having been lodged; and*
- *the ASC should have the power to extend any of those time-frames.*

95. Section 246 of the Corporations Law obliges the directors of a company upon receipt of a requisition by members to "as soon as practicable convene a general meeting of the company to be held as soon as practicable but, in any case, not later than 2 months after the date of the deposit of the requisition." If the directors do not within 21 days after the deposit of the requisition proceed to convene a meeting the members may themselves convene a meeting at the company's expense to be held not later than three months after the deposit of the requisition.

96. The Committee also referred to s.227 of the Corporations Law, which provides that a resolution to remove a director under that section is not effective unless notice of the intention to move the resolution has been given to the company at least 28 days before the day of the meeting.

97. The Committee was concerned that directors might unduly defer the date for the convening of the meeting, and that this might especially be the case when the purpose of calling the meeting was to remove a director under s.227 of the Corporations Law.

98. The Government considers that the Corporations Law should not place unwarranted procedural barriers to the prompt resolution of requisitions calling for the removal of directors under s.246. It agrees with the Committee that s.246 should ensure that the power to convene a meeting, especially one to consider the removal of a director, should operate effectively, without diminishing the rights under s.227 held by the director the subject of the proposed resolution. The Government proposes to give consideration to the Committee's recommended amendments in the course of its on-going program of reviewing and updating the Corporations Law.

Recommendation 29

The Committee recommends that section 13 of the Australian Securities Commission Act 1989 should be amended to allow investigation of:

(a) any breach of a unit trust deed;

(b) any act or omission within the scope of the oppression remedy in section 260 of the Corporations Law; and

(c) any breach of directors duty whether or not attracting criminal sanctions.

99. In its consideration of the investigative powers of the ASC the Committee noted certain deficiencies in the legislation conferring those powers. In particular, it noted that section 13 of the ASC Act restricted investigations to contraventions of the Law and did not extend to investigations of the affairs of unit trusts, and that the ASC does not have a general mandate to investigate issues of oppression.

100. Subsection 1073(1A) which was inserted into the Corporations Law by the Corporations Legislation Amendment Act (No.2) 1991 provides that a person must not contravene a covenant contained in, or deemed or taken to be contained in, a deed which has at any time been an approved deed. Any contravention or suspected contravention of this provision will allow the ASC to make an investigation if it thinks expedient for the due administration of the national scheme law.

101. Acts or omissions within the scope of the oppression remedy in s.260 of the Corporations Law will generally also constitute a contravention of s.232 of the Corporations Law. The Corporate Law Reform Bill 1992 proposes the partial decriminalisation of a range of provisions of the Corporations Law, to be known as civil penalty provisions. The civil penalty provisions will be defined to include, for example, the directors' duties established by s.232 of the Corporations Law. Consequently, the Commission will be able to investigate contraventions of directors duties, notwithstanding that the contravention might be a civil matter only.

102. Having regard to the amendments made by the Corporations Legislation Amendment Act (No.2) 1991 and proposed by the Corporate Law Reform Bill the matters identified by the Committee should shortly be rectified.

Recommendation 30

The Committee recommends that criminal liability provisions of the Corporations Law should be reviewed so that criminal consequences only flow from conduct which is genuinely criminal. To that end the Committee recommends:

- *section 232 should no longer combine civil and criminal aspects in the one legislative provision. The separate criminal provision should be restricted to situation where the director has acted in deliberate or reckless disregard of his or her duty;*

- *the civil and criminal aspects of section 592 (concerning recovery of debts from a director) should be separated and dealt within the manner referred to in the Committee's earlier recommendation concerning that section; and*