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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Friday, 22 January 1999

Members: Senator Chapman *(Chair)*, Mr Sercombe *(Deputy Chair)*, Senators Conroy, Cooney, Gibson and Murray and Ms Bishop, Mr Cameron, Mr Rudd and Dr Southcott

Senators and members in attendance: Senators Chapman, Conroy, Cooney, Gibson and Murray and Ms Bishop, Mr Sercombe and Dr Southcott

Terms of reference for the inquiry:

Corporate Law Economic Reform Program Bill 1998

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Committee met at 9.10 a.m.

CAMERON, Mr Alan John, Chairman, Australian Securities and Investments Commission

LONGO, Mr Joseph Paul, National Director, Enforcement, Australian Securities and Investments Commission

SEGAL, Ms Jillian Shirley, Commissioner, Australian Securities and Investments Commission

TANZER, Mr Greg, Regional Commissioner, ACT, Australian Securities and Investments Commission

CHAIR—I declare open this morning's hearing of the parliamentary Joint Committee on Corporations and Securities. Firstly, welcome to those new members of the committee. It is the first in-person meeting, I guess we would call it, of the committee, although we did have a telephone meeting at the end of last year. Welcome to the new members, Bob Sercombe and Julie Bishop, and a particular welcome to the officers of the Australian Securities and Investments Commission.

Today's hearing will be in two parts. First, the committee will receive a general briefing from the officers of the Australian Securities and Investments Commission. The committee will then hear evidence on the provisions of the Corporate Law Economic Reform Program Bill 1998. The committee prefers to conduct all of its hearings in public but if there are any confidential matters which witnesses wish to discuss with the committee we can move into in camera at their request. I therefore open proceedings by welcoming Mr Alan Cameron and his colleagues to the hearing. Mr Cameron, do you wish to make an opening statement before we proceed to questions?

Mr Cameron—I have not prepared any particular remarks, but I thought it might be useful if I mentioned that I have just ensured that members of the committee do have access to our most recent annual report. That annual report covers the period to 30 June 1998, but it has been prepared with an eye to the future and therefore refers to our new name and attempts, in brief form, to explain what we are doing as from 1 July with our new responsibilities.

In short, we are, as the report says, the independent government body that enforces and administers the Corporations Law and consumer protection law with respect to the financial sector. What that means is that we have, in effect, three different strands to our activities now. We have the traditional registration function, done through what we call the information division. That is the division that looks after the incorporation of companies. The receipt of all documents that are lodged and registered with the commission is done through the information division.

Secondly, we have the traditional securities and futures market and Corporations Law functions that this committee was used to up to 30 June last year—all of the activities with respect to the Stock Exchange and the Futures Exchange, takeovers, prospectuses, the

licensing of investment advisers and so on. That responsibility in a sense has been expanded since 1 July with the addition of all of the market integrity type functions with respect to the finance sector. Banking, insurance and superannuation have all been added in there.

Finally, the third strand to our operations is the general role of consumer protection with respect to the finance sector. This is the first time that the traditional consumer protection role of the Australian Competition and Consumer Commission has been divided up. It took effect from 1 July. The finance industry is now used to the fact that we are the regulator there. We have entered into a memorandum of understanding with the ACCC to ensure that there is no gap or overlap between our operations. I have to say—and I suspect Professor Fels would agree if he were here—that that is working very well. There have been some cooperative matters handled between us, and there are some being handled at the moment—it is probably not appropriate to describe those but they are under way. There is a good relationship between us and it is working well.

It is unusual for us—and for them I suppose—but there is a new regulator on the block with respect to consumer protection. We think the ACCC has done a very good job over the years in this area, but it is now our role. Incidentally, they were not alone in it before. The Reserve Bank, through the Australian Payments System Council, was really responsible for the banking sector, so bringing it together inside our shop has meant that we have a coordinated and consistent approach. We are announcing at the moment that we have set up within the commission a small office called the Office of Consumer Protection, and that is an office simply designed to ensure that within the commission consumer protection continues to get the right level of priority and has, in effect, an internal advocate to ensure that the interests of that part of our work are not lost.

It was never intended to be a very large part of our work—it is not in staffing terms a significant part of our work, as it was not for the ACCC. That is because individual consumer complaints in the finance sector are handled, first of all, by the institutions and, secondly, by the complaints resolution schemes, of which there are quite a few in the finance sector. We have had a traditional role, with respect to that, coordinating the round table of those complaint schemes and so on. I am happy to answer questions, and my colleagues would be happy to answer questions too on other aspects of our work, but I thought I should briefly report that since 1 July we have assumed those new responsibilities, and so far it has been working well.

CHAIR—Do you believe you have adequate resources to cope with the additional responsibilities? Have the resources expanded commensurate with the additional responsibilities?

Mr Cameron—As far as I can tell at the moment, I think the answer is that we do have extra resources as a result of these new responsibilities. We are still working into the responsibilities, so it is probably too early to say yet whether they will turn out eventually to be sufficient, but they are certainly not at the moment insufficient. If anything, because of the difficulty of gearing up to the new responsibilities, it may well be that by the end of this financial year we will have underspent on these areas because we are still recruiting staff.

We have not yet fully recruited the people we would like to recruit to handle our market integrity function for banking insurance, general insurance, life insurance and superannuation, and we are still looking for more people in the consumer protection area. We do have some senior people in all of those areas but we are still looking, particularly in this city, which is a very difficult city for a government agency to recruit in because of salary differentials. If there is a problem area, it is really in this city and the other major business centres, but we have succeeded in recruiting some good quality staff for this work elsewhere. So, in short, the answer to your question is: we did get extra resources and there is no indication as yet that they will not be sufficient.

CHAIR—In the context of our inquiry into the CLERP bills, we have received a number of submissions from a Mr Fielding in relation to several companies in which either directly or indirectly he has got interests. In his submissions he has exchanges of correspondence which he has had with the ASC on some of these matters, and I know there is one instance where you declined to take action because it was beyond the statute of limitations and so on. I will quote from one of the responses from the ASC, from Mr Transfield, which says, in relation to Continental Venture Capital Limited and Laserex:

We understand that your complaint is of great concern. We would like to be able to investigate every matter that is reported to us, but unfortunately we do not have the resources to deal with all of them.

Accordingly, the ASC gives priority to complaints according to:

. the seriousness of the conduct;

. the conduct's effect on the market;

. the level of public interest; and

. whether it involves fraud or dishonesty by company officers.

That would indicate that you do have to give some priority to which matters you do investigate and which you do not because of resources. Obviously you get many, many complaints which could be regarded as trivial in nature, but how do you really distinguish between what might be trivial and do not warrant investigation, and those that perhaps do but where, as this letter might indicate, the resources are not there to look at them even though perhaps you may like to.

Mr Cameron—I might get Mr Longo to address that question in a little more detail if he wishes but, in short, we have established and shared with the committee on a confidential basis the case selection criteria that we use with respect to our traditional areas of responsibility. I do not incidentally immediately recall the detail of the matter that Mr Fielding was talking about, but the letter from Mr Transfield does accurately summarise for general purposes the case selection or the subjects that are covered by the case selection criteria. We are very keen to ensure that all matters of major public importance will be investigated. I am sure that the government and the parliament would be, but I also believe, and have believed ever since I have been in this position, that you would not expect us to be resourced to handle every individual complaint.

I think one of the great advantages of the Australian system at the moment is that almost—as far as I can tell—uniquely in the world, you have a corporate regulator responsible for all of the 1.1 million companies in Australia. That does mean—and I am not suggesting this is the case in Mr Fielding's present allegation—that we get complaints about the conduct of a two-person proprietary company, where one of them believes that we should investigate the conduct of the other with respect to that company. We normally would take the view in that case, for example, that that is a matter of civil interest only to those two people, and you would not expect to resource the government regulator to resolve that conflict. That is at one end of the extreme. A publicly listed company with thousands, or hundreds of thousands of shareholders and many employees, and millions or billions of dollars of assets, is clearly at the other extreme if its affairs were not being conducted properly. The case selection criteria are designed to provide guidance to our staff about that. Joe, would you like to say a little more about them?

CHAIR—Can I just add, perhaps before Joe comments, that in later correspondence there has been an indication—well, in fact, a letter from you indicates that there has been a further review of the Laserex complaint, and there is further consideration being given to that matter as of September last year. Now, I do not know what has happened since then.

Mr Cameron—I do not recall either—but, again, that would certainly be the case. It would be the case that we would always review it if somebody thought we had misapplied the criteria or, if the criteria were inapplicable for some reason—that there was some ground of public interest that meant that we should look at it anyway—we would always consider it. I think, from recollection, that is the last of the criteria.

Mr Longo—In broad terms, the way that the chairman has described the system is obviously entirely accurate. I would make two or three points in the nature of key themes.

The first is: what is the point of the system, other than to ensure that people's behaviour changes and there is overall compliance with the Corporations Law? That is not necessarily going to be achieved by taking on every matter. We are not going to be resourced to take on every matter, so the fundamental goal is: what things should we be doing or steps should we be taking to ensure that outcome? So our broad approach is a strategic approach. We garner intelligence from the market, and these complaints are captured in a way which enables us to readily analyse them electronically. So, for example, we have a pilot program now where we are electronically receiving and analysing reports from liquidators, for example. The system is constantly being designed and finetuned to enable us to ensure that we are actually looking at matters or issues that are going to make a difference, if we take steps. We refer to that as 'regulatory impact'.

There has been some discussion this morning about consumer protection. I should note for the committee that the criteria or guidelines that our staff are using—to choose matters for resourcing—are being developed. As the chairman noted, we are still absorbing these functions. We are recruiting, and our understanding of these responsibilities and how we should handle them going forward, is a matter we are actually working on now. We do have, of course, interim guidelines and criteria that have just been developed over the last few months in order to handle what is coming in the door now. But those criteria or guidelines have not been developed or finetuned in the same way as the guidelines and criteria for the

functions we have been discharging for many years now. We are hopeful that that process will be completed over the next six months, as our experience and understanding of these new functions and responsibilities gather some pace.

Another key area in this question of market matters is the area of publicly listed companies. We have a very close working relationship with the Australian Stock Exchange and, as the committee would know, we have a number of memoranda of understanding with the ASX which cover such issues as continuous disclosure, market manipulation, insider trading and other market abuse. So, in terms of complaints assessment, it would not be entirely accurate to refer to that part of our work as an application of the case selection criteria. We are working closely with the exchange and the Sydney Futures Exchange to ensure that the steps that we take are, firstly, in cooperation with the exchanges—because they have their own powers to discipline members—and secondly, to ensure that we work on matters that require attention. So that is a separate way of approaching those issues. I think that covers the more important themes arising out of that subject.

Ms Segal—Mr Chairman, I think it is worth noting that a number of complaints which are looked at do not result in investigations—as we have just heard—under the case selection criteria. But there are a range of other activities and remedies that we do apply. We have cautions and we certainly advise people as to what they should do. A large number—I think something like 40 per cent—are referred to our surveillance programs so that, if we have a complaint which, initially, does not seem to be something so serious but it is something to watch, then we feed it into our surveillance program to monitor what is going on there. It may indeed result in due course in some action, or it may not. It is not as if there is only one course of action. After the surveillance, we might take a whole range of other actions which include penalty notices or bannings, or undertakings, enforceable undertakings and so on. So I think it is a panoply of results that we are looking at, in terms of regulatory impact.

Mr SERCOMBE—Just on a broad matter—over the silly season I probably have not read the financial press as closely as I might have—there have been comments from the fourth estate critical of the ASIC in terms of the use of its discretions—I think particularly in this Smorgon-ANI matter and I think also in relation to AMP-GIO. On this broad question of the utilisation of your discretion within the context of the Corporations Law, you referred earlier to guidelines or criteria with respect to matters you take up. Are you developing criteria that are publicly available in terms of how you would intend to use the discretions you have presently got under the law? If you can refer to the ANI-Smorgon matter, for example, that would be useful.

Mr Cameron—Let me seek to address it this way. The commission is given, under the law, a wide power of exempting and modifying with respect to takeovers in particular. We, therefore, have prepared and published—and they are available generally—the policy statements that indicate the way in which we will apply those exempting and modifying powers, inasmuch as you can predict them—not knowing what the circumstances are. The particular characteristic of takeovers is that they are very rarely all alike. There are always special circumstances and that is the reason, I am sure, why—not only in Australia, but in every other major jurisdiction—there is a wide range of discretion given to the regulator to intervene to affect the strict operation of the law as it would otherwise appear. I might say that that is one of the factors in the proposed amendments about takeovers that you are going

to be talking about during the day, because the proposed expanded role of the panel would include, as I understand it, the taking over of that exempting and modifying power that we presently use.

First of all, some members of the fourth estate have a philosophical objection to the regulator having that power. I am talking about some obvious individuals and, therefore, you will periodically see articles that are very similar in intent, and often in words, that are critical of a particular exercise of that power. Secondly, there may be instances in which the way we have exercised them, or the mere fact that we have exercised them at all, could be the subject of a legitimate debate among people who believed that we should have that power, but still disagreed with a particular exercise of it. Can I remind you that, at least at the moment, every exercise of those powers is subject to review in the Administrative Appeals Tribunal. They frequently are appealed to the Administrative Appeals Tribunal, and they are very regularly upheld by the Administrative Appeals Tribunal. Indeed, it has become one of the factors that has led the government to suggest that the proposed new revamped takeovers panel should be immune from that sort of review. If it is going to make those decisions, it has got to have some level—I cannot remember whether it is absolute immunity, but some level—of absoluteness in its decisions.

Everybody thinks takeovers need to be conducted quickly and efficiently—and they are. Our use of those powers is designed to ensure that there is a free, effective and efficient market for shares and, sometimes, regulatory intervention is needed to bring about that proper market. That is the spirit in which we exercise those exempting and modifying powers, and we do publish for general consumption all of the policies that guide us in those. Every decision is subject to full administrative review anyway.

Mr SERCOMBE—Okay.

Senator COONEY—On the question of takeovers and getting it done quickly and efficiently, we are going to get some evidence later in the day. Have these reports been released? In any event, I do not think I would be in contempt to say that in this submission it says, ‘Australia has a takeover code best described as "quaint".’ This is in the context of somebody who has commercialised an invention. He is quite critical of the financial markets and of the ASX. He says it does not have a proper idea of the way inventions should be funded and how they should be priced. He also says that in the takeover proceedings not enough time is allowed for the person who is being taken over to resist.

What you have is a great difficulty for inventors like him, who have a scientific background and who have changed an idea into a cashflow, to do anything about it so as to preserve an invention in Australia. As a result of this, he says that inventions must go overseas. He, in fact, goes to the point of saying that the best thing he could do is avoid Australian money markets and fundraising and just go overseas. Do you have any ideas about that? Do we know how many scientific ideas have been commercialised in Australia and have been kept here? Have you heard anything about that at all?

Mr Cameron—It is the subject of a deal of debate in the financial press. I was able to work out, listening to you, who your complainant is and what he is talking about.

Senator COONEY—As you probably guessed, this is a submission from Mr Denis Hanley from Memtec. He is going to come and give evidence after lunch. It seems to me a fairly interesting area in the sense that we really have not looked at this idea that our present corporate structure does not lend itself to developing scientific ideas into commercial realisation.

Mr Cameron—I think there are a wide range of issues that are raised by that. Let me try to identify several of them. It may be that we should have some informal discussion at some stage, if not today, about some of these.

Senator COONEY—Yes.

Mr Cameron—Let me try to pick up several of the themes. Firstly, on the general theme of whether the Australian market is conducive to the promotion of high technology—whether it is biotechnology or any other kind of technology—the particular technology there was clearly world-class. The Australian market was perceived, I assume, by the promoters as not being sufficiently vigorous for full funding.

Senator COONEY—What they found was that it was so structured, both in terms of its attitude and in terms of the law itself, not to be able to respond.

Mr Cameron—I think one of the difficulties is to sort out whether it is any aspect of the structure of the market or the law that is causing that problem, or the sheer fact that Australian institutional investors are somewhat risk averse about these for quite good reason in some cases, due to the fact that they cannot get enough spread of them.

To go to that highly liquid and highly accepting of high technology market called the US market is a perfectly rational response, whatever the market structure that we are providing, if you like. It is a factor of the United States willingness to accept such ventures that led, I am sure, the promoters to take Memtec to the United States. We could discuss that in great length, but I did want to get on to the second part of the question implicitly, which is how it relates to Mr Sercombe's point.

