The Parliament of the Commonwealth of Australia

SUMMARY OF EVIDENCE PRESENTED TO THE COMMITTEE ON THE DRAFT CORPORATE LAW REFORM BILL 1992

JOINT STATUTORY COMMITTEE ON
CORPORATIONS AND SECURITIES

JUNE 1992

The Parliament of the Commonwealth of Australia

SUMMARY OF EVIDENCE PRESENTED TO THE COMMITTEE ON THE DRAFT CORPORATE LAW REFORM BILL 1992

JUNE 1992

JOINT STATUTORY COMMITTEE ON
CORPORATIONS AND SECURITIES

JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND SECURITIES

MEMBERS

Senator Michael E. Beahan Chairman

Senator Austin W. Lewis Deputy Chairman

Senator Ian Campbell

Senator Barney Cooney

Senator Sid Spindler

The Hon Janice Crosio MP

Mr Frank Ford MP

Mr Duncan Kerr MP

The Hon John Moore MP

The Hon Gary Punch MP

Secretary

Mr Derek Abbott
The Senate
Parliament House
CANBERRA ACT 2600

DUTIES OF THE COMMITTEE

Section 243 of the Australian Securities Commission Act 1989 reads as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

(i) activities of the Commission or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of any national scheme law, or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of a national scheme law;

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

CONTENTS

INTRODUCTION

1.1 This draft bill was released for public discussion in February 1992. The Attorney-General's Department held practitioner workshops to allow public comment on the draft bill in Sydney, Melbourne and Adelaide. This committee decided to hold hearings in Perth, Sydney, Melbourne and Brisbane to provide further opportunity for public comment. It was felt that a bipartisan parliamentary committee was better equipped to conduct such sessions than the government department which had carriage of the project and would inevitably find itself in the position of defending its proposals. To ensure that the Attorney-General's Department was fully involved in the process a senior officer from that department attended all the hearings and provided advice, comment and interpretation of the draft for committee members and other witnesses.

1.2 The committee believes that a record of the hearings and a summary of issues raised at those hearings will assist members and senators in dealing with the legislation when it is before the Parliament. It will also assist the Attorney-General's Department in revising the draft bill prior to its introduction into the Parliament in the budget session of 1992.

1.3 The draft bill includes proposed changes to the Corporations Law in four main areas - director's duties; loans to directors and transactions between associated companies; civil penalties and insolvency. Changes with regard to annual returns and stock exchange settlement procedures are also proposed. However, while important, these proposals did not generate discussion before the committee and thus this paper does not deal with them.

1.4 It is not the committee's intention to examine in detail and make recommendations on the matters covered by the draft bill. They have already had wide exposure through other inquiries. The Law Reform Commission produced a major report on insolvency in 1988[1]. The questions

---

[1] *General Insolvency Inquiry*, Report No.45, Law Reform Commission. (Canberra 1988)

of director's duties and civil penalties were considered by the Senate Standing Committee on Legal and Constitutional Affairs in its report on *The Social and Fiduciary Duties and Obligations of Company Directors*.[2] The issues of loans to directors and related party transactions were discussed in reports by the Companies and Securities Law Review Committee[3] and the Companies and Securities Advisory Committee[4]. However the committee retains the option of inquiring into any matter with which the bill deals at a later date if the revisions made to the current draft leave significant issues unresolved.

1.5 The general view on the proposed reforms to insolvency procedures was that they represented a significant improvement over existing law. However there were a number of constructive suggestions to further improve the proposals.

1.6 Most of the comment to the committee on directors' duties, loans to directors and related party transactions were critical of aspects of the draft bill. This is inevitable given that these proposals have the potential to impose onerous new burdens on directors. Thus the evidence taken by the committee on these matters and summarised in this paper is not necessarily representative of all shades of opinion in the community and does not reflect the views of the committee.

---

2 *Company Directors' Duties*, Senate Standing Committee on Legal and Constitutional Affairs (Canberra 1989).

3 *Directors Statutory Duty to Disclose Interests and Loans to Directors*, Companies and Securities Law Review Committee, 1989.

4 *Report on the Law Governing Corporate Financial Transactions*, Companies and Securities and Advisory Committee, 1991.

GENERAL ISSUES

Are the changes needed?

2.1 A number of comments were made in evidence to the committee that many of the problems of the 1980's which the bill is responding to - the duties of directors, loans to directors and related party transactions - were failures of regulation not of law.

2.2 Professor Bob Austin warned against pursuing a 'scorched earth' approach to corporate legislation regulation aimed at eliminating all fraud within a jurisdiction. To set the ordinary standard of regulation at the level necessary to catch the determined corporate criminal would '...unacceptably inhibit good and proper business.'[5] In discussing the loans to directors provisions, Professor Austin made the general point that:

> where there is a series of corporate scandals there is a tendency for legislation to overreact and to produce provisions which interfere with the legitimate in order to catch the illegitimate.[6]

2.3 It was noted by a number of witnesses that the climate of corporate regulation has changed significantly in recent years. The courts have shown an increasing willingness to extend their interpretation of the duties of directors and a properly funded and vigorously administered regulatory body, the Australian Securities Commission, is having considerable success in prosecuting, or recovering civil damages from, corporate offenders using the existing law. It was strongly argued that amendment to the existing law should be slowed to allow the full impact of these two trends to be assessed before resorting to further legislation.

2.4 John Green, a partner in Freehill, Hollingdale and Page, warned that one effect of these changes was that the environment in which business operates had undergone a 'fundamental shift' as a result of which:

> ... when directors were assessing whether the company should do something ... the question that they used to ask was, 'How will it benefit the company? How will it take the company

---

5 Prof. Bob Austin, *Committee Hansard*, 21 May 1992, p.314.

6 Prof. Bob Austin, *Committee Hansard*, 21 May 1992, p.345.

> forward to meet its strategic challenges?' and so on. The first question that many of them ask now is, 'What risk do I have personally?' ... That is the wrong question.[7]

2.5 Other witnesses queried whether legislation was the most effective way to influence corporate behaviour. Commenting on recent trends Professor Ralph Simmonds put the view that:

> ... it is probably somewhat less important than one imagines that one has a tightly drawn duty of care statement. If your business climate is favourable towards recognising high community expectations of directors, it probably does not matter much what the legislation says ... .[8]

2.6 Professor Paul Redmond also queried whether the emphasis on legal rules with regard to a director's duty of diligence, as a means of influencing director's conduct, was justified given that:

> ... the reality is that in terms of care, skill and diligence there are very few cases that are litigated and reported in relation to director's duties... Our leading cases, still, were decided in the first two decades of this century.[9]

He argued that in recent years cases where the decision making and standards of conduct of directors have been reviewed have all occurred in liquidation and insolvency.

Drafting of the Bill

2.7 The drafting style of the proposed bill was a source of concern to many witnesses. The Corporations Law and its amendments are generally drafted in a detailed, 'black letter' style which has been criticised for its complexity and rigidity. It is argued that this style of legislation is not readily accessible to its users and requires expert and costly legal advice to enable them to interpret it. It is also too rigid to provide the basis for the regulation of the diverse corporate forms that comprise the business sector.

---

7 Mr John Green, *Committee Hansard*, 21 May 1992, p.349.

8 Prof. Ralph Simmonds, *Committee Hansard*, 23 April 1992, p.144.

9 Prof. Paul Redmond, *Committee Hansard*, 21 May 1992, p.325.

2.8 A number of witnesses favoured the adoption of what was variously described as open-textured drafting, principled drafting or fuzzy law, where legislation establishes general principles which the courts apply to individual cases. However it should be noted that support for this was not unanimous. Mr David Selig, a partner in a Sydney law firm, expressed support for black-letter drafting. Mr Selig pointed to the inconsistencies in the application of s.592 of the Corporations Law in recent cases as an example of the difficulties of getting consistency of decision making even from reasonably detailed law.[10]

2.9 Professor John Farrar, while supporting the use of principled drafting where appropriate, warned that 'there has to be some underlying moral agreement for the use of a particular fuzzy concept, otherwise it is just slack drafting.'[11]

2.10 The committee acknowledges that the regulation of corporations is a complex subject and does not lend itself to simple laws. However concern at the direction the Corporations Law is taking is widespread and extends far beyond what some might consider the self-interested protests of the business community. Practitioners and academic lawyers have also complained about its complexity. The committee notes that the Attorney-General has responded to this concern and has set up a working party to examine the drafting of the most complex part of the draft bill - that dealing with loans to directors and related party transactions. In the long term consideration should be given to reviewing the whole Corporations Law with the object of, at the very least, simplifying its language and layout.

The Law Reform Process

2.11 The introduction of the national scheme of corporate regulation in January 1991 was a significant change in the administration of the law. However the content of the Corporations Law is largely a consolidation of the state and Commonwealth laws it replaced. It was put to the committee that the opportunity to reform the content of the law is being missed, partly because the Corporation Law is based on pre-existing laws and partly because the law 'reform' agenda is now dominated by amendments to that

---

[10] Mr David Selig, *Committee Hansard*, 21 May 1992, p.334.

[11] Prof. John Farrar, *Committee Hansard*, 22 May 1992, p.380.

law to remedy perceived problems arising out of the so-called excesses of the '80's.

2.12 Witnesses commented favourably on the New Zealand and Canadian approach to law reform in this area. In both countries comprehensive draft laws were published and extended periods of exposure were allowed for law reform proposals. In Canada, revised drafts were also published for further detailed consideration over a period of years. Professor Bob Baxt queried whether there was any need for urgency in getting the legislation passed:

> We often put [urgency] forward as the argument for getting this legislation through so that not only does the community not have appropriate time to assess it but, I wonder how much time you have as parliamentarians to assess the legislation.[12]

2.13 Critics of the Australian approach to corporate regulation also argue that Australia is getting out of step with its neighbours, trading partners and other countries with similar legal systems in its approach to corporate regulation. While it must be acknowledged that Australia's Corporations Law is broader in its scope than the corporate laws of comparable countries, and is thus inevitably longer and more complex, witnesses argued that Australia was failing to give sufficient weight to the need for a degree of international comparability in this area of law in view of the trend towards harmonisation of laws overseas.

2.14 International companies seeking to incorporate here or maintain offices in our region look very carefully at the regulatory regime they will have to comply with. If Australia is perceived as being excessively onerous or even unfamiliar this will act as a disincentive to establishing businesses in this country. Professor Farrar's view was that:

> The end result is that [Australia] is going up a blind alley, completely separate from every major jurisdiction overseas in a lot of [its] legislation. I think that it is a very bad thing for Australia, particularly in terms of encouraging companies to incorporate here.[13]

2.15 Quentin Digby outlined some of the practical effects of this. The

---

[12] Prof. Bob Baxt, *Committee Hansard*, 22 May 1992, p.379

[13] Prof. John Farrar, *Committee Hansard*, 22 May 1992, p.385.

prospectus provisions introduced in the Corporations Law in 1991 are, it is claimed, resulting in Australian shareholders being excluded from rights offers and employees from employee share offers. If Australia introduces restrictive asset transfer rules, comparatively over-regulated directors duties and statutory continuous disclosure with personal liability for directors these will provide further disincentives to incorporation in Australia.[14]

2.16 It was argued, for example, that Malaysia and Singapore, with similar legal systems inherited from Britain, had largely followed Australia's lead in corporate regulation until the early 1980's. Since that time Australia has adopted an increasingly prescriptive,' black letter' approach while other countries have not, with the result that links between the jurisdictions have weakened.[15]

[14] Mr Quentin Digby, Mr Tony Greenwood, *Committee Hansard*, 22 May 1992, p.388 and p.397 respectively.

[15] Mr Tom Bostock, *Committee Hansard*, 22 May 1992, p.389.

DIRECTOR'S DUTIES

3.1 Discussion of the proposed changes to director's duties concentrated on three main issues - the extent to which the proposed amendments with regard to directors duties actually improve on the existing law; the introduction in proposed s.232(4AA) of a list of matters to which a director or officer must have regard in discharging his or her responsibilities, and the failure to introduce a business judgement rule.

3.2 The existing duties of directors are contained in s.232 of the Corporations Law.

> s.232(2) An officer of a corporation shall at all times act honestly in the exercise of his or her powers and the discharge of the duties of his or her office.
>
> s.232(4) An officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his or her powers and the exercise of his or her duties.

The draft bill proposes to replace s.232(4) with new sections (4) and (4AA). Proposed s.232(4) [at page 46 of the draft bill] reads:

> "(4) In the exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise the degree of care and diligence that a reasonable person would exercise in exercising those powers, and discharging those duties, as an officer of a corporation in the corporation's circumstances.

3.3 An 'officer' is much more broadly defined than just a director - it includes director, secretary, executive officer, receiver, official manager, liquidator and trustee. It was argued that this poses specific problems for officers who are not directors; for example many of a the factors included in s.232(4AA) may be quite inappropriate to an officer of company who has clearly defined and limited responsibilities.[16]

3.4 These proposed changes have their origins in the Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee)

---

[16] Mr Richard Kneebone, *Committee Hansard*, 22 May 1992, p.421.

report on *The Social and Fiduciary Duties and Obligations of Company Directors*. In considering this subject the report concluded that:

> The courts have been concerned to allow for flexibility and not to hamper entrepreneurs unduly. The standards laid down, however, barely meet the requirements of contemporary business and fall far short of the standards required of other professions.[17]

3.5 The committee recommended that an objective duty of care which all directors would be expected to meet be introduced. This would replace the subjective standard defined by reference to the individual director's 'knowledge, experience and circumstances.'

An Objective Duty of Care

3.6 Proposed s.232(4) seeks to replace the existing subjective duty of care in a way that does not discourage 'honest, informed risk taking...'. In framing the proposed amendment the Government has also considered a number of recent court decisions with regard to company directors, particularly Commonwealth Bank of Australia v Freidrich, which have imposed considerable personal liability on directors. The government believes that these cases have raised the standards of care and diligence required of directors and that the proposed amendments will bring the legislation into line with those recent court decisions.[18]

3.7 Professor Bob Baxt has argued that an effect opposite to that which is intended might be achieved: '... by changing the law, using more specific language, ... a different message may be sent to the courts, thus nullifying the trend which has developed ...'[19]. This view was widely supported in evidence to the committee.

3.8 There was general agreement in evidence presented to the committee that there should be "..an objective standard of diligent attention to the company's affairs...".[20] However there was some disagreement whether it

---

17 *Company Directors Duties*, op cit, p.28, para 3.24.

18 *Commonwealth Bank of Australia v Freidrich (1991) 5 ACSR 115.*

19 Company Director, March 1992.

20 Prof Bob Austin, *Committee Hansard*, 21 May 1992, p.306.

was possible or desirable to go further and seek to impose an objective standard of skill. The Australian Institute of Company Directors put the view that:

> ...the setting of a uniform objective standard of skill for company directors is, in practical terms, impossible...[21]

Professor Austin, representing the Institute, considered that, although the word skill was not used in s.232(4), the section taken in conjunction with paragraphs 90, 94 and 98 of the explanatory memorandum would have that effect.

3.9 The Institute cited the diversity of company types and the range of background skills required from directors, and distinguished the company director from a member of professions such as medicine or law where 'it is reasonable to insist on an objective standard of skill'.[22]

3.10 Many submissions to the committee commented on the apparent failure of s.232(4) to consider the variety of skills, expertise or experience which should desirably be found on a board of directors. It was put to the committee that boards, particularly of major companies, should include a range of skills and experience.

3.11 Mr W J Beerworth, in a paper circulated to committee members, criticised the draft bill's failure to acknowledge the different capacities of directors. The proposed amendment, when considered in conjunction with clause 101 of the Explanatory Memorandum[23] would, he argued, result in the test of due diligence being applied 'mechanically' with the same test being applied to the 'old honorary director ' and the 'young, highly-qualified and highly-paid executive director.'

3.12 The Business Council of Australia (BCA) has expressed a similar view:

> This proposed amendment ... does not reflect proper corporate

---

21 *Submission to the Attorney-General for the Commonwealth of Australia*, Australian Institute of Company Directors, May 1992, p.8.

22 ibid., p.9.

23 Clause 101 reads in part, 'The court will not be required to consider whether the director was a an executive or non-executive director, or a paid or honorary director. Whilst these matters are relevant to the director's circumstances, they are not relevant to the companies circumstances.'