What Mr Hanley, I imagine, is saying to you is that he thought the relief granted by the commission to enable a takeover to take place at Memtec was inappropriate for some reason. I have not seen the submission, but we know he thinks that because he challenged it in the Administrative Appeals Tribunal.

Senator COONEY—If it is not testing the good relationship we have, would you care to comment on the submission?

Mr Cameron—Yes.

CHAIR—What Senator Cooney is saying is that the offerer for the takeover has six to 12 months to plan their takeover, but the defender has only one month to mount their response. There are other issues, but I think that is the nub of the issue.

Senator GIBSON—To follow on, if I may comment, he is basically recommending technology companies to register in Delaware in order to give 12 months of protection in a takeover case. As against that, there is the other general argument in Australia, of course, that a lot of Australian listed companies have not been performing very well profit-wise by comparison with US and UK companies and that more heat is required. That is the general policy thrust of where the law has been going in this area.

Mr Cameron—I find it very difficult to respond to the general suggestion that the period should be extended from one month to, presumably, at least two or three months if it is going to make any difference for high technology companies. That is a matter of policy which I think is very difficult for the regulator to respond to. As a regulator, my first answer is also that identifying the companies that should get the benefit of that intentional extra protection would be quite difficult.

I do not mean to be particularly critical of any particular company, but I will name one because it is easier. BHP, for example, has an information technology division which is a major business in its own right. Does that mean that you would extend to the whole of BHP that extra protection because it has a high-tech division, or do you have to have a high-tech division of particular size to qualify? There is a concept in corporate law called poison pills, and it would be seen as the perfect poison pill just to set up a high-tech division that gives you the extra two months protection. All of those are policy issues that are very hard for me to respond to on the spur of the moment.

If you would let me, I would like to say a little bit about the other part of the question because, implicitly, you do need to know that the directors of Memtec objected to the relief we granted to enable that bid to occur. It is linked to the US question. The question arose because Memtec was listed in both Australia and the United States. We gave relief to ensure that a takeover was possible at all. The law is so inconsistent between the two jurisdictions. You might find that surprising, but it is true. It was effectively impossible for an offer to be made for that company unless we modified the law. I ask you to remember that when you bear in mind that some members of the fourth estate think we should not modify the law at all. That gives you some idea of why it is an area of such tension.

Again, it is the perfect poison pill problem. If, in effect, getting yourself listed in both Australia and the United States gave you that protection that would be a real problem. It is the reason why we think that whoever is regulating takeovers needs to have some capacity to modify the strict operation of the law. It does have to be the regulator, if I may say so with respect, not the government and not the legislature because there is not enough time. I know Mr Hanley is asking for more time, from one point of view, but I would still say that that is not the way to achieve that protection. If there is an issue about the philosophy of takeovers and extra time for targets, I would be inclined to think that ought to be addressed more generally than merely with respect to high technology companies.

Senator GIBSON—One of the matters that Mr Fielding raised with us is Holyman. I know there has been correspondence and, in essence, he is very critical of the auditor in details of that case. I do not know whether you want to take the opportunity of saying anything about that here or perhaps give us some advice about it later on. I was concerned

when I read his allegations about what happened with Holyman. I think the committee would like an explanation and a considered response from you.

Mr Cameron—I wonder if we might take that on notice.

Senator GIBSON—That is what I meant.

Mr Cameron—I am aware of it, but it is probably safer if I make sure that I am fully aware of all of the circumstances. It is also still, if I might say so, a live matter.

Ms JULIE BISHOP—I have a more general question about the consumer protection aspect of your responsibilities now. Are you putting in place some method for keeping statistics at present on the number of people who are complaining, the outcome, where you are putting them in terms of 'we have dealt with it', 'we have disregarded it' or 'it is a matter for surveillance'? If so, is it similar to what you are doing in the regulatory field? Do you keep statistics—and are they available—of how many complaints and inquiries you get and where they fit in your category of dealing with them?

Mr Longo—All those things, Ms Bishop. We noted earlier that the new function and responsibility criteria and guidelines are being developed in a way that will enable us to do all of the things we are doing already in other areas. The short answer to those points is that we are doing all those things. Just yesterday the commission got a briefing from the director of that program designed to ensure that the commission can be satisfied that it knows in detail exactly how many complaints there are, what parts of the country they are coming from and in broad terms whether they are super questions or general insurance questions.

A couple of things are already emerging about unregistered insurance brokers and premiums not being passed on. I am not sure whether the committee saw this, but in Melbourne just before Christmas the ASIC took action against a broker who failed to pass on premiums to insurance companies. We took that person to the Federal Court and got orders requiring that person to identify his various customers so that we could communicate with them. That matter had to go to court a second time because he refused to comply with the order. In the end we used the media to ensure that people were aware that they were at risk of not being insured.

Ms JULIE BISHOP—That brings me to another point. Are you satisfied that the public and consumers in this context are aware of your new roles and responsibilities? If not, what more could be done?

Mr Longo—Commissioner Segal has a special interest and expertise in that area, so I will ask her.

Ms Segal—The community as a whole is probably not sufficiently well aware of our new role. We have in mind a program of communicating further in terms of reaching them with our new functions and our new responsibilities. As you might be aware, we have established the consumer panel where we have brought all the consumer organisations with their representatives and some individuals together to advise the commission on how to reach consumers so we have a representative group ourselves to feed into the commission's own

policies and actions. We are using them to advise us how best to communicate. At the same time they themselves are commissioning a study to look at consumer education at the moment and to see what gaps are out there and, once we understand the gaps, how best to fill those gaps. It is no use just going out with a series of advertisements, for example, if you do not really know what need you are trying to fill.

So I think it is fair to say that we are absolutely determined to get across the message of our new function, but also to do so in a sensible way and to reach the people who need to know and to provide them with additional information about what they need to know to protect themselves. Obviously, consumer protection is a complex subject and it is not to protect consumers from losing money; it is to make them informed and confident so that they understand the risks and have sufficient disclosure to make sensible judgments. We also follow up complaints and keep statistics—not only for the sake of that but also because looking at statistics can give one a clue that some of the complaints really are reflective of systemic problems. We are very concerned to ensure that we put our resources not just where there is a complaint but where it reflects a systemic difficulty.

Ms JULIE BISHOP—That is where my question was coming from in relation to statistics.

Ms Segal—That is exactly where we are focusing. It is the key strategy and we spent a lot of time yesterday looking at it. With regard to a complaint we say, 'Yes, we have kept all the statistics and the follow-up, but is it reflective of a systemic problem? Are there two or three like it? How do we collect them from different parts of the country? Do we have a real problem here? If so, how do we deal with it? Is it a campaign, an investigation or is it something else?' That is exactly where we are focusing our resources.

Ms JULIE BISHOP—Would you be working with the ACCC on what I call this 'awareness campaign'?

Ms Segal—I think that as we go forward we have to work with a number of organisations. We have to work with APRA, as we have in reaching the superannuation and insurance community. We have put out a joint booklet with them. We have to work with the ACCC generally on consumers. We have to work with other industry organisations, such as the Offices of Fair Trading, and industry associations like the FPA, for example. We have produced a number of brochures with them like 'Don't kiss your money goodbye', which is going into its second printing. Similarly, we did the survey on financial advisers with other organisations. The regulator has to maximise its utilisation of not only its resources but also other resources to reach the community.

Mr Cameron—I will add to that. There are over 100,000 individual consumer complaints a year about the finance sector that are dealt with by the Banking Ombudsman, the FPA's complaints resolution scheme, schemes operating in the insurance area and so on. We do not want to handle those. We do not want them to come to us. We want them to be dealt with by those schemes. We are really only interested in ensuring in the first instance that the individual issues between consumers and institutions are dealt with by those schemes. If there are systemic issues, we want to know about them and help fix them, but

we do not want the bulk of the complaints coming to us because that is double handling, inefficient and we are not resourced for that.

Ms JULIE BISHOP—Does that mean you send them off?

Mr Cameron—We do not really want them to come to us in the first place. We want the community to understand that if they have a major problem of a systemic kind they can come to us and we will help them with it. We have set up the financial complaints referral centre to ensure that people can find the complaints resolution schemes, but we are trying to develop a relationship with the schemes that will ensure that if there are systemic issues we find out about them. We are also trying to develop a relationship with community legal centres and those sorts of centres that will ensure that where they find systemic issues they will be confident to bring them to us. But we do not want the individual person who has had a particular problem with an insurance company to feel that their first port of call is the big government regulator, because there are more efficient ways of dealing with those complaints.

Ms Segal—It is also worth noting that we are just about to release a draft policy where we give licences to these complaints schemes. We say, 'You are a registered complaints scheme,' and put conditions on them. They have these conditions on them at the moment in sort of an interim way, but we are working towards a more final policy where they have reporting obligations to us, where they have the onus to identify systemic problems and to issue a report to us, and so on. So ultimately we get the information we really need, but we use those other mechanisms.

Ms JULIE BISHOP—Without the double handling.

Ms Segal—Yes, without the double handling.

Senator MURRAY—Mr Cameron, when do you have to put your agency's budget to the Treasury?

Mr Cameron—It is effectively going in now because the new policy proposals and so on, if there were any, would be going in at the moment.

Senator MURRAY—I thought it was January or February. If that is so, with regards to the new areas of responsibility, which you have been given and where, understandably, you do not yet have a firm fix on the resources you will need, what view are you taking in that budget submission?

Mr Cameron—The funding for the next three years was already in effect settled. The only issue that we are discussing at the moment is the question of whether there are any new policy proposals. As far as I am aware, the forward indications are likely to be the basis of the commission's funding for the next two or three years and that is the basis upon which we are working. In other words, we are not assuming that we are in the phase at the moment of seeking to justify the existing funding that has been already announced; we are only really interested in whether there is any new policy proposal that means we should be seeking extra resources.

Senator MURRAY—But although your funding is fixed, you know as well as I do that it is open to you to make a pitch for additional funding if you are underresourced in those new areas you have been given which you are still settling down with. My question really is that question of the chairman: will you have enough money to do the job in those new areas?

Mr Cameron—We are not planning to seek any additional funding for our new areas, or our traditional areas, beyond some consideration—and I have to be careful here about cabinet-in-confidence type rules. The now government had as part of its election policy a proposal what I think was called publicly CLERP No. 7. It is not presently on your agenda for today, but it is the one that deals with the way in which we receive documents; it is, in effect, the information division part of the Corporate Law Economic Reform Program. Under the government's election policy, it is up for consideration as to whether that could be funded for next year.

Senator MURRAY—You appreciate the thrust of my question because, of all the things you will be assessed against, it will be your ability to do the new job you are given—

Mr Cameron—Yes.

Senator MURRAY—and that very much is a money and resource matter.

Mr Cameron—I think that is right, Senator. I tried to say earlier, and perhaps I should be a little more explicit, that we always knew—and you would recall better than most—that the final decision on the final passing of all of the legislation that took effect on 1 July occurred from late May through until late June, so there was very little time to prepare for the implementation that we are now going through. We are working into these new jurisdictions. I do not believe there will be any issue of reconsidering the resource levels until we have had a full year of operation and possibly some more. It has taken some time to work into the system.

Mr Longo reminds me that there was the transfer of 26 pallet loads of files from the Insurance and Superannuation Commission. All of that process has taken some time—and it did not start until 1 July. That is why I do not think there will be any resource issue, with one exception that I know you know about but it might be worth reminding the other members of the committee. The other thing that started on 1 July is the Managed Investments Act. I do not want to go into detail about this or we could spend all day on it, but you may have seen a report in the *Financial Review* yesterday from the managing director of one of the large trustee companies which is well known to members of this committee.

Senator MURRAY—Yes, it is No. 3 on my list of questions.

Mr Cameron—I just want to give you ASIC's perspective on the same issue he mentioned. Did you notice he suggested that their revenue had not been affected materially during the first six months and he now thought it would take rather longer for it to have any impact at all? We had exactly the same problem. We were geared up for a two-year transition to the new Managed Investments Act and it has barely started—not for reasons

connected with the commission but for all sorts of reasons connected with what is going on out there between managers and trustees. There will eventually quite conceivably be an issue for this committee and the parliament about the implementation, the two-year transition period. You would recall that, if the funds do not make a decision as to what they are to do by the end of the first year, which is just over five months away, then there will be a series of meetings conducted all around Australia in the next 12 months after that for every fund that has not changed.

One fund to my knowledge has converted since 1 July 1998. So there is a long way to go before the Managed Investments Act is implemented. Our funding was done on the assumption that we would have two years and it would be spread over the two years. We are getting apprehensive and we will talk to the government if it looks like either a delay or a ballooning effect into the final 12 months could cause considerable problems not only for the community but for the regulator.

Senator MURRAY—Mr Cameron, I am glad you were prescient enough to understand that I would ask you to bring us up to date, and I am glad you have. The transfer of custodianship has been slow. In the one instance that I think was approved, was it Deutsche Grenfell, the bank, which then merged with the independent custodian? Is that right—Bankers Trust and Deutsche Grenfell? My understanding of that issue is that, having separated from the trust, they are now back together again as one entity. Deutsche Grenfell I think was originally in a trustee relationship—or the other way round—with Bankers Trust, they separated and, as you know, a merger is now under way or has occurred. So there are those kinds of issues.

The other issue—and we were forewarned of it by Standard and Poor's submission to this committee at the time of the bill—relates to ratings and how new entities' ratings will be affected. If you take an institution such as a merchant bank, the entity in which they might choose to have their managed investments applied runs on the $5 million guarantee level. It is not the entire merchant bank which stands behind that institution and there is the question of how the entire institution is viewed by the ratings agencies. These things are slowing up the process of transference. The trustees have quite properly, I think, listed a whole lot of duty of care issues before they will resign their situation. All that leads me to the conclusion that we are going to have an extensive delay in transference and the two-year period may not be sufficient. I think your early warning of that would be appropriate.

Mr Cameron—First of all, I am not sure what happened inside Deutsche. For the particular fund that I am aware of that has converted—and I believe it is the only one that has—I would have to make inquiries. I do not know what has happened to its custodial arrangements. We will get some information and come back to you on that.

On the general delay, it is probably worth saying that the trustee industry as I understand it has referred to several factors in their consideration, one of which is the capital gains tax issue. I recall that the Assistant Treasurer on behalf of the government issued a press release four or five months ago now indicating that there would not be a capital gains tax problem, but that release was not seen as satisfactory or sufficient by the trustee company representatives. My belief is that the government is about to make a further statement that will indicate that any problem will be solved by legislation, it will be fixed and that is not a

reason to fail to implement managed investments. I am not sure what stage that is at. I have not been up to date over the last few weeks. But that is happening.

You correctly identify, though, that they do have a corporate trust issue they also raised. I do not know how in due course they will be persuaded, if indeed they will be, that that is not a problem. Until that is resolved, we will be put into the position of having a series of quite difficult meetings, including for trusts with literally hundreds of thousands of members. I think the potential for difficulty in the community—the doubt and uncertainty that that will create in the public mind—is quite great. I would hope some solution would be found to avoid that.

Senator MURRAY—My questions are really to alert the committee to the need for you as a regulator to keep both us and the government advised on an early basis of any major problems that might be emerging. I agree that the government can fix the capital gains problem. That is perfectly within its possibilities, but the other process problems may raise some real issues in terms of timing and so on.

Mr Cameron—Can I just assure you that I have been keeping the government informed.

Senator MURRAY—But not this committee yet. Is that true, Mr Cameron—not this committee yet?

Mr Cameron—We have not met the committee for some months.

Senator MURRAY—What I am suggesting is that you give us a formal briefing.

Mr Cameron—We are happy to do that on each occasion that we see you. We regard it as potentially one of the major issues that we will confront as a commission over the next 12 months. In a sense it has to be dealt with before the end of June or there will be significant issues about whether some modification of the legislation might be needed to deal with some variations in the transitional arrangements because this compounding into the final 12 months was not the assumption underlying the legislation. The assumption underlying the legislation was that these things would change during the first 12 months and only the ones where agreement could not be reached would be dealt with in that way in the second 12 months. If only one out of the hundreds out there has changed so far, it is not a good look, is it?

Ms Segal—To clarify, whilst only one has transferred, there have been a lot of new entities actually established as responsible entities. A range of new schemes, whether financial, real estate or agricultural, have been established and licensed under the new managed investments regime. Our managed investments team has been busy with these new ones, looking at compliance plans and working through its policies. It is not as if there has not been action. It is just that the translation of the old ones into the new regime has not occurred. But there has been a lot of work going on with the act and with working through and understanding and developing the whole compliance regime.

Senator MURRAY—My third area of questioning is the area of small claims. You would be acquainted with the fact that the tax office, for instance, has a small business division, and the judicial system will have a small claims court and so on. Do you have any

institutional mechanism for hiving off the myriad of small inquiries you get to a specialist group in your organisation so that it is dealt with on that basis?

Ms Segal—I will put aside the complaints question for the moment—we can come back to that. We run a separate program labelled the Small Business Program which is run in each state. That does deal with small business—small business issues and their problems. We run a separate focus on small business education because the people running small businesses tend to be people perhaps with less resources, less understanding of their obligations and less information. So a great deal of our attention is focused on meeting their needs for education and dealing with their problems differently.

Senator MURRAY—It is the mass that we deal with as parliamentarians most commonly—the big people go to you; the small people come screaming to us. I assume that it is the same for you and you need a way of managing that in a specialist manner.

Ms Segal—Yes.

Mr Cameron—As one of the earlier questions indicated, if people with a very small company or a smallish company have a problem they frequently go to you and you send them to us. We review them again if they have been rejected on the grounds that they did not meet the case selection criteria. We do frequently review and rereview whether we should be dealing with individual small complaints. There are a lot of them and many of them come through parliamentarians or through ministers.

Senator COONEY—Do you give them better service if they come through parliamentarians than if they go to you direct?

Mr Cameron—It is a very real question, isn't it? It would be unacceptable that they should, at the end of the day, get a different answer depending upon whether they do that or not. That may sound harsh. That is why I suspect that as individuals you will see letters from us saying, 'We still decline to deal with this matter,' because we cannot allow it to arise that you automatically get dealt with—in any business—by the regulator if you choose to go through the parliamentarian.

Senator COONEY—You have been asked this morning about the information you give out. I note that you send out a lot of media releases, some of which I have brought up this morning, on all sorts of issues which are very useful. That ought to be noted.

Mr Cameron—It is a mixed blessing, Senator. Some people believe that we are blowing our own trumpet. If members of the committee want to receive them you can be put on that list and you will get very used to receiving them over your fax machines. You can also be taken off the list if you get tired of them. The mixed blessing is that while people think we are blowing our own trumpet, we are really trying to ensure that our individual actions—as Mr Longo explained earlier—do have a wider effect. We think it is our duty. We therefore have a policy that requires us to announce every result, whether it is positive or negative. So even if we lose, we will issue the release because we think that the person who may well have been blackguarded in the public's eye by the fact that we were looking at them is

cleared. If that has become publicly known, we are obliged, we think, to release the outcome, whatever it is.

Senator COONEY—It is not only that; I was talking about other things. There are advance notices about Claire Grose and Jane Diplock. There are also matters such as the approach to operational requests on superannuation. You give guidance on good advice—all that sort of stuff. It was not the court stuff that I was talking about so much as the other stuff.

Senator CONROY—I have a quick question about our favourite ongoing issue, Yannon.

Mr Longo—The committee is in public session, which makes it particularly difficult for me to answer that.

Senator CONROY—Sure.

Mr Longo—But I should add that even if we were not, it would still be a particularly difficult question for me to answer. The commission is very conscious of the fact that that is a matter that needs to be concluded. We are striving to bring it to a conclusion and it is certainly one of the major enforcement matters in 1999 that we would like to see concluded. I cannot really take it much further in the current context.

Senator CONROY—You were in litigation with Crown last year. You reached a settlement. Could you outline how that finished up?

Mr Longo—Again, the Crown matter had a number of features. There was a litigation that Crown commenced against ASC and the Australian Stock Exchange. The litigation against the ASC related to comments made by one of our senior officers in connection with an inquiry. That litigation was brought to an end without the need for a trial. At the same time, of course, we had a number of inquiries ongoing into the continuous disclosure practices of Crown at that time. That culminated in one of the first enforceable undertakings that the commission accepted since its power to do so was legislated for on 1 July last year. That undertaking provides for a very comprehensive system for compliance by Crown with its continuous disclosure obligations.

Interestingly, I got a briefing this week on how compliance with that undertaking is going. The market is also giving us some indications that the sorts of practices that were causing the market and us concern, for example, selective briefings and matters of that kind, have come to an end. We have been monitoring compliance with the undertaking and we do not have any further issues at this stage that warrant any further action by us arising out of that matter.

Senator CONROY—On what basis did you intervene in Pasminco Savage?

Ms Segal—I do not know to what extent you would like detail—whether a note might be more useful. I could take you through it. Pasminco sent out takeover offers that were due to close on about 15 January. That offer was highly conditional, including a condition that Pasminco became entitled to 90 per cent of Savage shares. Their lawyers contacted ASIC to

discuss the possibility of varying the offer by an extension. A number of discussions were held where hypothetical matters were discussed: 'If we extended it, what might be the attitude of ASIC,' et cetera.

As a result of those discussions, the lawyers for Pasminco formed the view that ASIC was likely to grant an extension. They told the company that that was the case, and on the basis of their advice an announcement was made to the market that an extension would be sought and possibly granted. They also released a notice, which they were obliged to give at that point in their takeover offer—seven days before the offer ended—announcing their intentions to the market.

They gave the notice, which basically said that the offer was going to end, but at the same time made the announcement to the market that said that the offer was likely to be extended, which was highly contradictory and very confusing to the market. They had applied for the extension but, when the written extension came, ASIC's review of that indicated that ASIC should not grant the extension because it was a highly conditional offer and, on that basis, consistent with our policy, would not be something that we would do. At the same time, the notice had been given, and that was, again, a matter where, once the notice was given, that was final—it was traditional that that was final in the marketplace and ASIC would not grant an extension.

They then came back to us and were concerned at the confusion out there. We took further information from them—had some discussions with them—and it became apparent that they had made these contradictory announcements under the misapprehension following the discussions. We took the view that it was really important that the market be well informed and that the confusion, which was clearly affecting the shareholders, be clarified, that that was the paramount role at that point of the regulator exercising a discretion, and that the directors of Pasminco at all times had been acting in good faith—they had received the incorrect advice as to what might be the intention of ASIC.

I think it was a lesson for advisers dealing with the regulator that you do not do anything other than according to ASIC policy—on the basis of written submissions and written responses. But the circumstances—that there was no bad faith in giving those contradictory notices—were something that we needed to clarify. At the same time, because of the confusion that had been generated in good faith but based on a misapprehension by them, ASIC took the view that it should grant an extension—particularly at that time of year, in January, when small shareholders are often away and finding things difficult. But it was just a vanilla extension; it just extended it for two weeks and at the same time clarified the matter for the shareholders that the offer would become unconditional on certain terms. So it was an extension which, at the same time, tried to clarify all the terms for the market.

Senator CONROY—Why did they threaten to take you to court?

Ms Segal—That was reported in the newspaper but, to the best of my knowledge, there was no threat to the regulator—that they were going to take us to court. When we had the discussion, we did ask them, 'Have you looked at your options?' Their option was to go to court—to get the court to grant the extension on the basis that there had been this mistake or misapprehension.

Senator CONROY—You invited them to take you to court?

Ms Segal—No. I do not believe that we invited them to take us to court. At first we said we were not granting an extension. The traditional letter says, 'If you are not happy with this, you have the following remedies: you can go to the Administrative Appeals Tribunal, and so on and so forth.' The court can correct the situation, but it was not a question of them taking us to court that I am aware of.

Senator CONROY—It just read that way in the newspapers.

Ms Segal—I think the newspaper reporting, from our perspective, was extremely interesting because on one side—

Senator CONROY—I am inviting you to give your side.

Ms Segal—I think traditionally the regulator has not decided to put its views out there in terms of contested takeovers.

Mr Cameron—Let me intervene at this point to say that that is exactly right. As I was sitting on the sidelines on a beach in Queensland when this was going on, I thought to myself that it was very hard. Fortunately, Jill had pointed me to which newspaper was closest to a correct version, and I was able to find it—it was not one published in Queensland, but I found it. The difficulty is that over this Christmas period there have been more live takeovers, with major issues for the commission than in a sense we would have liked—several of us were trying to take a break. It struck us this week, in reflecting upon that, that what actually happens and what the market thinks happens are often quite different, because they see sometimes different and contradictory reports in the newspaper.

Whether the commission has made some error or somebody else has made some error is very hard to understand, so we have decided, and we will announce shortly, that we will—probably in March—have a series of workshops in Melbourne, Brisbane and Sydney to go through these recent episodes for the benefit of the market and to explain what did happen and suggest how people can avoid them happening in the future.

The commission frequently is portrayed as the villain in the piece when, quite often, the situation is far more complex than that. People need to understand the procedures—for example, where you lodge documents. Part of the problem was that documents were not being lodged in the right places by the parties. With something as basic as that—when the time frames under the takeover law are frequently 24 hours—the fact that there is a document lodged in the wrong place can produce very unfortunate consequences. For example, we had to say to one bidder, 'You really do need to go to court to get your document validated. We can't fix it for you—you have to go to court.' So we are saying that on the one hand.

We had another offer in the last few days where, if you read the newspapers, you would think that we had the power to rule that a takeover was invalid. We were not saying that; we were simply saying, 'On the face of the documents you have given us, you do not have a takeover offer any longer.' In this case, they might have liked that result, but it is not

something we are happy with—it portrays us as the villain in the piece from the market's point of view, when all we are trying to do is to act as the umpire in the middle in quite frequently contested situations. We do need to explain this a bit better to the market.

Senator COONEY—You did put out a press release, as you well know, on 11 January which explained a lot of this.

Mr Cameron—We tried, but that press release, which you have read, does not look very much like the newspaper story.

Senator COONEY—No, it does not, but it explains. I see here that there was mutual exchange between Pasminco and you. You said:

Pasminco and its advisers have acknowledged they misunderstood ASIC's position and they have apologised to ASIC for suggesting that the Commission was inconsistent in its approach to relief.

Ms Segal—We actually got a written apology.

Senator COONEY—It continues:

The Commission acknowledges that Pasminco and its advisers were acting in good faith at all times.

So there is peace, gentleness and the Christmas spirit, I thought, in the letter.

Ms Segal—We have been looking at the newspapers, as have you, and in one case a journalist said that we should have upheld the very strict provisions and not in any way looked at what might have been the issue of market knowledge and market integrity. In another case, the same journalist—or a similar one—said, 'They should have granted this exemption, and they should not have taken such a strict view.' It is one of these things where it is very hard for the regulator each time to go out there and say, 'But this is the situation.' We try to do it. Where it is appropriate, we put out a press release, particularly for practitioners.

I say this in all humility—probably having been there a number of years ago—but practitioners and advisers in this area are very intensely committed to the success of their clients' result, maybe more so these days than they used to be, because of remuneration forms. I think there is a lot of intensity and emotion from these advisers, who do use the media very much for their purposes. I think it is very hard then for the regulator to get its message across, but we do try to look at the very strict letter of the law—and it is a very prescriptive regime. At the same time we look at what we see to be the broader objective of the regime and the Eggleston principles—to allow investors to have the benefit of equal opportunity, proper information, adequate time and fair price.

That is where the discretion and the judgment come in, and it is undertaken by the commission and its advisers; it is never something where an individual has the power to grant anything. As I tried to point out to the Pasminco people, a discussion with one person at ASIC does not give you an answer. It is dealt with in a proper and open forum by a committee. The decisions are open, discussed and recorded, so you do not know that you have a decision until you have a formal application to the regulator, it is heard by this

committee and a decision is recorded. Then you know you have a decision. We need to educate the advising community particularly that that is the way to deal with the regulator.

Mr Longo—One of the key themes in the process that was just described so well then is that it is a semijudicial function and it is quite improper for the regulator to go into the market saying that, 'When one party said that, this was our response to them.' Then the other party says something and we go into the market and say, 'Well, that is not quite right. What we actually said was this.' So it is very important during the heat of a takeover that we do not add to the confusion by trying to explain what is going on. That is further complicated by duties of confidence owed in one direction or another and often involving commercial confidences of great significance to the parties. So, from the regulator's point of view, there is a great need for understanding of the process that Commissioner Segal has described.

Many of these issues have an enforcement component. We several times consider referring matters to a panel or to a court, and it is very important, from the public interest point of view, that those decisions are made by the regulator in a perfectly proper and objective way, and that they are not seen to be influenced in one direction or another by an unseemly public dispute between the parties and the regulator about whether a belief was given about whether you have six days to lodge a document or seven.

Dr SOUTHCOTT—When you decide to investigate a matter and then later proceed to enforcement action, what factors do you consider when you make that decision?

Mr Cameron—If we decide to investigate it, that means that it satisfied the criteria for that, which we were discussing before you arrived. So that is there. In terms of deciding whether to take action, that really, if it is a prosecution, depends upon the prosecution policy of the Commonwealth, which is a document that is in the responsibility of the Director of Public Prosecutions. We have had a lot of debate with the director, as have the other law enforcement agencies in the Commonwealth's arena, about the different remedies that are open. The prosecution policy is all about criminal prosecution, but regulators these days have a much wider range of remedies than that, including administrative remedies of banning and suspension and so on.

We have, after some debate with the director, attempted to elucidate policies that will ensure that the right matters get investigated, get referred to the director or do not, and so on. It is probably too complex an issue. I do not think I could summarise it off the top of my head on the spur of the moment. I do not know whether you feel you could, Joe. Joe Longo is our national director of enforcement. I always look to him on these issues for that reason.

Mr Longo—I think the way the chairman has described that is entirely accurate. The only additional remark that might be of assistance in the limited time we have is that when we are confronted with a situation that raises a lot of serious issues then we try to prioritise that. If we are able to preserve assets, then we do that, and we will make an application for appointment of a receiver or take such other steps designed to preserve the situation—if not assets, documents—so that the various options that the chairman mentioned are still there a

month or two later. For example, if it is decided that the criminal path is not the appropriate one and that we will take a civil path, then that option is still there.

Issues like that weigh on us as well: when you get confronted with a situation, what can you usefully do to preserve it, to maximise your various options? But the key distinction is between criminal and civil, and the Commonwealth Director of Public Prosecutions is the key entity as far as that is concerned. As far as civil action is concerned, that is a matter for us to decide, usually after taking advice in the more difficult matters from independent counsel, as to whether we institute proceedings or not.

Dr SOUTHCOTT—In terms of resources for investigation, you are happy that you have enough resources to investigate?

Ms Segal—That is dangerous question to ask the director of enforcement.

Mr Cameron—One of the curious things about the annual report, which I do highlight for your attention, is that it points out that we achieved in the last financial year the same throughput, the high quality and degree of success, despite the reduction in resources. I mention that to emphasise that it really proved for me that we had succeeded in doing what we intended to do, namely, ensuring that we were removing support service type overlap by, in effect, consolidating support services and trying to remove less productive activities. We have succeeded in doing that. The government has reduced our resources significantly over the last few years, but we have succeeded, notwithstanding that, in keeping up a good throughput of work, and we are not seeking, at the moment, any general increase in our funding.

Senator CONROY—Without wanting to tie up the committee, could you take on notice why you changed your position? I know you have briefly outlined it in terms that it causes market confusion, but I would be interested in something—in writing perhaps to save time now—about what led you from one position on one day to a change in position a few days later.

Ms Segal—Sure. I would be happy to explain that.

CHAIR—There being no further questions, I thank you, Alan, and your colleagues for your appearance before the committee this morning and for the way in which you have answered our questions. We appreciate that very much. We have gone quite a bit over time so we appreciate your patience in responding to questions.

[10.27 a.m.]

JARRETT, Mr John Dallas, National Policy Manager, Securities Institute of Australia

CHAIR—We now move to consideration of the Corporate Law Economic Reform Program Bill 1998. I welcome our first witness, Mr John Jarrett, National Policy Manager of the Securities Institute of Australia. Do you wish to make an opening statement before we proceed to questions?

Mr Jarrett—Yes, I do. The Securities Institute represents practitioners in the financial markets ranging from corporate advisers, fund managers, analysts and stockbrokers to financial advisers, treasury dealers, lawyers and accountants servicing the industry. As such, we have a diverse membership with a broad industry perspective. Our focus is on effective regulation for efficient markets with high standards of professional integrity, meaningful disclosure and market transparency.