> practices and will result in a lowering of the standards of care and diligence presently imposed under the existing law ... This is because the existing law has regard to the particular skills and expertise which the individual has ...[24]

3.13 Attention was also drawn to the different types of director. Not only are there clear distinctions between executive and non-executive directors; nominee directors will be constrained by the terms of their appointment. In other cases the companies own articles will define the roles of directors, for example by vesting controlling authority in a governing director.

3.14 Professor Ralph Simmonds of Murdoch University, Western Australia, recommended that s.232(4) include a reference to 'skill' as well as care and diligence on the grounds that it is reasonable to expect company officers from whom special skills might reasonably be expected, e.g. directors of finance, to exercise those skills. He notes that the common law has such references as do comparable statutory statements of a duty of care. Professor Redmond made a distinction between publicly listed companies and others and put the view that, for the former:

> having an objective standard of skill enhanced by particular competencies which individual directors bring to a board, is important and should be urged.[25]

3.15 Prof. Simmonds also favoured including the phrase 'in a like position and under similar circumstances' in proposed s.232(4) to '... make it plainer that more can and should be expected of such officers as executive directors and non-executive ones with relevant business experience.' Professor Simmonds' amended version of s.232(4) would read:

> In the exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise the degree of care, diligence and skill that a reasonable person would exercise in a like position and under similar circumstances. (Added words underlined)[26]

---

[24] Business Council Of Australia, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.216.

[25] Prof. Paul Redmond, *Committee Hansard*, 21 May 1992, p.328.

[26] .Prof. Ralph Simmonds, *Committee Hansard*, 23 April 1992, p.31.

Professor Simmonds' proposal does appear to meet most of the criticism both of the existing subjective duty and of the government's proposed amendment to it.

3.16 Mr de Govrik, representing the Australian Corporate Lawyers Association, made a similar suggestion favouring the retention of the existing sub-section 232(4) with the addition of the words '...having regard to the nature of the corporation concerned.'[27]

3.17 The BCA and the Institute of Company Directors recommended that the existing law be retained. Mr Rod Halstead, representing the BCA, argued that the existing s.232(4) met the requirements of those who wished to see an obligation to exercise specific skills by individual directors recognised by the law. In contrast, Mr John Story, chairman of the Companies Committee of the Queensland Law Society, put the view that:

> If we take that section as amended, with the very clear line that courts have taken in recent years, we have a very adequate test and an adequate rule.[28]

Factors Indicating Care and Diligence

3.18 Proposed s.232(4AA) identifies a series of factors relevant to the appropriate standards of care and diligence.

> "(4AA) In determining whether or not an officer of a corporation has contravened subsection (4), regard must be had to such of the following as are relevant in the particular case:
>
> (a) what information the officer acquired, and what inquiries the officer made, about the corporation's affairs;
>
> (b) what meetings the officer attended;
>
> (c) how far the officer exercised an active discretion in the matters concerned;

---

[27] Mr A.C. de Govrik, *Committee Hansard*, 21 May 1992, p.331.

[28] Mr John Storey, *Committee Hansard*, 20 May 1992, p218.

(d) what the officer did to ensure that the corporation made adequate arrangements:

(i) to ensure that people who prepared reports, or gave advice or opinions, on which officers or employees of the corporation relied were honest, competent and reliable, and were in other respects such as to inspire confidence in their reports, advice or opinions; and

(ii) to monitor and ensure compliance with the law, and with the corporation's constitution, by the corporation and its officers and employees; and

(iii) to ensure that persons who took part in the corporation's management did whatever was necessary to avoid a conflict of their pecuniary or other interest with the proper performance and exercise of their functions and powers; and

(iv) to ensure that decisions made by persons on the corporation's behalf were adequately monitored; and

(v) to ensure that persons who made decisions on the corporation's behalf had adequate information about the subject matter of the decisions;

(e) what the officer did to ensure that arrangements of the kind referred to in paragraph (d) were given effect to;

and to any other relevant matter".

3.19 The Explanatory Memorandum accompanying the bill notes that:

> ...in determining whether or not an officer of a corporation has contravened proposed subsection 232(4), regard must be had to such of a number of specified factors as are relevant to the particular case.[29]

---

[29] *Corporate Law Reform Bill 1992*, Explanatory Paper, para 106, p.278.

3.20 The memorandum notes that while the Government does not intend to introduce a business judgement rule, as recommended by the Cooney Committee, it has taken the rule into account in developing the factors included in s.232(4AA).

3.21 This proposed section has been widely criticised both for the general effect it may have and for the wording of the factors included in it. Professor Simmonds favoured the introduction of s.232(4AA) if it were seen as a:

> ...sensible basic arrangement reminding directors that the role as manager is as much supervision of management as it is hands-on management, certainly in larger companies.[30]

3.22 Professor Simmonds proposed changes to the section to emphasise that it was an encouragement to directors to establish good information systems and an inducement to good corporate behaviour, not a check list for the courts to apply to potential offenders. He suggested altering the wording to reflect this - deleting the language of 'contravention' and 'regard must be had to' - and removing the final catch-all clause referring to 'any other relevant matter'. To ensure that directors could reasonably rely on the information so generated, Professor Simmonds proposed an additional clause 232(4AA)(e) which would read:

> The officer reasonably relied on reports, advice or opinions prepared by people, including where reasonable other officers, who that officer reasonably believed merited confidence.[31]

3.23 Mr Noonan, representing the Attorney-General's Department, stated that the intention of s.232(4AA) was to '...act as a general guide and not to be prescriptive or limit the court's discretion in any way.'[32] Mr Noonan noted that the introduction to the various factors identified in s.232(4AA) included the phrase '... to such of the following as are relevant in the particular case' which would have the effect of moderating any use of the sub-section as a check list. However both Bill Beerworth and Professor Redmond were of the view that the list of matters would in effect be

---

30 Prof. Ralph Simmonds, *Committee Hansard*, 23 April 1992, p.144.

31 Prof. Ralph Simmonds, Submission, *Committee Hansard*, 23 April 1992, p.37.

32 Mr P. Noonan, *Committee Hansard*, 23 April 1992, pp.153-4.

prescriptive.[33]

3.24 Mr Alan Pocock supported Professor Simmonds' proposed changes to s.232(4AA) on the basis that the courts tended to treat check lists as setting the '...level at which you either meet the standard or you do not'. He argued that, given that approach, it would be possible to act negligently while complying with s.232(4AA). The Institute of Company Directors was also concerned about the 'check list' in that it might put directors under pressure to lay a 'paper trail' to ensure compliance. It was argued that the pursuit of compliance may be at odds with good business practice and a distraction from the director's principal responsibilities.[34]

3.25 The BCA has also criticised the section, claiming that many parts of it:

> address issues of form and procedure rather than substance. The better approach is to leave the law as it presently stands so that the appropriate issues which are relevant in a particular case will be identified having regard to the facts of that case.[35]

3.26 Bill Beerworth raised additional concern about the possible affect of s.232(4AA) -that it will require the court to have regard to general conduct rather than the matter in question:

> I do not begin to understand why the general behavior of a director over a period of time should have any relationship to a particular prosecution or a particular inquiry about whether or not a director was negligent in a particular case.[36]

3.27 He also questioned whether s.232(4AA)(d), which requires all officers 'to ensure that the corporation made adequate arrangements' with regard to a whole list of factors, is capable of being complied with.

---

[33] Mr W.J. Beerworth, Prof. Paul Redmond, *Committee Hansard*, 21 May 1992, p.308 and p.327 respectively.

[34] Prof. Bob Austin, *Committee Hansard*, 21 May 1992, p306.

[35] Business Council Of Australia, Submission, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.217.

[36] Mr W.J. Beerworth, *Committee Hansard*, 21 May 1992, p.308.

> To impose on a non-executive director that he ensure ... that the corporation comply with the law, that is, the whole body of the law and the corporation's constitution, is obviously incapable of fulfilment.[37]

This view was supported by the Institute:

> How an individual non-executive director can, for example, ensure the things that are required to be ensured, whether the standard is met, is just beyond us. The language seems inappropriate, except perhaps for the chief executive.[38]

3.28 The general view is that s.232(4AA) in its current form, if enacted, will:

> ...place a burden on directors and officers, who will feel that because the court must have regard to these matters, directors and officers must be able to demonstrate that all of the listed matters have been properly addressed.[39]

3.29 The BCA also emphasised that the check list dealt with matters more relevant to directors than officers and that for the latter group compliance would be impossible. A number of witnesses favoured the replacement of s.232(4AA) with a business judgement rule.