With this in mind, I would like to raise some specific issues relating to accounting standards setting, takeovers and the appropriate liability for prospectuses and takeovers documents in accordance with our submission to the committee. I would like to turn first to accounting standards setting. The institute has been a strong supporter of Australia's push to obtain high standards of financial reporting, including recent efforts to harmonise our standards with those issued by the International Accounting Standards Committee. However, we are concerned to ensure that Australia's hard won reputation for quality is not weakened. In our view, IASC standards still fall short of the high standard required, as shown by the harmonisation process. Automatic application of those standards rather than harmonisation would be damaging to our international reputation unless they have first been accepted for domestic purposes in key world markets such as the United States.

Weakness in reporting standards of some of our Asian neighbours has been a key factor in the substantial drop in confidence in those markets from international investors. Chairman Arthur Levitt of the US Securities and Exchange Commission in his speech of 8 December 1998, 'A partnership for public trust', put it clearly when he said:

> Look across the Pacific. These countries are paying a price for a system defined more by relationship-driven finance than market evaluation of risk and return. Everyone here knows what investors expect. They expect clear, comparable, dependable and honest reporting of events as they occur. And, if those expectations are not met, not only will a company's future be jeopardised, but so will the fundamental trust that allows our system to operate.
>
> We can never forget that lesson. As technology and the forces of more globally integrated markets redefine the operation of capital markets, new demands for capital are increasing that must be satisfied at a global level. There has been an international effort, as many of you know, on several projects to reduce disparities in reporting and disclosure requirements.
>
> We are very sensitive to the costs associated with non-uniform standards—particularly those relating to accounting. But as we attempt to answer the call for more harmony, we must focus, first and foremost, on the needs of capital markets and capital market participants.
>
> Participation in US capital markets delivers great benefits—but membership has a price. While we are looking for ways to reduce costs, we will not do so by diminishing the benefits our markets provide.

I don't presume to demand that the world's capital markets adopt our standards—

that is, US standards—

But, any set of global accounting standards must satisfy a fundamental test—does it provide the necessary transparency, comparability and full disclosure?

We agree with Chairman Levitt's concerns and believe that acceptance of international standards in our jurisdiction must occur only if those standards are accepted for domestic reporting purposes in major capital markets, particularly the United States, given that it accounts for half the world's capital.

This is not simply a plea to do our own thing. Australia is a net importer of capital and needs the confidence of overseas investors, especially those in places like the United States, to keep the cost of capital at a reasonable level. Indeed, in practical terms we suffer a risk premium due to geographical remoteness and the fact that our companies do not report under US GAAP standards. If our standards are seen to be weaker it will only exacerbate the problem. This is why in our submission to the committee we propose some simple changes to the legislation to ensure we adopt international standards only when appropriate.

Regarding takeovers: the institute, as the initiator of the 'follow-on' or mandatory bid rule, strongly supports the changes proposed in the takeovers area. However, in our submission to the committee we have commented on two particular issues: escalation clauses and the powers of the Corporations and Securities Panel. In our view, escalation clauses should be allowed in any takeover situation. They allow a seller, prior to the offer, to reach an agreement that, if a full bid occurs, any price obtained will be increased to match the bid price if that price is higher than the one obtained prior to the bid. This will be of comfort to the seller and encourage the development of stakes by bidders in preparation for a bid. It is illogical to allow escalation clauses only in mandatory bid situations and we recommend that they be allowed for all takeovers.

We support the changes which make the Corporations and Securities Panel the main forum for resolving takeover disputes. However, we believe that the panel's power should include the power to declare conduct acceptable as well as unacceptable. This will allow the panel to resolve issues at an early stage so that the bid can proceed to shareholders on its commercial merits. We also believe that the panel should be able to intervene of its own volition if it observes abuse of the takeovers process and to be able to enforce its own orders. This would maximise its effectiveness.

One final but very important issue is the overlap between section 52 of the Trade Practices Act and section 995 of the Corporations Law. This issue arose in the well-known NRMA case, although that case did not turn on whether due diligence defences applied, which is the aspect with which we are concerned.

When the Corporations Law was enacted, it provided a balanced approach involving a positive disclosure obligation on the part of fundraisers and a corresponding defence to liability if reasonable steps were taken to ensure accuracy in documentation. On the one hand, the fundraiser must produce a comprehensive disclosure document for potential investors which contains 'all such information as investors and their professional advisers

would reasonably require, and reasonably expect to find, in the prospectus'—section 1022 of the Corporations Law—in order to assess the financial position and prospects of the corporation and the rights attaching to the securities being offered. In return for producing such an informative document, if those involved in its production take reasonable precautions and exercise due diligence to ensure statements in a prospectus are true and not misleading and no material omissions occur, they are entitled to a defence to an action for false or misleading statements or material omissions in a prospectus.

Due diligence is no easy exercise. For example, the institute's own due diligence guide, which is currently out of stock, has some 80 pages of detail about the appropriate due diligence procedure. It should also be noted that if a fundraiser does not take reasonable precautions or exercise due diligence, no defence is available.

The Corporations Law provides a complete regime which is designed to protect investors at reasonable cost to those raising funds. In our view, section 52 of the Trade Practices Act was not intended to apply to this situation, otherwise there would have been no point enacting the regime in the first place. The application of section 52 has been a significant impediment to capital raising in Australia. We believe that the approach proposed in the bill will restore the original intent of the legislation.

I am happy to answer any questions on what I have just said, or on our submission.

CHAIR—Thank you very much, Mr Jarrett. We have received a number of submissions which I suppose we could characterise by the description 'from small shareholders' who have expressed some concern about the new takeovers provisions of the legislation. I suppose you could say they describe them in a sense as confiscatory, in that no longer will the market judgment be used to set the price but a so-called independent analyst will be used to set the price. They also raise the issue of it no longer being a requirement that 75 per cent of investors have to agree to the takeover. It is purely the 90 per cent shareholding figure that has to be reached, and the company that is trying to take over the remaining 10 per cent is able to make rights issues at a price above the market price, which they then underwrite, and creep up to the 90 per cent through that mechanism. I was just wondering what your comments are on those objections that have been raised.

Mr Jarrett—We were not specifically going to raise those issues but, now that you have, I am happy to speak to them. That would be basically relating to the compulsory acquisition aspects of the legislation. All these things are a matter of balance between probably three competing considerations. The first would be the efficiency for companies to be able to achieve 100 per cent and achieve the efficiencies that come from being a full subsidiary. The second group would be those shareholders who have determined not to accept the offer and who have rights attaching to their holdings of shares, and whether those rights should be taken from them. Third, there is a group who are known as greenmailers who deliberately take up stakes in order to attempt to block takeovers and then extract a special premium above that which applies to any other shareholders in order to benefit from having that blocking style stake. So it is really a question of trying to balance those competing considerations.

In our view, the current provisions can make the ability to achieve a compulsory acquisition quite difficult and so some relief is justified. Also, the provisions in the current bill provide not only for an independent expert valuation but also for a court procedure for objection if 10 per cent or more of the remaining shareholders agree to object to the compulsory acquisition.

I might also add that they must be provided with a notice of the compulsory acquisition, therefore every remaining shareholder is on notice and can object to the compulsory acquisition if they see fit. So there is a mechanism for trying to find a balance between the objections of those who do not wish to be taken over, particularly if they have concerns about the valuation, which must be done by an independent valuer, and they have rights to have those concerns addressed through a court mechanism.

Of course, there could be some benefit in looking at whether or not, for example, rather than the court system being invoked, there might be some role for the panel in that sort of procedure. That would also assist in probably keeping the cost of that procedure down if there are sufficient objectors to the compulsory acquisition.

CHAIR—What is your view on the suggestion that the price should be set by an independent valuer rather than the market or the price that was paid by the offerer to get to the 90 per cent situation?

Mr Jarrett—That, of course, applies in situations which do not follow a takeover offer. But the difficulty in all these cases is that valuation is always a matter of opinion and probably there will be a difference of opinion between the bidding company and the remaining shareholders. So there needs to be some mechanism whereby a fair price can be struck and justified. One of the best known mechanisms for that is to obtain an independent valuation so that that balance can be struck.

There will obviously still be situations where remaining shareholders in those circumstances will still be unhappy, for whatever reasons they may be unhappy—it may be about the price or it may be for some other reason. That is why the mechanism in the bill, as I understand it, has been set up—to try to provide a mechanism for resolving that through an objection procedure.

Senator COONEY—Has there ever been a truly independent expert?

Mr Jarrett—That is a good question, Senator Cooney—which is why you asked it, of course. It is always a matter of opinion as to whether that is the case, particularly in a market like Australia where most of the people that are independent valuers are in the market and acting for a variety of parties all the time. So you will always run into some difficulties over whether someone is truly independent or not.

Senator CONROY—If you have been employed by the 90 per cent, is it possible to be independent?

Mr Jarrett—I believe it is possible to be independent, and part of the mechanism in the bill as well is that any connections you have ever had with the bidding company must be

disclosed. So there is a fair amount of openness about how independent you might be. There will be circumstances, I would imagine, where absolute and total independence would virtually be impossible, particularly with fairly large companies that do a lot of takeover work. In those circumstances, there would often be past connections between them, sometimes past connections on the other side.

Senator CONROY—Or possible future connections?

Mr Jarrett—Or possible future connections.

Senator CONROY—That is probably more of a concern.

Mr Jarrett—It is certainly reasonable to suggest that there are some difficulties with that sort of thing, and probably there have been in the past in relation to independent valuations. That is why having a secondary mechanism is a useful way of trying to resolve it. As I have suggested earlier, the bill provides for the court system to be invoked. But I think there would be some merit in examining whether the panel might be a more appropriate mechanism, particularly on the basis of cost for what can often be fairly small shareholders who do not have a lot of resources.

Senator CONROY—You mean that the panel would employ the independent valuer?

Mr Jarrett—No, the panel would be the body to which you could object to the independent valuation. For example, if the independent valuation is done in such a way that the remaining shareholders are happy with the situation, then there does not appear to be any need to have some other body become involved. It is only in circumstances where the remaining shareholders object to that valuation and do not want to accept it that you would need to have some form of independent umpire invoked. That is the situation where I am suggesting the panel could perhaps play a role, rather than the courts, particularly if cost considerations come into it, which in a lot of these circumstances they would.

In the case of greenmailers that might not be such a concern, given that they probably do have a few resources because they are in that sort of activity. But I think in the case of very small shareholders, trying to find a mechanism which is fair and not overly expensive would be useful.

CHAIR—There are also objections that the only matter to which recourse to the court can be had is with regard to the price, rather than any other issues in relation to the takeover. What is your view on those objections?

Mr Jarrett—I am not quite sure what other types of objections would be legitimate in the circumstances of a compulsory acquisition. If the legislation provides for the mechanism, then really the key issue is the price for the shares. The mechanism was designed to allow a company to achieve 100 per cent, overriding the rights of the existing shareholders. That mechanism is designed to allow for a more efficient allocation of assets in the economy and for those companies, and for them to be able to use the resources involved in a more efficient way and get value out of them. So the question then becomes: 'What is the key issue in relation to that compulsory acquisition?'—and surely it would have to be price.

Senator COONEY—What the chairman is saying is there is a sort of a 'clean hands' approach. If you have not got to that situation with clean hands, then should that be a matter that you take into account?

Mr Jarrett—If you have not come to, for example—

Senator COONEY—If you have gone into the market and you have manipulated so that you get to the point of your 90 per cent—

Mr Jarrett—You are talking about a situation such as that which I read about in the media yesterday of getting yourself to 90 per cent by virtue of doing a rights issue at a price well above value, et cetera—that sort of mechanism?

Senator COONEY—Yes, whatever it is. It is something in addition to price. That is what I mean by 'clean hands'—that you get to 90 per cent, as I think the chairman is suggesting, by the method that you have mentioned or by some other method. Should that be a consideration? Or do you say that that is a matter that should have been attended to at the time and now the only real issue is the price?

Mr Jarrett—Once again, in line with the institute's position on the panel, we would think that if there are those types of concerns regarding illegitimate means of putting yourself in a position to exercise compulsory acquisition powers, they probably ought to be dealt with by the panel. That is why we are very strongly in favour of giving the panel a wider brief. Those sorts of circumstances would be exactly the types of circumstances that would be involved. But once you have got to the 90 per cent and that is not objectionable, then really the only issue is price.

CHAIR—Another issue that has been raised is the impact of capital gains tax and the fact that in a takeover situation, particularly in a compulsory acquisition situation, a shareholder becomes potentially liable for capital gains tax in a situation where they have not initiated the sale or the action—they really have no say in the matter. I was wondering whether you have got any response to that. Should there be rollover provisions in the tax legislation to take account of that or should that be a reason for someone not having to accept a compulsory takeover?

Mr Jarrett—The institute is a strong supporter of implementing rollover relief of capital gains tax in share swap merger situations, regardless of whether they involve compulsory acquisition or not. One of the strong arguments we have put forward has been this very issue. This applies in the current compulsory acquisition provisions too. It really does not necessarily relate to these changes. In any compulsory acquisition situation you will have shareholders who have not wanted to have their shares taken over. But, under the current capital gains tax provisions, not only will the shares be taken from them in the compulsory acquisition but, in fact, the tax liability will arise by virtue of the current provisions that apply to capital gains tax.

The other serious concern we have about capital gains tax is that in those types of circumstances you have two different sets of shareholders: you have the shareholders in the bidding vehicle and the shareholders in the target. The shareholders in the target are subject

to compulsory acquisition and a capital gains tax liability. Those in the bidding vehicle do not get any tax liability at that time. In fact, it is quite a big concern in friendly mergers, such as some of the bank mergers and the like between regional banks and some of the major national banks that have been taking place.

One of the biggest objections raised by shareholders in those has been from one set of shareholders, being the set of shareholders for the company that is being taken over, because under our laws you cannot just bring them together like a couple of pieces of plasticine—you have to have one over the top of the other. The one that is underneath will cop a capital gains tax liability. It is particularly an issue for self-funded retirees because they are relying on an income stream which comes from their capital base. If they are subject to capital gains tax liability, then their capital base will be diminished and therefore their income stream will be diminished, even though they have continued their investment, so to speak, through the merged vehicle. So it is quite a serious issue for people who are relying on the income stream from their shareholdings.

I understand from the Bank of Melbourne merger that over 50 per cent of the objections were related to the capital gains tax issue. Also, the recent AMP-GIO takeover seems, from media reports, to be a clear example of the fact that a lot of small shareholders decided not to accept the takeover bid because they were very concerned about capital gains tax. In fact, I was speaking to someone who was a shareholder and that was pretty much the prime issue. They looked at their shareholding before the takeover and after the takeover and, with the capital gains tax liability, they had less and they were going to have less of an income stream, and they said, 'I don't want any of that,' despite what the price was. We think it is a very serious problem. In Western economies, Australia is almost totally isolated on this issue. Nearly all other jurisdictions have a form of rollover relief which is reasonably easy to access.

Dr SOUTHCOTT—On the accounting standards, you mentioned earlier that you felt it was a problem if we adopted international accounting standards—or the IASC standards—before other major capital markets. Do you think, if we were to adopt beforehand a set of standards which were perhaps better than the standards operating now, that it would detract from Australian companies' ability to attract overseas capital?

Mr Jarrett—In our view, the clear test of whether or not the international standards are the best available will be whether they are adopted for domestic purposes in major markets. If they are not, that will be an indication that they are not accepted as such. In fact, at the moment the international accounting standards have, in lots of cases, alternative accounting treatments, some of which are almost opposite. That being the case, if you have automatic adoption in the situation where you have alternatives, that clearly is objectionable if you are taking as the criteria comparability and transparency in financial reporting—and that is really the key thing for us.

We are concerned that until the international standards are brought up to the level whereby they are seen as being of the highest standard, we should be cautious in jumping into the International Accounting Standards Committee type of standards. Also, there may be another path that comes through in the next few years whereby people will say, 'We are really not going to go down the IASC path; we are going to go down some other path.' The

real question is: what do investors think; and, in particular, what do investors in the major markets that we are trying to get capital from, particularly the United States, think? At the moment, if you do not report to US GAAP you are given a risk premium automatically. I do not believe IASC standards will change that situation.

The IASC standards have been good in lots of respects. And the harmonisation process we have gone through in Australia has meant that where Australian standards have been weak we have been able to get them up to a good standard and where Australian standards are strong we have been able to keep that level. In a number of cases the standards that have come through from the Accounting Standards Board are of a stronger nature and of a higher level than the IASC standards but, because it is harmonisation, they take into account the IASC standard but do a bit more. That is not objectionable on a harmonisation basis, but that would not occur if it were an adoption basis—and that is our concern.

Dr SOUTHCOTT—So there is nothing wrong with the accounting standards. Are there any countries at the moment that adopt IASC standards?

Mr Jarrett—I understand that there are some, but they are not major capital markets of any type. Out of the major capital markets, if you include Australia in that group of a dozen major capital markets, Australia would have the greatest level of compatibility with the IASC standards, as I understand it.

Dr SOUTHCOTT—I just want to clarify one thing you said. It would be possible for Australia to adopt IASC standards and still have a risk premium associated with it, in attracting capital.

Mr Jarrett—Yes.

Senator CONROY—The government's proposed changes to the takeover rules are based on the perception that the current arrangements inappropriately discourage takeover activity. You are strongly supporting those changes. What do you perceive are the hurdles to takeovers?

Mr Jarrett—There are probably a number of hurdles to takeovers. In fact, the Securities Institute went through a series of meetings with the top corporate advisers in the second half of 1996 to look at this very issue prior to all of these things coming forward.

A number of key issues were raised. The lack of capital gains tax rollover relief was one of the key issues. The fact that Australia's takeover laws are some of the most restrictive in Western economies was another. Problems with the ACCC relating to their restrictions on certain mergers were seen as a problem. They were probably the three key issues. There were some other issues relating to matters like the treatment of goodwill and things like that under the accounting standards that were seen as a concern. But I would say the three key ones were: competition policy restrictions on takeovers; taxation policy in relation to capital gains tax—that was probably the number one, I would say; and the number two would have been the restrictive takeovers regime.

One other matter I should have mentioned is litigation risk and issues relating to the cost and also damage to reputation that arises from tactical litigation that goes on through takeovers. That is why we are very strongly supportive of increasing the role of the panel.

Senator CONROY—There is no rollover relief proposed at the moment, though, as part of this legislation?

Mr Jarrett—Not as part of this legislation. It is being looked at by the Ralph review of business taxation.

Senator CONROY—Is the ACCC's role in competition issues addressed in this bill at all?

Mr Jarrett—No, not in this bill. The whole issue of competition policy is a tricky issue. I do not want to really go into that because we could speak for a few hours on it. I think a lot of the advisers feel that that is a restriction—and it is a restriction—but it is a policy issue as to what level of competition policy requirement we have and what restrictions we have on mergers that arise out of that.

Senator CONROY—So that leaves the current restrictive set of laws?

Mr Jarrett—Yes.

Senator CONROY—Could you give an outline?

Mr Jarrett—The greatest difficulty that we see is that the Australian regime effectively requires a single method of takeover, that being the public auction method. In most other comparable jurisdictions there is a range of possibilities. For example, in the United Kingdom they have a mandatory bid style rule, which is the type of thing being suggested in this bill. There are lesser restrictions still in the United States and there is almost no restriction in New Zealand. So there is a range. Australia probably has the most restrictions. We basically require you to go to no more than 20 per cent and then you must make a public bid, therefore you are subject to a public auction.

What has been found by the corporate advisers that we consulted is that a number of potential bids do not come forward because those who might make the bid are concerned about the fact that they have to go through a public auction process and cannot just purchase the company or cannot purchase a large stake in order to then move to purchase the company. Also, a potential public auction process could involve damage to the reputation of their company and they are concerned about that. Those seem to be the major objections that come through. Therefore, a lot of potential deals do not take place.

In fact, Australia's level of takeover activity right through the 1990s has been at a very low level compared to other jurisdictions around the world. In fact, I obtained some figures yesterday which show that at the level of part A and part C bids in Australia we are still at only about one per cent of total market capitalisation in terms of the capital of companies being bid for under part A or part C bids. That compares to overseas jurisdictions where the

numbers are five, six or seven per cent. So we really have a very low level of takeover activity in Australia in terms of the size of our market. I think that is the concern.

It has often been argued—and Henry Bosch was very famous for this in the 1980s—that there can be too much takeover activity. In the 1980s—I think it was 1989—I think they had nine per cent of market capitalisation that was in takeovers, and that is very high. I certainly think that in Australia you could say that we have activity that is perhaps too low at the moment. That means there is much less pressure on management to perform.

One of the greatest ways in which to encourage better and more efficient management is to have the threat of takeover over the shoulders of the management, because then they are really forced to perform—otherwise they are off, because the shareholders will accept a bid. I think that is really the major aspect of our concerns.

Senator CONROY—Mr Cameron lamented the number of major takeovers taking place over Christmas—they were disturbing him—so there does seem to be a bit of a boom on. Maybe it is just a coincidence of timing that there seems to be a fair bit of activity right at the moment.

Mr Jarrett—Yes. There is actually a worldwide boom in mergers and acquisition activity but Australia is still lagging well behind it, in terms of the level. I saw some media reports the other day about a record level of merger acquisition activity in Australia—but that was in dollar terms. In terms of the size of our market, it is nowhere near a record level—so figures, as you know, can always be a bit misleading.

Senator CONROY—Sure.

Mr Jarrett—I think it was 1.1 per cent of market capitalisation in 1998, compared to, for example, 1989, which was nine per cent. Although, in total dollar terms, certainly Australia has had a record, those figures included such things as privatisations—and I understand they may have also included demutualisations—so they can be a bit distorted.

Senator CONROY—The 1998 figure?

Mr Jarrett—The figures that were in the press the other day: I am not entirely clear that they only relate to takeovers and mergers. We have been trying to actually clarify that since we saw the media reports. But the information I have received, through one of our members, is that it is still only at 1.1 per cent in 1998, which is still very low, given that the world levels—particularly in Western jurisdictions—are up four or five times that, at least.

Senator CONROY—You mentioned that people had indicated the public auction process was something they had a concern about and therefore did not proceed. What would be those concerns? What would they see as the problems with a public auction process?

Mr Jarrett—Really, it is one of those things like regulatory arbitrage. The issue is that they look at Australia and say, 'There is a set of laws.' They look at another jurisdiction—say, for example, Canada—and they say, 'There is a set of laws there. We have got a range of possible investments we can make.' This is really talking about international level firms.

If those potential purchases are reasonably equal in terms of strategy for the company, they are going to look at the legislative regime and say, 'We can go to this jurisdiction. We can purchase a substantial stake and then move to take over the company without having to go through a potentially damaging public auction process; or we can go to Australia and we can do that.'

I think that is where those decisions tend to be made—on that sort of level. A lot of potential bidders really just do not like getting into that sort of a process, if they can avoid it.

Senator CONROY—Then you describe it as potentially damaging. We have just seen a very public dispute between AMP and GIO—

Mr Jarrett—Yes.

Senator CONROY—which we got to watch it on television each night—in terms of the ads and everything: is that what you are finding is potentially damaging? I am just trying to come to terms which what you mean by 'potentially damaging'.

Mr Jarrett—Sometimes these auction processes can end up in court. Directors of the bidding company can be called to appear. They are worried about whether they will make a fool of themselves in that process. They are worried about the reputation of the company. In hostile bids, people use all sorts of tactics to damage the bidder's reputation if they are protecting the target. So there will be endeavours through the press et cetera to damage their reputation in whatever way—particularly if there is a share scrip exchange involved in the auction as at least one of the alternatives, because then it is an issue of: 'How valuable is the bidding company?' Then you can get into what can become quite unseemly disputes, and that puts people off.

Senator CONROY—How do you balance that—directors in GIO is an example—if directors consider that the takeover will be detrimental to their existing shareholders? You are sort of shifting the emphasis so that the bidder has a greater degree of certainty, potentially, at the expense of directors who consider it a poor takeover.

Mr Jarrett—Yes.

Senator CONROY—You mentioned earlier these things are a question of balance.

Mr Jarrett—They are a question of balance.

Senator CONROY—I am just interested in whether or not you see the incumbent director as being in a worse off position. I am thinking of the Memtec one that was mentioned earlier. I think you might not have arrived then but there was some discussion about the Memtec case, where existing directors were very opposed and took it through the courts.

Mr Jarrett—Perhaps the best way of addressing that is to look at what happens in the UK, which has a mandatory bid style rule and has done for, I think, 30 years. From our

discussions with people in the UK—and I have discussed this with a number of people and have actually gone over there and talked to a few people about it—it has settled down to the extent that everybody knows what the rules are. The level of takeover activity using a mandatory bid is not huge. Off the top of my head—I cannot remember exactly—about 15 per cent of all bids are through a mandatory bid process. It is just one of the mechanisms that can be used for a takeover, but it is not the exclusive one and it is certainly not the dominant one in the UK.

From my understanding from the groups that represent investors in the UK, they are quite comfortable with that sort of process. It means that more bids do come forward and, at the end of the day, that puts pressure on management one way or the other. It is a very rare circumstance that a major shareholder will sell to a potentially mandatory bidding company for a low price or a price that is not reasonably justified. They are going to be under the gun, they are going to want to get the best price. Often, also, they will say, 'Despite all of those things, I am not prepared to go through the mandatory bid process. You have to go to a public auction.' Then you have the decision where you are going to do that, go to another shareholder, or you will not go forward.

All we are talking about in being very strongly supportive of the mandatory bid is to say that there is another way of having some sort of competition for ownership of companies and it is to the benefit of shareholders overall. You will certainly get situations in some cases where the price might not be as high as it would have otherwise been. You will certainly get other cases where there just would not have been a bid, so a bid comes forward and value is achieved for shareholders. We believe quite strongly that, overall, the shareholders will benefit from the ability to have greater takeover activity, either through takeover bids being more prevalent and therefore more successful, or through improved and more effective management because of the threat of takeover.

Senator CONROY—Moving on to fundraising, what do you consider are the important factors for an efficient capital market for both large and small enterprises to be able to successfully raise capital?

Mr Jarrett—I am not quite sure what you mean by your question.

Senator CONROY—Disclosure?

Mr Jarrett—The institute's basic philosophy, in fact, is that meaningful disclosure is the most critical part to the markets, that transparency is the most critical thing. In the case of fundraising, you have to strike a balance between the volume of information that it is reasonable to require and what can be meaningful to, and easily digested by, people who might potentially invest, and that is where you try to strike that balance.

That is why we are very supportive of the general test that is in the Corporations Law under section 1022, which was brought in when the Corporations Law was introduced at the beginning of this decade. It provides a fairly general test of what is reasonable for an investor and also the due diligence defences that go with that. So there is a mechanism whereby companies investigate as much as they can the state of the company; they delve into it further than just the report they receive up at the board or whatever.

One of the problems with prospectuses can be that there can be a massive volume of information, so we are also supportive of having some mechanism to have a shortened form of prospectus size to enable people to get that version of the information that is appropriate to them, as well as the full prospectus so they can get the full gamut of information and either absorb that themselves or talk to their advisers about the investment or whatever.

Senator CONROY—Just on the issue of prospectuses, the government is arguing that the changes will lead to significant savings. What are the major costs involved with prospectus preparation?

Mr Jarrett—There are a number of costs involved. Clearly, due diligence is a quite expensive part of the whole process but, we feel, quite a necessary one. Obviously, there are substantial costs—

Senator CONROY—What does that involve—auditing, legal and those sorts of things?

Mr Jarrett—Yes, all those sorts of professional costs that are associated with the investigations necessary to conduct a due diligence.

Senator CONROY—Are they still going to be needed, though, under the new proposal?

Mr Jarrett—Yes.

Senator CONROY—And they are the major component of a cost preparation?

Mr Jarrett—They are a substantial part of it, yes. Some of the other costs are the costs of printing, publication and distribution of prospectus documents. There is a point in time—

Senator CONROY—Distribution will be the same, though, under the current or the new proposals. The distribution, presumably, is to the same place.

Mr Jarrett—Yes. It will probably be marginal in those circumstances. The thing about it is that there is a point in time in relation to a prospectus whereby the cost outweighs the benefit of raising the capital. That is one of the great concerns with the way that the Corporations Law works at the moment. You have a gap group in the middle. You have very small capital raisings that really involve only getting a little bit of money from selected people. That is allowed under some of the exemptions that apply under the Corporations Law, so therefore there is not a prospectus procedure there.

Then you have the very large fundraisings where the cost factor as a proportion of the cost of the raising of the capital is not so unreasonable it becomes impractical. Then you have a whole lot of people in that middle group who might be in the $5 million or $10 million type range—around those sorts of single figure millions—who need that sort of capital and where the cost involved in actually going through the fundraising exercise is such that it is just not practical to go through that capital raising and they will try to find their capital in other ways, such as debt capital.

Senator CONROY—I am just trying to identify the saving. What you described as the professional costs are not going to change, from what you have said. Distribution costs may change marginally. So you are really just down to your printing costs and the majority of printing costs, from anything I have experienced, is for set-up and design.

Mr Jarrett—Unless there is a use of such things as the offer information statement, which is not a prospectus so does not require the due diligence, but it is subject to section 995. That particular special mechanism, which was, if I recall, only available as a one-off, will fill that gap. I understand it is designed to fill that gap for those who need to take that step up, so to speak, in terms of having capital to be able to expand.

That is an important area, I think, that is being addressed through the offer information statement. But that is not a prospectus and it will not involve a prospectus type document. It will involve a lesser document but it will also mean that there are not those due diligence defences available and it is subject to the usual misleading statements type provisions.

Senator CONROY—Directors' duties in corporate governance: there has been some concern that the proposed safe harbour rule would weaken the power of shareholders to keep directors accountable. Would you agree that that is a possibility?

Mr Jarrett—I would have to say I am not in a position to comment on those provisions because we have not taken a view on those. I will bow out from that one, if that is all right.

Senator CONROY—Okay, no problems.

Ms JULIE BISHOP—Back to the accounting standards, Mr Jarrett: what are you suggesting the proposed Financial Reporting Council does in regard to the accounting standards setting procedure and the IASC standards—wait to see if the USA, for example, or any other major overseas capital market adopts the standards or await the accounting professions harmonisation moves? What are you suggesting? Secondly, have you any other comment on the role of the Financial Reporting Council?

Mr Jarrett—I will answer the first question first. In our view, the Financial Reporting Council should consider the adoption, or otherwise, by most capital markets as being pretty fundamental to Australia's decision to adopt international standards as against harmonising.

Ms JULIE BISHOP—Would the USA, for example, be enough?

Mr Jarrett—Particularly the USA, being a key player. They may or they may not but, at the end of the day, the practical reality is that the risk premium is substantial. If the US does not adopt IASC standards for domestic reporting purposes, then we could perhaps do ourself even further damage by going down that road if those standards are seen as being not as good. That is the concern that we have.

The harmonisation process itself is due to be completed fairly shortly, so I do not think that will really be a concern or issue; it will really be how much faith there is in the international accounting standards on the part of the markets that count in terms of Australia as a net capital importer. That is really our concern.

Ms JULIE BISHOP—The FRC should point that out in its reporting?

Mr Jarrett—It certainly should. I think it is absolutely critical. In fact, we believe it would be strange if they were to recommend adopting those standards without there having been substantial adoption in those major jurisdictions.

As to the general role of the FRC, we are quite supportive of the new regime. We believe it is important that users in particular, which we represent as being the professional practitioners between shareholders and those offering their shares—groups like ours and others who are representing that user view rather than the preparers of financial reports—have a substantial say on the Financial Reporting Council.

We think it is very important, and the FRC proposal will, in our view, give us that opportunity. We will certainly be pressing very strongly for representation for user groups on that body because, at the end of day, it is the users of financial reports who actually count in the process of financial reporting. They are the ones who need the information and they are the ones who have the least amount of information about the activities of the company.

Senator GIBSON—Mr Jarrett, I quote from a recent article by Phil Ruthven of IBIS:

The US corporations now aim for three times the bond rate, the UK corporations twice the bond rate, and Australia corporations 1½ the bond rate . . .

He quotes actual rates of return on the 30 largest listed companies. The returns on shareholders' funds for the last five years are at 19 per cent in the US, 15 per cent in the UK and 10½ per cent in Australia. Is it the institute's view that, if the takeover regime were made easier in Australia and the level of takeovers and mergers were lifted higher, the rate of return on all shareholders' funds in Australia and investment funds would tend to lift towards international standards?

Mr Jarrett—We would believe that on average that would be the case over time because of the pressure on management that comes from increased activity.