The Business Judgement Rule

3.30 The Cooney Committee recommended the introduction of a business judgement rule. This rule has been developed in the US courts to protect directors making informed business decisions. The essence of the rule is that if a business decision is taken in good faith, without the object of personal benefit and having regard to proper decision making procedures, then it should not be subject to review by the courts with the 'wisdom of 20:20 hindsight' irrespective of the outcome.

---

[37] ibid., p.309.

[38] Prof. Bob Austin, *Committee Hansard*, 21 May 1992, p.308.

[39] BCA Submission, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.216.

> The policy behind the ... rule is that informed business judgements should be encouraged in order to stimulate innovation and risk taking.[40]

3.31 In its response to that committee's report the government noted that existing s.1318 of the Corporations Law already gives the courts a general discretion to relieve an officer of civil liability arising out of a breach of duty and that, taken in conjunction with proposed s.232, it was not necessary to introduce the rule. However as the explanatory memorandum to the draft bill notes, the government has taken the rule into account in framing s.232(4AA).

3.32 The failure to introduce the rule has been widely criticised. In evidence to the committee Graham Young argued that the essence of the rule was already in Australian law to an extent and pointed to the judgement in Harlowe's Nominees Pty Ltd(1968) where the High Court stated:

> Directors in whom are vested the right and duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgement, if exercised in good faith and not for irrelevant purposes, is not open to review in the Courts.[41]

3.33 Mr Young argued that under the present draft bill a director could comply with all the matters referred to in s.232(4AA) and could still be open to a finding against him in the courts. He also argued that s.1318 of the Corporations law had none of the characteristics of the rule - it merely provided the courts with a discretion after they had reviewed the business decision. Mr Young argued that the object of the rule was to provide a safe haven for the businessman or woman where they could be confident that their actions would not be subject to review.

3.34 Professor Redmond agreed that Australia had a substantial business judgement rule composed of most court decisions on directors' duties:

> A whole body of general law principles on directors' duties

---

[40] *Company Directors' Duties*, op cit, p.30.

[41] *Harlowe's Nominees Pty. Ltd. v Woodside (Lakes Entrance) Oil Co. N.L. (1968) 121 CLR 483 at 493.*

> reflects a deference for honest views taken by directors, not for improper purposes. That is a very clear safe haven.[42]

3.35 Professor Austin disputed this view, arguing that the Harlowe's Nominees case did not deal with a duty of care and that, generally, there was 'a paucity of judge made law in relation to duty of care'.[43]

3.36 Professor Austin also dismissed the suggestion that proposed s.232(4AA) contained the essence of a business judgement rule:

> What we are looking for is a set of provisions that directors can have regard to at the time when they are making a decision and on the basis that they are not simply factors which will be taken into account by a court in deciding whether they are liable ...[44]

3.37 Mr Tony Greenwood supported this view, suggesting that the policy objective of this section, of not discouraging the honest, informed director, had been 'turned on its head' by the drafting which, by the use of 'must' in s.232(4AA), provided guidance to prosecutors after things had gone wrong rather than to directors.[45]

3.38 The majority of those participating in the committee's hearings believed that the rule should be introduced to protect the directors' right to be wrong. The BCA notes that the proposed amendments relating to loans to directors in fact impose liability:

> ... if a transaction is found to have been detrimental to the company judged by reference to events which subsequently occur, notwithstanding that the directors concerned properly formed the view that the transaction is in the best interests of the company having regard to all the facts then available ...[46]

---

[42] Prof. Paul Redmond, *Committee Hansard*, 21 May 1992, p.337.

[43] Prof. Bob Austin, *Committee Hansard*, 21 May 1992, p.339.

[44] Prof. Bob Austin, *Committee Hansard*, 21 May 1992, p.340.

[45] Mr Tony Greenwood, *Committee Hansard*, 22 May 1992, p.417.

[46] Business Council of Australia, Submission, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.217.

3.39 It was considered that the adoption of the rule would be an important statement of principle to underline '... that proper decision making leads to freedom from liability'. John Story also saw it as a message to the courts that they were not '...being called upon to substitute their own judgement for the judgement that the directors happen to make'.[47]

3.40 A number of witnesses referred to the recently published final draft of the rule produced by the American Law Institute as being worthy of adoption. In response to the calls for the rule's introduction the Companies and Securities Advisory Committee is examining this subject.

3.41 In considering the rule it is however advisable to bear in mind the question posed by Mr Noonan of the Attorney-General's Department - in what circumstances would a director deservedly escape liability under the business judgement rule but be caught under section 232 as proposed?[48]

3.42 Other witnesses also expressed reservations about the need for the rule. Mr Peter Kent of the Australian Shareholders Association was of the view that the proposed s.232 (4) and (4AA) would cover the same ground as a business judgement rule and that there was no pressing need for the rule.[49] Professor Redmond cautioned against the introduction of a statutory rule, noting that no other country had seen fit to legislate for it and implying that it was an area where Australia should not seek to lead the world.

3.43 Professor Redmond noted that the American rule included significant disqualifiers in relation to conflicting interests which if introduced into Australian law might result in 'a much less safe harbour than people are assuming'.[50]

Insurance for Directors

3.44 The issue of giving companies the right to indemnify their directors is not dealt with in this draft bill. However the issue has been examined by the Companies and Securities Law Review Committee and was raised in the

---

[47] Mr John Story, *Committee Hansard*, 20 May 1992, p.221.

[48] Mr Philip Noonan, *Committee Hansard*, 23 April 1992, p.148.

[49] Mr Peter Kent, *Committee Hansard*, 21 May 1992, p.336.

[50] ibid, p.338.

committee's hearings. Lynn Schiftan QC suggested that there are already difficulties emerging in attracting independent directors to the boards of major companies. Ms Schiftan referred to a:

> situation of extraordinary uncertainty as to the level of responsibility they will have to assume over and above that which is currently known. But far more importantly there is an inability for them to be protected, assuming they behave lawfully and appropriately.[51]

[51] Lynn Schiftan QC, *Committee Hansard*, 22 May 1992, pp.427-428.

CIVIL PENALTIES FOR BREACHES OF THE CORPORATIONS LAW

4.1 The Cooney Committee argued that a distinction should be drawn between criminal breaches of the Corporations Law, where directors acted fraudulently or dishonestly, and breaches where there may have been negligence or a failure to discharge a statutory duty but where there was no criminal intent e.g. with regard to the lodging of returns. The committee argued that the use of civil penalties would avoid the stigma of criminality attaching to the director. Criminal penalties would be retained only for cases where there was clear intent.[52]

4.2 This bill responds to that report by proposing a regime of civil penalties. A series of provisions of the Corporations Law would be identified as civil penalty provisions - [see proposed Part 9.4AA, s.1317AA, page 49 of the draft]. These are:

> s.232(2), (5) and (6) - an officer shall act honestly; an officer shall make no improper use of inside information and an officer shall make no gain by improper use of his position;
>
> proposed s243BA (2)(a), (b) and (c) - entry into a regulated financial transaction with a person who is relevantly connected with the company;
>
> proposed s. 243DA(5) - transactions between group bodies corporate;
>
> s.318(1) - financial statements and directors reports; and
>
> proposed s.588G - a director's duty to prevent insolvent trading by a company.

4.3 Where a person contravenes one of these provisions the court may make an order prohibiting a person from managing a corporation for a specified period and/or imposing a pecuniary penalty of not more than $200,000. Penalties may be sought for up to six years after the contravention. Where civil penalties are sought the standard of proof will

---

[52] *Company Directors' Duties*, op cit, pp.189-191.

be that of 'on the balance of probabilities'. In seeking a civil penalty it will be the ASC and not the Director of Public Prosecutions who makes the application. It was suggested that as most questions of directors' conduct arise in a context of insolvency, civil penalties should not go to the crown but be applied for the general benefit of creditors.