Senator MURRAY—Just quickly on that, is it not true though that the rate of return is materially affected in Australia by the fact that we are very commodity orientated and the rates of return of resource companies holds our rate of return down?

Mr Jarrett—Yes, that can have an effect in Australia for sure.

Senator MURRAY—If you look by category, you in fact find we are pretty comparable to the US and UK in some sectors?

Mr Jarrett—It can be, yes. I think what Senator Gibson has raised is interesting because of course the expectations of rate of return might be related to the actual rate of return that occurs.

Senator MURRAY—Yes, he is right. Very briefly, you made the link between the trade practices provision 52 and the Corporations Law. There are sections within the trade

practices law where the courts are specifically required to take into account other legislation in examining the consequences of a claim under trade practices law.

Mr Jarrett—Sure.

Senator MURRAY—Is it your intention to recommend to us that a similar kind of provision be inserted in the trade practices law so that the two are more appropriately linked? What is your solution, in other words, to the problem I have outlined?

Mr Jarrett—Our solution is that section 52 not apply in cases where there are dealings in securities, such as is suggested in the bill. This will take out its application in relation in particular to the documentation that is produced either for fundraising purposes under a prospectus or in takeover documents, so that the due diligence defences do apply. That is the cleanest and most straightforward way to deal with the matter, and section 52 of the Trade Practices Act is duplicated—I think almost identically, if not exactly—under section 995 of the Corporations Law. That was done deliberately so that that would be transported into the Corporations Law. The Corporations Law would then have its own regime such that, outside of those documents which have due diligence defences, you are subject to a general section 52 type liability, but then, where the due diligence defences under the Corporations Law do apply, they can apply on their face without the complication of the Trade Practices Act being involved. It was not really until the NRMA case that in fact people realised section 52 could have application. The assumption had been that the legislation had been designed such that it would not.

Senator MURRAY—So the proposition I have put to you would be second best but would be better than the existing situation?

Mr Jarrett—It would be better but certainly second best and potentially subject to further litigation as to what it really means. That would be the concern.

Dr SOUTHCOTT—Your position is that you are supportive of the bill as it stands regarding having section 52 of the Trade Practices Act not applying to securities?

Mr Jarrett—Yes, exactly, that is our position.

Senator COONEY—Just to exploit your mind on a matter that is not quite what we have been talking about: later in the day we are going to have somebody from Memtec Ltd that Senator Conroy mentioned. He is talking about converting scientific ideas into commercial enterprises—the clever country argument. He says you really cannot do that in Australia for a couple of reasons. First, the ASX does not know how to put proper value on scientific thoughts—or on brainy thoughts, I suppose, to make it wider than that—and therefore they do not value it properly and the capital becomes too high. Second, he says the takeover code is best described as ‘quaint’ because it only gives the target company a month to prepare an answer to a takeover bid. He says:

He also says:

. . . I am now of the firm conviction that you have to bypass the Australian market and gain access to the world capital markets who do understand how to value an enterprise which is commercialising invention.

He is really saying that we have great scientists here—you know the argument—but that they cannot make value of their ideas in Australia. Do you have any thoughts on what he says, first of all, about the takeover provisions? He says that we have quaint takeover provisions, that what we are proposing is quaint and that the ASX does not really know how to put a proper value on the matters of the mind.

Mr Jarrett—He may have been watching Internet stocks in the United States, where substantial value is put on potential arising out of intellectual capacity in corporations. We certainly do not have a strong history of that in Australia, so there is probably some merit in what he is saying. One of the other big problems in Australia is the difficulty in raising venture capital, particularly concerning some of the restrictions that apply in relation to overseas investors putting money directly into Australia. That has been raised by the Venture Capital Association in the context of the taxation review. There are some concerns there. That is a substantial problem in Australia at the moment because the potential upside in these ventures leads to a very large capital gain. But there are a lot of downsides as well. The risk return with the tax effects can make it difficult and it is better to take it overseas, where the regime works better in tax terms.

We certainly think that Australia's takeover laws are a bit quaint, but we probably take a different view about what changes ought to be made in relation to them. There ought to be more ability for takeovers and mergers to take place. For venture capital type enterprises, particularly in intellectual and scientific areas, there is great benefit in trying to encourage more merger activity so that companies in that sort of business can grow together. One of the big problems is the capital gains tax. You put the two together, but you do not get any rollover relief putting the two together; you get a capital gains tax liability. That kills the deal nearly all the time. That means that a lot of these companies remain small because they cannot come together.

CHAIR—As there are no further questions, I thank you, Mr Jarrett, for your presentation and answers to questions.

Mr Jarrett—Thank you for your time.

[11.25 a.m.]

ELKINGTON, Dr Gordon Bradley (Private capacity)

CHAIR—Welcome. Do you have any comments about the capacity in which you appear?

Dr Elkington—I am appearing in a private capacity. I am a director of a public investment company and, in a sense, I am speaking in the interests of small shareholders generally. I am a legal practitioner and a former academic from the University of Sydney.

CHAIR—We have your submission before us. Do you wish to make an opening statement before we proceed to questions?

Dr Elkington—Yes. It is clear that the committee is right on top of what I and presumably other small shareholders have said. The principal areas which I have had concerns about are, firstly, the lessening of the protection to small shareholders in a takeover situation by limiting the power of the court to look at aspects of fairness of the takeover when a compulsory acquisition is contemplated and, secondly, the limitation of the matters that both the expert and the court can take into account in assessing the value of particular securities subject to compulsory acquisition. They are concerns I have about the modifications to what we might call the traditional takeover and compulsory acquisition provisions.

I suppose that I am more concerned about the new provision—the 90 per cent compulsory acquisition provision—because I think it is something that is quite radical and new. It is not simply a development of the traditional compulsory acquisition provisions. They really are, as you have said—you indicate that you understand it is being submitted—confiscatory provisions which are, by and large, unknown elsewhere and certainly in the Anglo-Australian system of takeover law. It is clearly addressed to awkward situations.

If one looks at these situations, one sees that they have almost always arisen as a result of the 90 per cent holder's own actions. In some instances, the 90 per cent owner may have made a takeover offer at an earlier stage and not been able to reach the compulsory acquisition levels. Sometimes that has been because a lot of small shareholders are lost or dead or apathetic. In recent times, at least, that problem has been able to be addressed by the power of the commission to grant modifications in the law in a case where the failure on the part of the offerer to reach the compulsory acquisition levels has largely been because some of the shareholders are dead.

But there has been another problem. In a number of other situations where the principal shareholder has 90 per cent, it is because it has been very hard in a takeover offer for the offerer to climb over the second of the two limbs, being the second of the two compulsory acquisition criteria. One is, of course, climbing over the 90 per cent by the number of shares out of the total number of shares in the class. The other criterion has been that the offerer must gain acceptance of 75 per cent of the shareholders by number. That 75 per cent by number provision was introduced in the 1960s because there was some unfairness perceived in counting the number of securities for which acceptances were received rather than the

number of other actual security holders. In my view, that simply added another complication to the law and resulted in people splitting their shareholdings. In any event, it has been a very difficult hurdle for bidders to overcome.

To some extent, that has been addressed in this most recent legislation by changing the second criterion from 75 per cent by number of shareholders to 75 per cent by value of the shares subject to acquisition. Had that provision been in place over the last 20 or 30 years, very few of these situations would have arisen where a principal shareholder has held 90 per cent of the shares by number and there is then a very long tail of relatively small shareholders. Those situations simply will not arise under the modification that has been proposed in converting the 75 per cent by number of shareholders to 75 per cent by number of securities. The problems that the 90 per cent provision is intended to address are much less likely to arise now if that other provision—the change to section 90—is adopted. It has always been a bit puzzling to me as to why it was necessary to tamper with the original compulsory acquisition level. It was simply 90 per cent by number of the shares that were subject to acquisition.

That is such an attractive measure, it seems to me, of what could reasonably be regarded as fair, you wonder why the second limb is needed. We know it is there to try to make it even fairer, but in making it even fairer it has made it tougher for the offerer to reach the levels. I think it is far better to make it a little bit easier for the original offerer to reach these compulsory acquisition levels by means of a more simple measure of general consensus than to allow the offerer to make a bid where, in some senses, he is probably not too concerned whether he succeeds or not because he will have, at some later stage—at a time to suit himself—access to the 90 per cent rule where no consensus at all is needed.

Those are some general concerns. I have addressed some of them in my submission, but I have just raised some afterthoughts I have had in relation to the matter. I am pleased to answer any questions that you may have.

CHAIR—Thank you. I am trying to clarify in my own mind what you are saying the proposed legislation does. You are saying that, in effect, it maintains the present position of 90 per cent of the shares having to be obtained by the offerer before they can move to compulsory aquisition.

Dr Elkington—The offerer has to climb over 90 per cent.

CHAIR—Yes, over 90 per cent, which is the same as the current situation.

Dr Elkington—Yes.

CHAIR—The change is in relation to the 75 per cent. Currently it has to be 75 per cent of the number of shareholders, and you are saying that under this proposal it will become 75 per cent of the value.

Dr Elkington—Seventy-five per cent of the number of shares, I suppose would be the accurate—

CHAIR—If they have to have 90 per cent of the shares, how does this 75 per cent relate to it?

Dr Elkington—It is 75 per cent of the shares that he does not own at the beginning. If he owns none, climbing over 90 per cent is, by itself, enough, but if he owns about 67 per cent or 70 per cent of the shares he has not only to climb over 90 per cent but he has to pick up 75 per cent of the balance. That will mean that he has to climb over about 91 per cent or 92 per cent. Is that clear?

CHAIR—I see. So if he has already got, say, 60 per cent he has to get to 75 per cent of the remaining 40 per cent?

Dr Elkington—Yes. When he already has 90 per cent then all he has to get is 75 per cent of the balance—he has to get 7½ per cent of what is left.

CHAIR—Your real objection to the proposals relates to the matters that can be considered in relation to whether the offer is fair or not. You are saying that price is not a sufficient judgment of that.

Dr Elkington—It is not sufficient. I think there is quite a serious issue that may arise in relation to the matters which the legislation says the expert—and indeed the court—can take into account in assessing the fairness of a takeover offer. The legislation restricts the court to looking at simply the value of the securities. So far as the value is concerned, the method of valuing the securities is actually set out in the legislation and it limits the matters which can be taken into account in determining the value. There is the possibility that that raises a constitutional problem, because what is fair value or just terms is a requirement, at least for Commonwealth legislation—and I believe that this is, for present purposes, Commonwealth legislation. The requirement that legislation fix just terms is a constitutional guarantee under section 51(xxxi) of the constitution, and just terms is acquired over a long period of value of fair compensation. For the legislation to prescribe a formula where the matters to be taken into account in determining whether what is a fair price is, in fact, a fair price may, I think, be open to constitutional challenge.

Putting that to one side, you have used the expression ‘clean hands’. Certainly a number of offerers engage in practices which would hardly make a minority shareholder or a person subject to compulsory acquisition be very satisfied with having his property compulsorily acquired. For example, an offerer may do something in the period before the takeover offer which requires the approval of shareholders which may alter his position and make it easier for the takeover to succeed. In those circumstances, it would be hardly fair on persons who were then at the end of the takeover offer and told that they had to go, and who could think back to an earlier time when they might have given their approval to some conduct on the part of the offerer which put him in a position where a takeover was more likely to succeed.

Certainly there have been instances that I know of where the compulsory acquisition levels were met in a manner that really would have raised eyebrows with officers, such as offerers going around to hospital beds collecting people’s signatures to try to get over the 75 per cent by number. Not every instance is like this, but I think it certainly should be open to the court to consider any aspect of unfairness. I think the case law shows that unfairness of

price simply is not an issue in these cases, because once an offerer has acquired 90 per cent by number of the outstanding shares, or 75 per cent or whatever it is, the level of acceptance is so high in terms of numbers that there really is not any issue as to the fairness of the price. All that really the courts are concerned with in these types of cases are other aspects of fairness. I can see no reason in principle why a court should not look at every aspect of unfairness.

The policy seems to be that these matters have to be addressed at the relevant time, so at the time of the compulsory acquisition all that needs to be looked at is the price. But it is not practicable for a small shareholder to deal with many of these things, and certainly if they have arisen some time previously and the possibility of a takeover has never entered anybody's mind. So I do not see any reason in principle why a court cannot look at fairness generally. At present the legislation simply says that the court can order otherwise, and it has been left to the court to work out the principles under which they will order otherwise—that is to say, order that shares not be compulsorily acquired. And, indeed, they do not very often do it. Unless a person had some genuine cause of complaint, they could expect very little sympathy from the court. I think it is much better that the court has a general power to consider whether or not a person's property is about to be compulsorily acquired by a person who may not have had clean hands in what has led up to it, and that that power should continue to be vested in the court.

Senator CONROY—You talked about case history. Are there a number of cases that you can refer to the committee or supply to the committee which outline this argument about the fairness of the offerers' conduct?

Dr Elkington—Yes. One of the cases where the principles are all set out is the case of Vockbay, which I think was about four or five years ago in Western Australia. The principles are set out in that case. Essentially, the court will consider every aspect of fairness of the offerer's conduct. There may be some problem with an expert's report or there may be some misleading conduct on the part of the offerer. There is a range of things that an offerer can do which the court is prepared to look at. In general terms, it is just a simple question of fairness. There is the fairness of the price, and that is not really an issue, and then there is the fairness of the conduct of the offerer in the way that the offer has been conducted.

Senator CONROY—You mentioned earlier trailing around hospital beds.

Dr Elkington—Yes.

Senator CONROY—Are there other sorts of examples?

Dr Elkington—I just gave that by way of an example of the sort of thing that the court would not be allowed to look at under this legislation.

Dr SOUTHCOTT—Is there any common law which looks at the offerers' conduct in the period during the takeover preceding the offer when they are considering compulsory acquisitions?

Dr Elkington—Yes. They looked at it before the offer in Vockbay. Then there is an English case that might not be completely relevant here but it shows the sort of things that they will look at—that is called Bugle Press. That was one of the first cases where the court simply struck the thing down almost as a complete abuse of the compulsory acquisition procedure.

Dr SOUTHCOTT—I see. Is the offerer's conduct during the takeover and during the offer really relevant in compulsory acquisition?

Dr Elkington—It is. Because of what an offerer does, he may be able to persuade more people than would otherwise accept the offer to accept it. Thereby he would bring himself over the compulsory acquisition.

Dr SOUTHCOTT—He would trigger the compulsory acquisition.

Dr Elkington—That is right.

Dr SOUTHCOTT—There is one thing I am not clear about. You talked about three-quarters of the balance. Are you saying that where you measure what the offerer has is at the end of the offer period?

Dr Elkington—As to when it goes to is another issue. But putting aside when you measure it, the offerer has to climb over two hurdles in order to put himself into the position. Indeed, if one looks at section 661A(b)(ii), the bidder can climb over the 75 per cent after the offer has closed. There have been instances where an offerer has paid more to those people than he has paid to people under the takeover bid because once the takeover bid has closed it has closed—yet he has a further period to climb over the 75 per cent. That can be done by offering more to those persons. Under that legislation, those that are left get what the person got under the takeover offer. That is hardly fair. It is very hard to prove as well. Certainly, if the court were to hear of that they would be less than impressed.

Dr SOUTHCOTT—It seems to me that three-quarters of the balance is a lot more difficult to work out than 90 per cent of the shareholding, which everyone can work out. You still have the same sorts of problems. It does not make very much difference to the small shareholders whether you are talking about having to acquire three-quarters of the balance before you can compulsorily acquire the shares or having 90 per cent of the shares.

Dr Elkington—They have to climb over 90 per cent of the shares in the class—it may already be near the 90 per cent—and they also have to acquire 75 per cent of the shares that they did not hold at the commencement of the takeover. They have to do those two things. If they start with no shares at all then that second bid has no content because by climbing over the 90 per cent they climb over the 75 per cent. But that becomes important at a certain stage. Those figures are relatively easy to work out because you would know how many acceptances there have been. I do not think the mechanics of it are difficult.

CHAIR—If a company gets to a 90 per cent plus shareholding in a company, why would small shareholders want to remain part of that company in which they have virtually no influence in terms of its activities, other than for greenmail purposes or because of the

current capital gains tax issue, which was raised earlier? Apart from those two issues, why would anyone want to remain in that company?

Dr Elkington—Australian Consolidated Investments is a case where the takeover offer was accepted, as I understand it, by large shareholders who were desperate for money. Many of the small shareholders who are in there now were in there at the time and they thought it was a good company that they simply wished to stay in. The word 'greenmail' puts a label on somebody that really does not mean anything, other than to suggest that they are involved in something which is unconscionable or undesirable. I do not think many of these cases are of that sort.

CHAIR—So they just want to stay there for the future growth and income stream from that company.

Dr Elkington—Yes. Putting aside these aspects of not 'clean hands', in a case where there is an ordinary takeover and a large number of the shareholders with whom you are in the same category go, then it is really fair enough that you go too. That is nothing more than an extension of the scheme of arrangement provisions which have been in place for about a century and a half. They all required consensus. Of course, not everybody agrees to everything—that can never be in the case of companies—but when a large number of them agree then, prima facie, the rest have to go along with it. That is just the way it has worked.

I will say something further about compulsory acquisition, the 90 per cent rule. There is almost no end to the ways in which a controlling shareholder of a company can work himself up to 90 per cent of a company's shares. Then once he is over the 90 per cent mark, one of the ways, as has already been indicated, is to make a rights issue which small shareholders simply cannot afford to subscribe to. The principal shareholder can always afford to subscribe, so he can alter his interest in the company so as to put himself in the position required by an expert report. The question has been raised as to which experts are independent. Well they actually are not independent. Indeed, the expert, even with the best will in the world, and restricted as he is by section 667C of the proposed legislation, cannot really work out whether or not it is a market based valuation for the shares he is valuing.

A court is only allowed to look at the fairness of the price, but by making, for example, a large rights issue, not only can the principal shareholder reduce the interest of a company as a proportion of the total shares held, he can also devalue the shares if the rights issue is made at a discount. The shareholders still cannot afford to take it up. So by the very act of making a rights issue of this sort, the value of the shares of the small shareholders is actually diminished. It seems to me that it would be outrageous if a principal shareholder, having done that, could then come and say, 'I have devalued your shares and now I am going to compulsorily acquire them at the devalued price.' I suppose the idea would be that if you see a principal shareholder doing something of this sort you take whatever remedies you have at the time.

But it is all very well to say that. Many shareholders are willing to ride along with various difficulties but they certainly would not want, at the end of some time, to have their shares simply taken away from them. They are willing to put up with, I suppose, a little bit of oppression. There is always a little bit of oppression in companies where there is a

principal shareholder, but you do expect the principal shareholder and the directors on the board, which are no doubt nominated by the principal shareholder, to have regard to the interests of small shareholders.

Senator MURRAY—May I interrupt you? It seems to me you are putting only two propositions, and a third is possible, for consideration. One proposition is that the court should have regard only to the fairness of the price. The proposition you have put is that the court should have regard to fairness per se, in whatever terms it sees fit. But the third proposition is one adopted in the trade practices law under the unconscionable conduct provisions—the new ones that recently came in—whereby the government specified areas that the court would have regard to—in other words, they gave a check list. That third proposition is that there is a restricted area of fairness which would be determined by the court.

What you are suggesting, the option you put forward, is an option which would put a great deal of uncertainty in the minds of offerers and offerees as to what the prospects were. I understand that the main intention of the bill is in fact to reduce uncertainty as far as possible and to make the whole process as effective, efficient and quick as possible, without doing away with equity. What do you think of the proposition of a restricted check list of fairness?

Dr Elkington—I think it would be better than nothing. When you say that it would create uncertainty, the present provision has never created any uncertainty. It has simply ensured that offerers acted properly during the course of the takeover offer, upon pain of having a problem with the shareholder who objected to the way that the takeover had been carried out. I do not think that has ever created any uncertainty, and the court over many decades has worked out some relatively simple principles as to the matters that they are prepared to look at.

CHAIR—Hasn't the existing legislation allowed tactical manoeuvres to be taken through court action which have caused delays and uncertainty?

Dr Elkington—I do not know of any situations where people who have not had a genuine grievance have complained about what has been done. Many of these instances do involve something on the part of an offerer which can only be described as sharp practice. If you engage in sharp practice, this legislation is an encouragement, or at least it is opening up the possibility that you can engage in sharp practice, with the small shareholder having no remedy. I personally do not think it is fair to say that it has opened up the possibility of tactical manoeuvres. Certainly I know of cases in which people have complained, and they have always had some genuine grievance, it seems to me. It was not a case of this sort, but Mr Gambotto, who appears to have been one of the problems in this area, was complaining about something that had nothing to do with takeovers or compulsory acquisitions, and of course the High Court said that it was not appropriate for a principal shareholder to engineer a takeout by changes in the articles. I do not know of any cases under the takeover laws where people have done something that you could fairly say was not an appropriate thing for them to do. Many of the offerers under these circumstances have been ashamed of what they have done.

CHAIR—I understood that the Fairfax-Brierley Investments takeover issue was subject to that sort of court manoeuvring purely for the purpose of frustrating the takeover rather than any genuine grievance being involved.

Dr Elkington—Which one are you talking about?

CHAIR—Fairfax-Brierley Investments. I think there were three parties involved. I cannot remember the other party. There were three parties involved where various court actions were taken to frustrate the takeover procedure, I understand, without any real grievance but purely as a tactical manoeuvre.

Senator MURRAY—There was a difficult case recently, and I do not know enough about it, which was something like Western Mining, Aberfoyle and a few others on a mining case which had some difficulties about the way in which the takeover was phrased.

CHAIR—If you are not able to comment—

Dr Elkington—I do not know that particular case. I would like to make one last comment. What has been overlooked in introducing this provision about the 90 per cent takeover, a takeout of 10 per cent of the company shares by a 90 per cent holder, is that in every case—and indeed it is hard to see how it could arise otherwise—the person has achieved the 90 per cent holding in the company by his own conduct. It just does not happen any other way. In many instances it is by making a takeover offer which has not recommended itself to the people who remained in.

What it means is that holders of 10 per cent of a company's shares can be made to leave a company involuntarily. It seems to me unattractive. For example, you could have two holders of five per cent of a company's shares being asked to leave, so they are being regarded as unimportant. Yet, for the purposes of notification to the ASX and to the company, they are substantial shareholders and are regarded as very important. Conceptually, that is most unsatisfactory. It seems to me that 90 per cent is a very small number of shares to have in order to exclude perhaps large numbers of people, many of whom might have made very large investments in the company, from enjoying the rights which, until recently, they have anticipated ought to attach to their shares.

Senator MURRAY—Are you putting the proposition that it does not concern you where the majority in shares value matches with the majority in shareholders?

Dr Elkington—Matches?

Senator MURRAY—With the majority in numbers terms, so much as where the majority in value terms is a minority of shareholders in numbers terms. Are you distinguishing between those two kinds of things?

Dr Elkington—No, I am not. I personally do not believe in that distinction. That creates unnecessary complications. What I am saying is that to say that a holder of 90 per cent of a company's share by number ought to be allowed, just by number of shares, to dispossess the holders of 10 per cent of a company's shares by number of shares in many instances

involves very large amounts of money and very large investments by very large numbers of people.

Senator MURRAY—Okay. I understand.

Dr Elkington—That is all I am saying.

Senator COONEY—You are saying too, aren't you, that there is an arbitrary nature to it which you do not like? As far as the 10 per cent is concerned, what is done towards them seems to be a very arbitrary sort of a thing.

Dr Elkington—For a small company where there is a small number of people holding a couple of hundred dollars worth of shares, it would be fair enough. But for a company like, for example, Australian Consolidated Investments, where there are 4,000 shareholders, some of whom have very large investments in it, it is a very oppressive thing for them to have to leave a company. I do not think sufficient attention has been given to the actual monetary value of property that is being allowed to be confiscated by one person from another.

CHAIR—As there are no further questions, thank you very much, Dr Elkington, for your presentation to the committee.

[12.00 p.m.]

FIELDING, Mr John Arthur (Private capacity)

CHAIR—Welcome. Do you have any comments to make on the capacity in which you appear?

Mr Fielding—I am an investor. I am a member of the Institute of Chartered Accountants of New Zealand. I would be regarded as an investigating accountant. I have been resident in Sydney since 1974 and have worked as an investigating accountant throughout that period. In the 1990s a lot of my activity has been associated with companies and investigations. I spent the best part of four years in the litigation on the Westmex collapse.

CHAIR—Do you wish to make an opening statement? We have your several submissions before us.

Mr Fielding—Yes, I would like to say a few things. As Mr Jarrett talked, and as you asked him questions, there were certain things that came up that I would like to refer to briefly. First of all, in relation to greenmailing, I have made a submission—it is my view that the changes in the legislation will increase the opportunities for greenmailing and not diminish them, and I explain that. There was a question about the 90 per cent in chapter 6. The point is that that 90 per cent is going to be reached possibly two or three years after the original takeover has taken place. It will take place at a time of the—I will call him—predator's decision and it will be to the disadvantage of the shareholders involved.

In relation to 'clean hands', I make a submission where the majority shareholder of a company that I am a shareholder in got to its present position of 98 per cent by breach of the Corporations Law. I have complained to the ASIC about that. Initially, the ASIC was not prepared to do anything about it. I am hopeful, because of the submission that I made to Mr Cameron, that that will change. But the point is that, under the new legislation, I would not be able to address the court on the matter of what was wrong and how they got to 98 per cent.

The question of capital gains tax was raised. In relation to the Milton merger, a Mr James McLennan and McLennan Holdings Pty Ltd, of which I am a director, were opposed to the merger because of the capital gains tax issue. Mr McLennan and McLennan Holdings are to pay something like $400,000 as a result of the merger of the Milton Group.

My experience in Westmex indicated to me that international accounting standards are considered in the Australian context. Certainly where there was a problem with the Australian standards, the next step was to look at the international standards. They did have relevance and they were used by the expert accounting witness in his submission in relation to that. I did get the feeling as people were talking that they really did not get a clear understanding of the difference between the international accounting standards and the Australian standards. Generally speaking, it is my experience that those international accounting standards are a broader framework and do not put quite enough flesh on the

bones. Some of the ideas that have been put forward do not seem to be quite in accord with those concepts. I am quite happy with the Australian accounting standards.

In relation to section 52 of the Trade Practices Act, I will make a submission shortly in respect of that, but it is important to say that in the Westmex matter there was a case, John Fielding v. Vagrand Pty Ltd, which created a precedent. We were attempting to get back our assets in the Australian Petroleum Fund. The court decided that we had the right to do that. We did it under section 52 of the Trade Practices Act. This legislation, presumably, is going to take that right away from shareholders. I do not think that that is very fair.

I would like to talk briefly about some of the things I said in my submission on 19 January. It deals with experts who tend to regard the needs to allocate the assignments and to pay the fees. In any event, valuations are inherently variable. I give an example in the submissions I make to you about Arthur Andersen and the phosphate case, where the judge talks about Arthur Andersen being asked to consider valuations of $12.50, $50 and $400 for the same shares.

Turning to the Arnotts case, I made a submission to the judge about the future maintainable ebit suggested by the investigating accountant involved, which was $110 million. I list in my submission a number of matters that I could see, without doing discovery, that I thought were worthy of bringing to the court's attention. One of them, for instance, was the Huntingwood factory which would not be performing to capacity until the end of 1997, but the final commissioning was still in progress in November 1997. The whole flavour of that submission was that this was an unusual accounting period. Arnotts had gone through the extortion threat that you are probably aware of, and then that was followed by significant restructuring of Arnotts.

Yet we now find, when I get the accounts for the current financial year—which is what we are talking about—that the ebit was $114 million. It was greater than the expert accountant estimated.

Senator MURRAY—By how much?

Mr Fielding—By $4 million, but it is a full year. It is my estimation that when we get to a normal year, which will be the year we are now in, it will be something like $140 million.

What can we learn from Arnotts? I have made the point that the time of the share valuation is a time of the acquirer's choosing. In the Arnotts case, Campbells chose a time of major company restructuring and company trauma when profits were depressed and future results were difficult to estimate. Any share valuation undertaken by a person who is not economically independent will be subject to criticism and suspicion.

In the past, experts' reports have been prepared to assist shareholders to make decisions. Now they are used to determine compensation. I believe that this will lead to considerable social unrest. I believe that the Arnotts report was misleading. On the evidence before me I am now more certain than I was at the time. Next year will be a normal year of trading result and I will be able to speak with absolute authority about the future maintainable ebit.

The new legislation lends itself to review by investors who are unsatisfied with the compensation that they have received. Just as with Arnotts, the unsatisfactory valuations will be subject to complaints. Accountants, lawyers and politicians will be in the spotlight. We are talking about the investing public having their assets taken from them and given inadequate compensation. The Liberal-National government are brave men to believe that the investing public will not be outraged.

I would like to talk about the Milton merger that involved four companies. In the submission that I made to Justice Santow, I made an estimation of what I thought the goodwill on consolidation would be, based on the evidence that I had at the time I made that submission. I said that I thought it would be $20 million and that the amortisation figure would be $1 million per annum. Each of the experts referred to cost savings relating to the merger, which the company had estimated would be $600,000 per annum. The effect of my estimate of the goodwill amortisation on cost savings would be to eliminate it. Thus, the anticipated profit of the merged group would be not only reduced but eliminated by the merger.

I have given you a copy of abstract 10 of the Urgent Issues Group of the Australian Research Foundation on behalf of the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia. This consensus became effective on 15 October 1996. Each of the four experts whom I examined under oath in June 1998 had a copy of this abstract in his manual of accounting standards. The Urgent Issues Group met on 15 October 1996 and reached a unanimous consensus.

The UIG consists of 16 experienced accountants and an observer from the ASC. Support is given by the Accounting Research Foundation and the director of accounting practice is the secretary to the UIG. The views of the UIG are in full accord with the views that I expressed in the evidence that I submitted. Justice Santow must have found it difficult to believe that I could have been right when four accounting witnesses disagreed with me. Justice Santow's judgment does not accord with Australian or international accounting standards.

What can we learn from Milton? It is extremely difficult for a shareholder, no matter how knowledgeable or articulate and no matter how strong the evidence, to challenge an opinion by expert witnesses. I was advised by the solicitor who represented Mr McLennan that I would not be successful unless I introduced evidence from my own expert accounting witness. Time constraints did not make this possible. Discovery is a process that is absolutely essential if an expert witness is introduced by a shareholder. The costs of an expert witness and discovery are enormous. Unless the objecting shareholder is very lucky, he will easily be left with a bill for $100,000 relating to an unsuccessful objection.

I was fortunate to be awarded costs by Justice Santow, who recognised that the goodwill issue was a difficult one and thought it was something that he should have considered. However, his decision on costs would not encourage shareholders to challenge expert witnesses under the chapter 6 legislation. The new legislation may sound equitable, but the reality is that small shareholders will be forced to accept the valuation of the expert.

I would also like to make a few remarks about Westmex. The part A investigating accountants report was a document that I and all other shareholders relied upon when we accepted the offer of Westmex for our units in the Australian Petroleum Fund. I intend to make a submission that details all the problems that were experienced. Before any discovery took place, however, I did know in 1989 that the goodwill in the investigating accountants report in the Part A document was $95 million below the figure given in the Westmex annual accounts. No sales or purchases of subsidiaries had occurred between 13 June 1989 and 30 June 1989. The figures should have been the same.

To give an understanding of the discrepancy, total shareholder equity was only $158 million. The investigating accountants' report in part A simply accepted the information that was given to them. The information as to the profitability of the stationary subsidiaries was untrue. One of the papers that the experts were given would have led to this conclusion.

The auditor had his registration to practise as an auditor suspended for five years. The investors in the Australian Petroleum Fund received their copy of the part A document after 30 June 1989. At that date, Westmex was in serious financial difficulty. Their subsidiary, Charterhall PLC, was in breach of covenants to its bankers. Westmex accounts to 30 June 1989 had a profit of $27 million. The truth Western Australias that a substantial loss had been incurred. I will show that the auditor of Charterhall PLC had concerns and yet signed an unqualified audit report.

On the basis of the audit accounts, the shareholders of Westmex subscribed $30 million in fresh capital in September-October 1989, and the State Bank of New South Wales lent $150 million to Charterhall PLC in October 1989. Despite this, on 6 December 1989, Westmex met its principal bankers, who agreed to a two-month moratorium on the repayment of debt. Two months later, Westmex went into liquidation, paying only a few cents in the dollar to its creditors. I am critical of the ASC for not carrying out a full investigation of Westmex.

CHAIR—I will just interrupt. Most of what you are telling us now we have read in your submission. I do not think you are adding anything.