4.4 There was considerable support for the 'decriminalisation' of directors duties; for example Professor Farrar stated that he knew of no other jurisdiction in the world which criminalised what are otherwise civil obligations and described this criminalisation as 'looney'.[53] However the proposal contained in the draft bill was widely criticised on a number of grounds. The submission of Mr Alan Pocock to the Committee in Perth best summarises these issues.[54]

Lowered Standard of Proof

4.5 The ASC will be given the right to pursue significant penalties with a reduced burden of proof.

> It is quite wrong to suggest that by labelling the penalty for a particular course of conduct, a "civil penalty provision", that this somehow makes it different from a criminal penalty. The Bill has not decriminalised the offence by introducing a new name and in certain cases removing the threat of incarceration. It clearly requires a contravention of the Corporations Law and has retained the penalty of a significant fine and other sanctions.[55]

4.6 This view was widely supported. Bill Beerworth described the penalties as 'quasi-criminal' and argued that there is no difference between a fine and a civil penalty. The BCA disagreed with the whole concept of civil penalties:

> The only consequence of non-compliance with duties which do not constitute a criminal offence should be liability for whatever damage may have been caused ... and, where appropriate,

---

53 Prof. John Farrar, *Committee Hansard*, 22 May 1992, p.421.

54 Mr Alan Pocock, Submission, *Committee Hansard*, Perth, 23 April 1992, pp.8-17.

55 ibid., p.15.

disqualification from holding further office as a protective rather than a penal measure.[56]

4.7 The view that the civil penalty provisions are merely to facilitate ASC prosecutions at a lower standard of proof was frequently put in evidence.[57] Examination of the present court procedures to develop practices more suited to dealing with corporate prosecutions was considered a better course of action.

Double Jeopardy

4.8 Concern has been expressed about s.1317AV which provides:

> Where criminal proceedings are begun, an application may be made for a civil penalty order in relation to the same contravention but that such application will be stayed until the criminal proceedings and all appeals arising out of the criminal proceedings have been finally determined or otherwise disposed of.

Section 1317AV(5) provides:

> If the result of the criminal proceedings and all such appeals being so determined or disposed of is not such a conviction then:-
>
> (a) ...the [civil penalty] application may proceed; or
>
> (b) ... such an application may be begun;
>
> as if the criminal proceedings had never begun.

4.9 In effect the ASC could seek a criminal conviction and if it failed present the same case seeking a civil penalty at the lower standard of proof. The civil penalties are significant -a fine of up to $200,000 or an order prohibiting a person from managing a corporation for a period specified in the order. It has been suggested in evidence to the committee that if

---

[56] Business Council of Australia, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.218.

[57] Mr Alan Pocock, *Committee Hansard*, Perth, 23 April 1992, pp.164-6.

enacted this double jeopardy will open the way for the ASC to get involved in plea bargaining - 'if you are prepared to agree to pay us a penalty under the civil penalty order we will go for the lesser offence.'[58]

4.10 It is argued that the civil penalty provisions 'ignore the basic tenets of our law' with regard to standards of proof and double jeopardy. Some witnesses, who had no objection to the concept of civil penalties, did oppose this aspect of the proposal.

Investigatory Powers

4.11 A further issue with regard to civil penalties was raised in the committee's Perth hearings. Proposed s.1317AS enables the ASC:

> ... to oblige any person whom it believes may provide information relevant to the ... application of the civil penalty order to provide the ASC with all reasonable assistance ...

4.12 Concern has been expressed that this will enable the ASC to compel answers and remove the right to silence. Laurie Shervington, a former General Counsel to the ASC in Western Australia, commented in his submission to the committee that the investigatory powers set out in Part 3 of the ASC Act included protections of procedural fairness. He was concerned that this new investigatory power was being given outside that part of the ASC Act and thus was not accompanied by those protections.

Legal Professional Privilege

4.13 Mr Shervington also notes that this provision may override legal professional privilege.[59] It is argued that in the wake of the High Court decision in Yuill's case[60] that legal professional privilege is not available where a person is required by the ASC to produce documents or answer questions.

---

[58] Mr Alan Pocock, *Committee Hansard*, 23 April 1992, p.166.

[59] Laurie Shervington, Submission, *Committee Hansard*, 23 April 1992, pp.48-59.

[60] *Corporate Affairs Commission (New South Wales) v Yuill (1991) 65 ALJR 500; 4 ACSR 624; 9 ACLC 843.*

CORPORATE FINANCIAL TRANSACTIONS

5.1 Part G of the draft bill, starting at page 59, deals with corporate financial transactions. The Explanatory Memorandum states that it:

> represents a major reform of the law governing the financial relationship between a company and its directors and related corporations. The reforms seek to address issues arising from the potential for conflict between the interests of the company and its controllers.[61]

In pursuit of these objectives the proposed changes will:

> ... broaden the class of financial transactions subject to regulation, prohibit loans by a company to its directors except for certain transactions requiring shareholder approval, restrict (subject to appropriate exceptions) certain financial transactions with bodies corporate with which a company is connected and regulate asset transfers with associates of the company.[62]

5.2 Discussion before the committee concentrated on the general issues of the need for the proposed changes, the obscurity and imprecision of its drafting and the effects of the changes on ordinary business transactions. The comment on the detail is generally contained in the written submissions supplied to the committee and the Attorney-General's Department.

5.3 Opinions on the general objective ranged from the trenchant views of Mr Jack Tilburn[63] that all such loans be prohibited and all other benefits be subject to disclosure requirements, a view shared by the Australian Shareholders Association,[64] through a middle ground which accepted loans but called for full statutory disclosure[65] to the position of the Institute of

---

61 *Draft Corporate Law Reform Bill 1992*, Explanatory Memorandum, p.310, para 222.

62 ibid., p.311, para 224.

63 Mr Jack Tilburn, *Committee Hansard*, 21 May 1992, pp.317-319.

64 Mr Peter Kent, *Committee Hansard*, 21 May 1992, p.344.

65 Prof. Robert Walker, *Committee Hansard*, 21 May 1992, p.322. Prof. Walker noted that a study of Australia's top 50 companies over a period of four years suggested that:

Company Directors which questioned the policy justification for the proposals and favoured the status quo and disclosure based on self-regulation.[66]

Is This Change Necessary?

5.4 John Green, a partner in Freehill, Hollingdale and Page, was one of a number of witnesses who questioned whether there was sufficient evidence with regard to this area to justify the introduction of a new regulatory regime:

> ... whether those problems were as a result of a defect in the law or not, or as a result of a defect in enforcement, or as a result of a defect in some other form of remedy ... has not been satisfactorily answered.[67]

It was not suggested that the underlying issue was not a serious one, but that '... the law should have covered those things and it is a question largely of enforcement.'[68]

Drafting

5.5 The complexity of the provisions came in for almost unanimous condemnation. Professor Austin argued that complexity is inherent in the government's approach to regulating this area:

> ... once you decide to have a statutory structure dealing with loans for directors and prohibiting conduct which would otherwise be subject to fiduciary law, you must accept that you are heading down a path which will lead to great complexity. You cannot prohibit ... conduct in absolute terms without

---

What they disclosed, by way of loans to directors and related party transactions,... indicated that the introduction of regulation prompted far more fulsome disclosures than what had been voluntarily provided.

Even when information was provided it was often inaccessible.

[66] Mr Peter Dunstan, *Committee Hansard*, 21 May 1992, pp.320-323.

[67] Mr John Green, *Committee Hansard*, 21 May 1992, p.348.

[68] ibid., p.348.

providing exceptions to enable the legitimate to go ahead.[69]

5.6 Once the 'prohibition and exceptions' approach is adopted the practice of loopholing to avoid the provisions becomes a problem. The BCA pointed out that the exception in this part of the bill for exempt companies - those having less than fifteen members - provided fertile ground for avoidance of the provisions by the use of subsidiary companies.[70]

5.7 The BCA stated that:

> It is critical that the Corporation's Law remain a piece of legislation that a company officer of average skill and intelligence can read and then understand the boundaries of the conduct the government wishes to regulate. The present bill does not achieve this objective.[71]

The BCA's general recommendation was that the existing law need only be changed where there is a clear case for a particular amendment and that emphasis should be on enforcement of the current law.[72]

5.8 Among other comments on the drafting are those on the inadequacy of the definitions - 'interest', 'benefit' and 'relative' are either undefined or so generally defined as to be unworkable as a guide to action:

> a director will have to consider the conceivable range of undefined benefits which might arise directly or indirectly for herself, her spouse and their respective relatives. This will usually be an impossible task if the director is unacquainted with the interests of all of her and her husband's defined relatives, particularly as a benefit is said to accrue if it does so 'indirectly through one or more interposed bodies corporate, trusts or partnerships'.(s.243KB(2))[73]

---

69 Prof. Bob Austin, *Committee Hansard*, 21 May 1992, p.345.

70 BCA Submission, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.219.

71 ibid., p 219.

72 ibid., p. 219.

73 W.J. Beerworth, letter to the committee.

5.12 In the case of both related company loans and the transfer of assets between a company and associated persons the BCA argues that the proposals cover far too broad a range of transactions and will, as a result, intrude on ordinary business dealings including the sale of inventory between a subsidiary and its parent. Because the draft bill refers to the value of transactions over any six month period, compliance will be burdensome as companies will have to maintain cumulative records of the total value of all purchases or sales of assets between associated persons to ensure that they do not exceed the prescribed limits.[76]

[76] Business Council of Australia, Submission, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.222.

The Role of the Australian Securities Commission

5.9 The BCA submission is also critical of a number of aspects of the proposal, particularly the involvement of the courts and the ASC in commercial decision making and the exercise of commercial judgements on transactions. Tony Greenwood also commented on the role of the ASC, particularly where it is given a supervisory role over transactions which have been put before the shareholders and have been approved.

> That seems to me to be calling on the Commission to exercise some supervening judgement that is just inappropriate for a regulator. If the Commission has some view that the shareholders have been misled or inadequately informed, it should have the power to intervene, but it is an inappropriate form of discretion to require it to have a supervisory consent of this kind.[74]

5.10 A number of submissions to the committee have commented on the volume of paperwork which the returns to the ASC in relation to this part of the legislation will generate. The purpose of the returns is to enable the ASC to act on any questionable transactions at an early stage. However there is a widely held view that to examine each transaction and make a judgement as to whether it warrants further action will place an enormous burden on the ASC. At the same time, without that sort of analysis the returns themselves will be of little value. As an alternative Mr Shervington suggested that a system of checks by surveillance teams, modelled on the checks on investment advisers, would be more effective in terms of both the use of resources and outcomes.[75]

The Scope of the Proposals

5.11 The BCA also claims that, with regard to the need for a business judgement rule, where loans to related companies are concerned, directors will be judged by reference to subsequent events not whether their decision was a sound one at the time it was made. To protect themselves directors will seek shareholder approval for all relevant loans, no matter how unobjectionable, adding cost and complexity to the process.

---

[74] Mr Tony Greenwood, *Committee Hansard*, 22 May 1992, p.429.

[75] Laurie Shervington, *Committee Hansard*, 23 April 1992, p.163.

INSOLVENCY

General

6.1 The evidence presented to the committee on the insolvency proposals suggests that reforms contained in this draft Bill are an important step forward which should be proceeded with as a matter of urgency. However a number of witnesses suggested that some issues remain to be resolved and that considerable work may still be necessary to further refine and develop the new voluntary administration proposals.[77]

The Voluntary Administration Proposal

6.2 The Bill introduces a new procedure under which a company in financial difficulties can appoint an administrator.[78] This replaces the existing provisions dealing with official management:

> The insertion of the new part is primarily designed to redress concerns that Australia's current corporate insolvency laws are inflexible and that they too easily and too often lead to the liquidation of companies when some such companies could have been saved.[79]

6.3 The new procedure:

* allows directors to appoint an independent administrator who must be a registered insolvency practitioner;

* allows the administrator 28 days (35 over easter or christmas) in which to develop a proposed scheme of arrangement to present to the members and creditors;

* allows secured creditors to challenge the appointment if it is being used merely to delay an inevitable winding up;

---

[77] *Committee Hansard*, 23 April 1992, pp. 178-199; 20 May 1992, pp. 238-267; 21 May 1992, pp.350-362; 22 May 1992, pp. 430-446.

[78] *Draft Corporate Law Reform Bill 1992*, proposed sections 435-451C, pp.147-184.

[79] *Draft Corporate Law Reform Bill 1992*, Explanatory Memorandum, p.426.

* generally protects a company and its assets from legal action for the recovery of debts while allowing some exceptions;

* allows a creditor with security over the whole of the company's assets a limited opportunity to enforce its security;

* allows for court supervision and direction; but

* if a suitable and acceptable arrangement can not be made the bill provides for a simple, orderly transition to a winding up.

6.4 Although the administration proposal contained in the draft Bill has been generally supported as providing a sound base for reform in this area of the law concerns have been expressed about some individual parts of the proposal and the overall effectiveness of the proposal. The Australian Bankers Association (ABA) has put forward a detailed proposal aimed at improving the draft Bill.

6.5 Dr McGuinness (Visiting Professor, Faculty of Law, Queensland University of Technology) commenting on the basis of his experience in Canada with similar legislation has said:

> Again, I caution you that this legislation has been a mixed blessing in both Canada and the United States. There have been some companies that have been saved, which has been in everybody's interest, but there have been far more companies which have just wasted a good deal of creditor money in fruitless applications under the Act.[80]

6.6 Other general concerns expressed by Dr McGuinness are that the legislation may require general tightening up to ensure that the administrator is more clearly accountable to the creditors and that to be effective any administration must enjoy the support of at least a significant proportion of the companies creditors.[81]

Definition of Insolvency.

6.7 The definition of insolvency in the proposed legislation is whether or

---

[80] Dr K McGuinness, *Committee Hansard*, 20 May 1992, p.241.

[81] ibid., *Committee Hansard*, 20 May 1992, pp. 240, 248, 252.

not "the person is able to pay all the person's debts, as and when they become due and payable, from the person's own money"[82]. The adequacy of this definition has been questioned before the committee.

6.8 The law in Australia, England, Canada and the US has generally recognised two tests of insolvency, the 'cash flow test' outlined above and the 'balance sheet test' (ie. do the companies assets exceed its liabilities?) while New Zealand legislators are currently developing proposals incorporating both of these tests. Mr Ron Harmer, author of the Law Reform Commission's *General Insolvency Inquiry*, has expressed concern that adopting only one test and applying it to the whole body of the Corporations Law may cause problems.[83]

Commencement of Insolvency.

6.9 The draft Bill provides that a company is deemed to be insolvent where accounts for the company have not been kept. In evidence given to the committee it was pointed out that an honest director could be held liable for the company trading while insolvent if the records of the company are destroyed by a dishonest officer of the company. The Attorney-General's Department has agreed that the effects of this provision may need to be reconsidered.[84]

6.10 Similarly Mr Harmer has pointed out that this assumption could result in a creditor who has received payment being unfairly exposed to the antecedent transaction provisions. He has suggested that the antecedent transaction provisions are in need of extensive re-drafting.[85] Mr Harmer also noted that the usual provision contained in insolvency law, that the insolvency is presumed to have commenced 90 days (or some similar time) before a formal insolvency administration, is not included in this legislation.[86]

---

[82] *Draft Corporate Law Reform Bill 1992*, Section H95A, p.134.

[83] Mr R W Harmer, *Committee Hansard*, 21 May 1992,p.351.

[84] Mr J Story, *Committee Hansard*, 20 May 1992, p.261-263; Mr P Noonan, *Committee Hansard*, 20 May 1992, p.263.

[85] Mr R W Harmer, *Committee Hansard*, 21 May 1992, p.354.

[86] ibid., *Committee Hansard*, 21 May 1992, p.354-355.

Initiation of the Administration Proposal.

6.11 The ABA feels that a significant limitation on the legislation is that it can be initiated only by the insolvent company. The ABA has proposed an administration scheme which would provide an opportunity for the administration process to be initiated by an application to the court by the company or by a director, member, creditor or liquidator. This would enable the process to be initiated by an unsecured creditor in the absence of company co-operation.[87]

Applicability the Administration Proposal.

6.12 Concerns were expressed to the committee that access to the voluntary administration procedures is too open and should be limited to those companies that have a reasonable prospect of bringing forward a successful proposal:

> I think the primary weakness with part 5.3A is its failure to limit the availability of the voluntary administration procedures to those companies that have a reasonable prospect of bringing forward a successful proposal for the consideration of the creditors. The basic assumption that seems to underlie the voluntary administration provisions is that there are a vast number of companies out there that are liquidated every year, that are salvageable, that we could just somehow turn around. The fact is that there is really no evidence to suggest that that is the case.[88]

6.13 Dr McGuinness also expressed concern that if a debt moratorium is imposed on a company which does not earn sufficient revenue to cover its average variable cost the main result is that the company continues to lose money to the detriment of the creditors:

> There is no consideration given in the legislation as to whether the procedure should be limited to those companies that are earning sufficient revenue or could be restructured immediately

---

[87] Mr A Cullen, *Committee Hansard*, 22 May 1992, p.431; Mrs F M Mullan, *Committee Hansard*, 22 May 1992, p.432.

[88] Dr K McGuinness, *Committee Hansard*, 20 May 1992, p.239.

so that they were earning sufficient revenue, at least to cover their average variable cost.[89]

Creditor Support.

6.14 In evidence before the committee there was general support for the proposition that for a voluntary administration proposal to work effectively there would have to be support for the process from a significant proportion of creditors. The ABA raised a more specific difficulty concerning the moratorium on action over fixed charges. They have stated that where a bank's rights under a fixed charge have been stayed and may be varied, whether automatically or by the court, a bank in practical terms is inevitably forced to rule off the account. In these circumstances the bank would be unwilling to provide any further funding secured on that mortgage. Without this support an administrator will need to rely on cash flow from the insolvent business or the sale of assets for working capital. The ABA contends that this situation may seriously undermine the efforts of an administrator to develop successful schemes of arrangement.[90]

Effect on Creditor Behaviour.

6.15 The ABA contends that restrictions on the ability of creditors to enforce fixed charges will also lead to higher interest rates, restriction of access to credit and destabilisation of structured financing while creating an in-built incentive for unnecessary distortions and complexities to develop in lending practices.[91]

Eligibility for Appointment as an Administrator.

6.16 The draft Bill provides that only an official liquidator, not a registered liquidator, may be appointed as an administrator. The Explanatory Memorandum states that the duties of an administrator will demand the additional experience required of an official liquidator and that where winding up is necessary the transition from administration to liquidation will be smoothed by the appointment of the same person as both administrator

---

89 Dr K McGuinness, *Committee Hansard*, 22 May 1990, p.240.

90 Australian Bankers Association, Submission, *Committee Hansard, Submissions and Incorporated Documents*, 22 May 1992, p.239.

91 Mrs F M Mullan, *Committee Hansard*, 22 May 1992, p.434.

and liquidator.[92] This approach was supported by Price Waterhouse in its submission although it was opposed by a registered liquidator who appeared before the committee. The Insolvency Practitioners Association of Australia (IPAA), WA Division, has agreed that the reasons given for this in the explanatory memorandum are reasonable. However, it states that "in the past it has also been the practice of the ASC - or its predecessor, Corporate Affairs - to limit the number of persons that can in fact be registered as official liquidators".[93] The IPAA has expressed the view that the ASC should expand the list of official liquidators to accommodate all registered liquidators who meet the criteria.

6.17 A second, but closely related issue, is the appropriateness of a liquidators qualifications and experience for managing a particular business as an administrator. It was suggested that in the past liquidators in Australia have had little success at saving existing businesses and do not necessarily have appropriate expertise:

> There is no doubt that the history of Australia is that, whenever a formal insolvency administration is put in place, by and large, the inevitable result is failure thereafter.[94]

> In relation to the work that accountants take on when they are appointed as liquidators and receivers, I have to be critical of my own profession. There is no acceptance of industry knowledge or specialisation. So you get the accountant who is wonderful with the printing business getting appointed as a receiver for a construction company, and the accountant who is wonderful with construction and development and building getting appointed as liquidator or a printing company.[95]

6.18 It was put to the committee that other professionals and people with expertise in particular industries may be better equipped to act as administrators of companies in some circumstances.[96] However, the

---

92 *Draft Corporate Law Reform Bill 1992*, Explanatory Memorandum, pp.471-472.

93 Mr G F Totterdell, *Committee Hansard*, 23 April 1992, p.189.

94 Mr J Storey, *Committee Hansard*, 20 May 1992, p.245.

95 Mr F C B Haly, *Committee Hansard*, 20 May 1992, p.254.

96 Mr R McKenzie, *Committee Hansard*, 23 April 1992, pp.193-194.

committee notes that in North America similar schemes have also required that the administrator be an insolvency practitioner and that some practitioners have specialised in this type of work.[97]

Timing for Assumption of Liability etc.

6.19 The time frames for having the administrator accept liability for any debts incurred, for calling the first creditors meeting and for bringing forward a proposed scheme of arrangement have all been criticised for being unrealistic.

6.20 Particular reference was made to the difficulty of determining the full extent of the companies liabilities for group tax and the reservation of title clauses that creditors very often apply now to the terms of trade when goods are supplied to a corporation. The IPAA felt that given these difficulties the imposition of a personal liability on the administrator within seven days of appointment was somewhat inequitable:

> We think that perhaps the legislators have assumed that accounting records are sufficient so that within seven days an administrator can determine the financial affairs of a company. It is our experience, regrettably, that that is rarely the case in insolvency. Those companies that are in financial difficulties normally also have very poor records of account, or certainly those records might be brought up to date no more than monthly and may not necessarily correlate with the date of the appointment of the administrator.[98]

6.21 The requirement that the first meeting of creditors be called within seven days (proposed section 436E) has also been questioned:

> Having regard to the work required in compiling a list of creditors, mailing those creditors of the intent to call meeting and actually to call that meeting within seven days, we think that that time frame is unrealistic.[99]

---

[97] Dr K McGuinness, *Committee Hansard*, 20 May 1992, p.246.

[98] Mr G Totterdell, *Committee Hansard*, 23 April 1992, p.188.

[99] ibid., *Committee Hansard*, 23 April 1992, p.188.

6.22 The Bill itself later requires that at least seven days notice be given to a creditor (Section 436E(9)) while the bankruptcy act requires that at least 14 days notice be given to a creditor. In this regard section 436E is not consistent with similar requirements elsewhere.

6.23 The time allowed to bring forward a scheme of arrangement has also been questioned. In imposing strict time limits the drafters of the bill have sought to ensure that companies do no go into administration and remain there, apparently indefinitely, as has occurred under the chapter 11 provisions in the US. The timeframe was deliberately restricted to force all the parties to come to an arrangement as quickly as possible or wind the company up. However, several witnesses with practical experience of insolvency matters gave evidence to the committee that the time limit set by the draft Bill is simply impractical.[100]

Outcomes Available.

6.24 The ABA asserts that the proposal is too rigid in that the administration is designed to lead to one of only two outcomes, either a deed of company arrangement or a liquidation. It considers that the new system should provide a range of options, as in a receivership, so that the best strategy can be adopted in each case.

The Priority of the Commissioner of Taxation.

6.25 Under the amendments the priority for distribution among unsecured creditors has been clarified and some alterations made.[101] The priority accorded to the costs of an ASC investigation has been removed. Superannuation entitlements are given the same priority as unpaid wages. There is no change in this draft to the priority of the Commissioner of Taxation. The draft Bill does not address the proposal contained in the Law Reform Commission Report that the special priorities accorded to the Commissioner of Taxation be removed. The summary of the draft Bill states that this is a matter which is still under consideration.

6.26 The witnesses who appeared before the committee, and the submissions it received, were consistent in the importance that they attached

---

[100] Dr K McGuinness, *Committee Hansard*, 20 May 1992, p.243.

[101] *Draft Corporate Law Reform Bill 1992*, proposed section 556, pp.213-215.

to the removal of the priority of the Commissioner of Taxation and in their condemnation of the failure of the legislation to adopt this recommendation of the Harmer report.[102]

6.27 Evidence was given to the committee that liquidators frequently had difficulty determining the level of the debt. They were often told that there was no group tax owing either because the directors were unaware of it or were deliberately misleading the liquidator even though the debt had been allowed to accumulate over many months or even years. It was also stated that the priority given was contrary to the usual rule that all unsecured creditors ranked equally in insolvency. One witness said that:

> The Commissioner of Taxation can therefore continue to sit back and take absolutely no action to protect his interests and then come in with priority over everybody else.[103]

6.28 Mr Harmer has said that the effectiveness of the voluntary administration proposals could be seriously undermined by the priority where there is a sizeable element of unpaid group tax:

> Putting it as bluntly as I can, no-one will attempt a beneficial administration of a company that has financial difficulties if the result of that labour will simply flow to the revenue ahead of unsecured creditors.[104]

Creation of a Fund for Winding Up Insolvent Companies Without Assets.

6.29 The recommendation of the Harmer Report that a fund be established to provide for the investigation and orderly winding up of insolvent companies with few or no assets has not been taken up in this draft Bill. In rejecting this recommendation the Attorney-General's Department says that where there is a need to investigate such companies in relation to possible

---

[102] Mr G F Totterdell, *Committee Hansard*, 23 April 1992, p.185-186; Mr F C B Haly, *Committee Hansard*, 20 May 1992, p.261; Mr R W Harmer, *Committee Hansard*, 21 May 1992, p.352-353; Mr D Blackwell, *Committee Hansard*, 21 May 1992, p.356; Mr N L Watson, *Committee Hansard*, 22 May 1992, p.445.

[103] Mr F Haly, *Committee Hansard*, 20 May 1992, p.261.

[104] Mr R W Harmer, *Committee Hansard*, 21 May 1992, p.352.

fraud the ASC already has responsibility.[105] This view was not supported by witnesses who appeared before the Committee:

> The further concern that we have is that there has been a presumption in the drafting of this legislation that the ASC has the responsibility to investigate assetless companies and assumes, we think incorrectly, that the financial resources of the ASC are sufficient for that purpose. It is with respect that we say that that is not necessarily our experience; that we have seen very large corporation fail and be assetless. It is our feeling that the ASC has not had sufficient financial resources to pursue the investigations into the failure of such companies. I have had personal experienced of this situation, in the liquidation of a very well known company with a deficiency in excess of $900m.[106]

[105] *Draft Corporate Law Reform Bill 1992*, p.18-19.

[106] Mr G F Totterdell, *Committee Hansard*, 23 April 1992, p.187.

Appendix 1

The Committee has held four public hearings on the draft bill:

23 April 1992, Perth;

20 May 1992, Brisbane;

21 May 1992, Sydney; and

22 May 1992, Melbourne.

The following organisations and individuals participated in the hearings:

Attorney-General's Department -
- Mr Phillip Noonan

Australian Accounting Research Foundation -
- Mr Ian Langfield-Smith
- Mr Michael Ullmer

Australian Bankers Assosication -
- Mr Alan Cullen
- Mrs Francine Mullan

Australian Institute of Company Directors -
- Professor Robert Austin
- Mr Peter Dunstan
- Mr Ian Harper
- Mr Quentin Digby

Australian Institute of Company Directors, Qld Branch -
- Mr John Florence
- Mr Frank Haly
- Mr Darryl McDonough
- Mr Antony Ranson

Australian Securities Commission -

- Mr Barrie Adams

Australian Shareholders Association Ltd -
- Mr Peter Kent
- Professor Robert Walker

Australian Society of Certified Public Accountants -
- Mr Ronald Metcalf

Business Council of Australia -
- Mr Rodney Halstead
- Mr Antony Greenwood
- Mr Clive Speed
- Mrs Lynette Schiftan
- Mr Richard Kneebone

Barber, Mr Richard, Price Waterhouse

Baxt, Professor Robert, Arthur Robinson and Hedderwicks

Beerworth, Dr William, Beerworth & Partners Ltd

Farrar, Professor John, University of Melbourne

Green, Mr John, Freehill Hollingdale & Page

Harmer, Mr Ronald, Blake Dawson Waldron Solicitors

Harrold, Mr Neil

Hassen, Mr John, Price Waterhouse

Insolvency Practitioners Association of Australia - (NSW Branch)
- Mr David Blackwell

Jooste, Mr Peter, Parker and Parker

Kerr, Mr Edward, Mallesons Stephen Jaques

Law Council of Australia -

- Mr John O'Halloran
- Mr Jon Webster

Law Institute of Victoria -
- Mr Thomas Bostock
- Mr Stephen Newman
- Mr Nigel Watson

Law Reform Commission of Victoria -
- Professor David Kelly
- Mr Christopher Balmford

Law Society of New South Wales -
- Mr David Castle
- Mr Anthony de Govrick

Law Society of Western Australia -
- Mr Andrew Lynn
- Mr Robert McKenzie
- Mr Alan Pocock
- Mr Laurence Shervington

Little, Professor Peter, Queensland University of Technology

Lowndes, Mr Myles, Queensland University of Technology

McGuinness, Dr Kevin, Queensland University of Technology

Millar, Mr Kenneth

Queensland Law Society Inc -
- Mr John Story
- Mr Greg Vickery
- Mr Michael White

Priest, Mr Philip, Price Waterhouse

Selig, Mr David, Dunhill Madden Butler

Smith, Mr Brian, B. M. Smith & Co

Simmonds, Professor Ralph, Professor of Law, Murdoch University

Redmond, Professor Paul, University of New South Wales

Tilburn, Mr Jack

Totterdell, Mr Geoffrey, Price Waterhouse

Woodward, Mr Edward, Arthur Robinson and Hedderwicks

Young, Mr John, Northmore Hale Davy & Leake

19-6-92

THE SENATE
ROLL

SENATORS -

ALSTON
ARCHER
AULICH
BAUME
BEAHAN
BELL
BISHOP
BJELKE-PETERSEN
BOLKUS
BOSWELL
BOURNE
BROWNHILL
BURNS
BUTTON
CALVERT
CAMPBELL
CHAMARETTE
CHAPMAN
CHILDS
COATES
COLLINS
COLSTON
COOK
COONEY
COURTER
CRANE
CRICHTON-BROWNE
CROWLEY
DEMBREUX
DURACK
EVANS
FAULKNER
FERGUSON
FOREMAN
GILES
HARRADINE
HERRON
HILL

JONES
KEMP
KERNOT
KNOWLES
MIBS
LEWIS
LOOSLEY
MACDONALD
MacGIBBON
McKIERNAN
McMULLAN
MAGUIRE
NEWMAN
O'CHEE
PANIZZA
RAINER
PATTERSON
POWELL
RAY
REID
REYNOLDS
RICHARDSON
SCHACHT
SHERRY
SHORT
SIBRAA
SQUADRA
SPINDLER
TAMBLING
TATE
TEAGUE
TIERNEY
VANSTONE
WALSH
WALTERS
WATSON
WEST
ZAKHARCV

19-6-92
JW

THE SENATE
ROLL

SENATORS -

~~ALSTON~~
~~ARCHER~~
~~AULICH~~
~~BAUME~~
~~BEAHAN~~
BELL
~~BISHOP~~
~~BJELKE-PETERSEN~~
~~BOLKUS~~
~~BOSWELL~~
~~BOURNE~~
BROWNHILL
BURNS
~~BUTTON~~
~~CALVERT~~
~~CAMPBELL~~
CHAMARETTE
CHAPMAN
~~CHILDS~~
~~COATES~~
~~COLLINS~~
~~COLSTON~~
~~COOK~~
~~COONEY~~
~~COULTER~~
CRANE
~~CRICHTON-BROWNE~~
CROWLEY
~~DEVEREUX~~
~~DURACK~~
~~EVANS~~
~~FAULKNER~~
~~FERGUSON~~
~~FOREMAN~~
~~GILES~~
~~HARRADINE~~
~~HERRON~~
~~HILL~~
~~JONES~~
~~KEMP~~
~~KERNOT~~
~~KNOWLES~~
~~LEES~~
~~LEWIS~~
LOOSLEY
MACDONALD
MacGIBBON
~~McKIERNAN~~
McMULLAN
~~MAGUIRE~~
NEWMAN
~~O'CHEE~~
~~PANIZZA~~
~~PARER~~
~~PATTERSON~~
~~POWELL~~
~~RAY~~
~~REID~~
~~REYNOLDS~~
RICHARDSON
~~SCHACHT~~
~~SHERRY~~
~~SHORT~~
~~SIBRAA~~
~~SOWADA~~
~~SPINDLER~~
~~TAMBLING~~
~~TATE~~
~~TEAGUE~~
~~TIERNEY~~
~~VANSTONE~~
WALSH
~~WALTERS~~
~~WATSON~~
~~WEST~~
~~ZAKHAROV~~