Mr Fielding—I do not think anything I am telling you now is in my written submission. I am going to make a submission. You have not heard previously what I am now telling you.

CHAIR—Certainly I have the sense of what you are telling me from having read your written submissions. I am aware of the information that you are drawing out.

Mr Fielding—I am giving facts and information that I have never given before.

CHAIR—By reading your submission I am aware of the essence of what you are saying to me about the problems you have experienced. I am conscious of the time. We need to be aware of it if people are going to have a chance to ask questions as well as hear what you have to say. Can you abbreviate your remarks so that we can take account of the time constraints.

Mr Fielding—I am critical of the three chartered accountants from three firms who failed in respect of the investigating accountants reports and the auditors reports. There were four directors of Westmex who were chartered accountants, and they all walked away without criticism. The investors in the Australian Petroleum Fund and CAL Resources Ltd received worthless paper for their valuable asset. The State Bank of New South Wales made substantial advances on the basis of false accounts. Undoubtedly, it made substantial losses as a result.

I have given detailed information of the accountants involved in Westmex and the experts involved in the Arnotts merger and the Milton merger. In addition, I give detailed information of problems with three other auditors involved in the ASC and the Institute of Chartered Accountants in Australia. Those matters are ongoing. I will seek to question three auditors involved at the next three annual meetings of the companies involved.

I am critical of the funding of the ASIC, which restricts its ability to carry out a satisfactory function. In my submissions I show chapter and verse how that occurs. In its 1998 annual report, the ASC says it received 3,798 complaints from the public last year alleging breaches of the law. Of these, only three per cent led to formal investigations. There were 3,711 reports received from liquidators, receivers, administrators and auditors. Of the 2,842 alleged offences, only one per cent were investigated.

In relation to experts' valuations, one only has to look at the history of part A and part B expert valuations. Invariably they differ, with the part A valuation always being the higher one. I welcome any questions.

CHAIR—Thank you very much, Mr Fielding, for your presentation. Are you willing to provide that document to us as a further submission?

Mr Fielding—Yes. It is not written quite as a submission would be. I could hand over a copy now or I could let you have that document with a bit more attention given to it. These are notes for me to make my submission.

CHAIR—That will be fine.

Senator MURRAY—I regret that I will have to go early, so I appreciate the opportunity to ask questions first. Mr Fielding, one of the main thrusts of your submission, as I understand it, is as follows. Firstly, minority shareholders may not get a fair price because of the time frame within which the offerer or the predator may arrange matters to ensure that the price is most favourable to the offerer. Secondly, the means to rectify that situation are unduly costly and difficult for a minority shareholder to pursue.

I can think of two possible ways in which your concerns could be addressed. There may be many others, but there are two I want to explore. The first is the question of the approval of experts—lawyers, accountants and valuers—who may be participants in the valuing process. If the law were to consider that the approval of experts should be by a majority of numbers of shareholders rather than those who have control over the value of shares, you would have an added protection, if you like, for the numbers involved. That is one way in which the expert issue can perhaps be dealt with.

The second issue of price is a potential protection. It would need to be within a time frame. You could possibly require any offer to minority shareholders not to be less than the highest price the offerer has had to pay in achieving his or her shareholding—all the way up to 90 per cent. That would guarantee that minority shareholders who are compulsory takeover targets would never get less than the very highest price that the majority offerer has had to pay. What do you think of those two possibilities?

Mr Fielding—It is interesting that the shareholders should appoint the experts. It then raises the question of who will pay that person. The federal government gets about 60 per cent of the fees that are raised to run the ASIC. If the federal government were prepared to pay those experts, it would increase equity quite considerably.

Senator MURRAY—Let me interrupt you there. You stated as a fact that inevitably the offerer controls the brief of the experts—the lawyers, accounts, valuers and auditors. Payment is, in my experience anyway, guaranteed by the board.

Mr Fielding—Yes. That creates the difficulty that the expert is not independent. He never can be independent because he looks both to the present and the future.

Senator MURRAY—But if the majority by number of shareholders approves the appointment of the expert, surely they then have little ground to complain that the expert is not somebody in whom they have appropriate confidence.

Mr Fielding—I am afraid that I do not have confidence. I have great difficulty in selecting anybody. My experience indicates that.

Senator MURRAY—But the world cannot live like that. The fact is that you have to deal with experts.

Mr Fielding—I would like to see more done to make it harsher for the people who do not do the task. A lot of my submissions are related to that. I give numerous examples of the problems. I ask you to properly fund the ASIC.

Senator CONROY—An alternative might be for the same amount of money to be paid by the company but to the takeover panel and for the panel to appoint the independent expert. In that way, the independent expert does not have to appease anybody if the choice is being made ongoingly by the panel.

Mr Fielding—I can see that the panel appointing experts—

Senator CONROY—But paid for the by the company.

Mr Fielding—would be a definite improvement on what is envisaged.

Senator MURRAY—The second possibility—I recognise the alternative possibilities that exist—concerns a minimum price. In other words, the minimum price to those who are compulsorily paid out would not be less than the very highest price paid by the offerer in arriving at their eventual shareholding.

Mr Fielding—I can see that there are significant advantages in that. It certainly should be considered by you.

CHAIR—How would you see that situation operating where a company reaches the 90 per cent plus shareholding of the target but then does not move to compulsorily acquire for some years afterwards? How would you equate the values that were used to purchase the 90 per cent as against the remaining 10 per cent in that situation?

Mr Fielding—We have had some reference to Australian Consolidated Investments, where Brierley is at 98 per cent at the present time. They have not moved. They will probably move when you introduce the new legislation. In those sorts of instances, you would have to have regard to the prices that were being paid over a time—whatever you consider is appropriate, such as a year—by ordinary shareholders on the market. Those Australian Consolidated Investment shares have varied between 40c and 60c in the last six months. The asset backing is greater than that. There are significant tax advantages within the company. There were huge losses as a result of what Mr Bond did when the company was Bell Resources. There are quite significant reasons to pay more than the market price. Certainly all the shareholders that Mr Elkington referred to have not chosen to go. They think that the value is worth more than the market has risen to.

CHAIR—There being no further questions, thank you very much, Mr Fielding, for your evidence before the committee this morning. It is very helpful to our deliberations.

[12.30 p.m.]

ELLIOTT, Mr Robert Max, National Manager, Research and Policy, Australian Institute of Company Directors

FORSTER, Mr Ronald William, Member, Corporations Law Committee, Australian Institute of Company Directors

CHAIR—Welcome. Do you have anything to say regarding the capacity in which you appear?

Mr Forster—I am also a partner of the law firm Deacons Graham and James.

CHAIR—Thank you. Do you wish to make an opening statement?

Mr Elliott—Thank you for hearing us today and especially for rearranging your schedule for the day to fit in with our schedule. I will start with a general overview of the Institute of Company Directors for those who are not aware of who we are and what we stand for. Then I will make some general comments on a broad policy level relating not only to CLERP, which is your term of reference, but generally to business regulation. Then I will hand over to Ron Forster, who has some more specific details on the legal issues of directors' duties, takeovers and fundraising matters. If time permits I will then close with a few statements regarding accounting matters.

I know that some people on the committee are well aware of the Institute of Company Directors, but for those who are not it is important to realise that the Australian Institute of Company Directors is a body which has over 13,500 members. They are individuals, not companies. They are the company directors in their personal right. They represent and sit on more than 50,000 Australian companies. Those companies that they sit on the boards of are of every size, from Australia's very largest to some of Australia's very smallest companies. They are in every state and every industry. They are of every type of corporate form from private to public to not-for-profit to no liability, et cetera.

Whilst the members of the Institute of Company Directors sit on over 95 per cent of the top 200 listed companies in the country, it would be unfair to represent ourselves as the big end of town. Over 75 per cent of the institute's individual director members come from the small and medium sized sector of the business community. That is where we are coming from.

The AICD applauds the goals and the aims of the CLERP process and this piece of legislation. We also applaud the extensive consultation process that has been undertaken. This is part of it, and we appreciate the opportunity to appear. The institute has lodged numerous submissions on each of the papers that has been released through the whole process. If any of those papers are not in your records we would be happy to resubmit any of them.

The AICD's views of CLERP are driven by the AICD's general and overriding policy goals. It is important for us to put that in context before we get to the specifics of drafting. The Institute of Company Directors believes that laws, and in fact any business regulation, must be aimed at being as clear, as certain and as simple as is possible. They should attempt to minimise compliance costs. They should maximise business efficiency and encourage sensible—and I emphasise sensible—business risk taking. The system of business regulation must be enabling and not constrictive. It should be aimed at enabling the markets to operate efficiently and ensuring the Australian economy is competitive. Why? We believe that if Australia's economy is internationally competitive there will be more Australian jobs and greater wealth for all Australians.

We feel that the current regional financial problems create a window of opportunity right now, and it is very important that we grasp it with clear, simple, transparent and low compliance cost business regulation. Australia has an ideal opportunity right now to position itself as a leading regional financial and business headquarters.

With that background I will hand over to Ron to provide some of the specifics on the more legal side.

Mr Forster—The institute very much supports the broad thrust of the CLERP bill in the areas of directors' duties, takeovers and fundraising. This afternoon I would like to make some comments on those three areas.

Moving first to directors' duties and corporate governance, you are aware that the institute very strongly supports the introduction of the business judgment rule. The institute considers, however, the current proposals are too narrow. The business judgment rule should be extended in two respects. One is that it should cover other liability provisions in the Corporations Law, such as for insolvent trading or continuous disclosure, so there is an umbrella defence for directors that exercise their proper responsibilities in those areas.

The other area where it is too narrow is that there is a plethora of legislation being continually introduced which imposes strict liability on directors. The institute firmly believes that that legislative program should be changed by enabling a business judgment rule or a due diligence defence to strict liabilities for directors.

The other area of general compass for directors' duties is the carve-out for section 52 of the Trade Practices Act. Section 52 of the Trade Practices Act, as you know, is extremely extensive and broad. There have been a number of problems there in the fundraising area. The bill proposes to carve-out the operation of section 52 of the Trade Practices Act in the fundraising area but not in other areas. The institute believes that there should be a carve-out for liability under the Corporations Law in all areas so there is not an overlap.

The institute also believes that it is not appropriate to put in a due diligence defence in the Trade Practices Act as a solution to that issue because you are likely to have overlapping regulatory regimes as a process of doing that and two regulatory bodies examining the same sort of conduct.

The other issue in relation to directors' duties is slightly more narrow. It relates to nominee directors. While it is more narrow, the concept of the directors' duties for nominee directors has continually been an extremely difficult legal issue. The bill introduces a situation where nominee directors on the board of wholly-owned subsidiaries are protected in the event that certain safeguards are followed through—namely, it is in the constitution, et cetera. The institute very much endorses that approach but, again, feels that it is too narrow, that it should be extended to any subsidiary and any situation where there is a nominee director.

As a matter of practice, it probably works like that in any case because, where you have company A that has a significant investment in another company and it appoints a nominee to the board of that other company, the directors on the board of the other company would anticipate that that nominee would operate more in the interests of the appointer rather than the company itself. It is a development that has been adopted in New Zealand, and the institute would wholeheartedly recommend that it be adopted here as well.

Moving on to takeovers, as a broad comment, the institute believes a more holistic approach should be taken in analysing the takeover laws. While it is in support of the proposals set out in the CLERP bill, there are other key areas, both tax and trade practices. Tax has the potential, if it is not changed, to undermine the good work that the current bill is doing by enabling business conduct to be more efficient. If there is not a CGT rollover relief introduced, while the mechanisms of the takeover laws and takeover procedures may be streamlined, the impediments on the offers will still be there because, where there are share-for-share exchanges, there will be a major detriment on behalf of the offeree in accepting the offer.

I think this issue has probably hit the high-water mark in the case of the GIO takeover. As many of you know, shareholders would have come in on the original float at a low price of approximately $2.40. Since then the share price has appreciated greatly. We saw, as part of the defence program implemented by GIO, that they were recommending shareholders not to accept because of the potential CGT liability. It is clearly inefficient.

More technically on takeovers, there is an issue which has plagued practitioners in this area and companies wishing to make takeover offers. That is the area of collateral benefits. In 1991, with very little analysis when the Corporations Law was introduced, sections 698(2) and 698(4) effectively prohibited an offerer giving any benefit to a shareholder in the target company, outside what is proposed to be offered under a takeover scheme.

That covers the four-month period leading up to the bid and then there is another prohibition which covers the period during the bid. It has been particularly problematic in the four months up to the bid and there have been a number of cases on this issue. It still has not resolved the issue. There has been recent litigation, both in the Federal Court and the Supreme Court, which has left the issue uncertain as well.

CASAC has analysed that issue and takes the view in its anomalies report on the takeover law that the policy underlying 698(2) and (4), which covers the four-month period prior to the bid, is misconceived because what the takeover provisions are seeking to do is to regulate opportunity of participation while the takeover offer is on foot—not in the four

months leading up to the takeover offer. CASAC recommended that those provisions be repealed, and the institute would recommend that as well.

Moving on to the panel, as a general comment the institute would like to put on the record that one of the major factors in the success or otherwise of the panel is likely to be the constitution of the panel. The institute believes that the panel should be constituted from a broad base and not simply advisers, lawyers and investment bankers. It should include members from the business community—directors who have to face these issues on a day-to-day basis. On another area—a technical issue—in relation to the panel: currently you have a situation where the ability of people to take action before the panel is significantly expanded, so anybody who has interests affected by the issues may approach the panel. That is part and parcel of making the panel effective, of course. What happens, though, under proposed section 657G is that, once the panel has made an order, if the party that is affected by that order does not abide by it, the only party that can seek enforcement of that order is the ASIC. The institute submits that this is likely to be a major impediment in the proper administration of the panel's orders. The ASIC is motivated by a number of factors which would be different from the protagonists in the takeover, and it should be open to parties that have an interest in the matter to enable the orders to be enforced.

Before leaving takeovers, I came in at the tail end of the discussion on the buy-out provisions following a takeover offer. Having acted on both the minority shareholder side and on the side of the offerer, it is certainly my view and the institute's view that the new proposals enabling a buy-out once 90 per cent has been reached are a favourable development. Currently the balance is weighted too far in favour of the minority shareholder, allowing greenmailing opportunities which make it extremely difficult for companies to achieve 100 per cent ownership once they have got to that 90 per cent level. There are a number of companies that remain listed with a relatively small number of shareholders. Effectively, they have no legal mechanism to mop up the minority shareholders and hence are not taking advantage of full 100 per cent ownership.

Moving on to fundraising, I first wanted to make some brief comments on the excluded offers and then to make some brief comments on the defences. The fundraising provisions have introduced various new excluded offer processes and have imposed some restrictions on old ones. Proposed sections 708(1) and (2) deal with what is currently the 20 in 12-month offer process. Section 708 imposes two restrictions which do not currently exist. The first restriction is that there is a $2 million ceiling. The second restriction is that the offer needs to be a personal offer. The institute believes the legislation is not seeking its intended objective by putting a $2 million ceiling on the 20 in 12-month rule if the objective is to assist small business enterprises in efficiently and easily raising capital. At the moment they can make an issue of 20 in 12 months with no ceiling, and we do not see the rationale for limiting the process and imposing a ceiling of $2 million.

Secondly, the restriction in proposed section 708(2) imposes that the offers where the 20 in 12-month process is utilised must be personal offers. The institute considers that that is really achieving very little by imposing restrictions that are not necessary, particularly when you have regard to the criteria that are set out there which need to be satisfied as to whether or not it is a personal offer. They are vague and will be very difficult to enforce.

The other excluded offer that the institute is concerned about is one of the ones relating to sophisticated investors in proposed subsection (8)(c), which covers the licensed dealer exemption. This is a new excluded offer category and it enables an offer to be made through a licensed dealer if the dealer has satisfied itself on reasonable grounds of various matters, including that the offeree has satisfied their own information needs, the adequacy of information given by the person making the offer, et cetera. The institute believes that this is likely to be opening a crack in the door, which is going to be thrown wide open. It is possibly going to be a system that can be easily used to circumvent the prospectus provisions where you will have a number of licensed dealers being able to offer projects that currently require the full protection of prospectuses to unwitting investors who do not have the background. These elements are, in some senses, vague and subjective as to whether or not they are satisfied.

Senator GIBSON—So what would you recommend to do there?

Mr Forster—We would delete it altogether and not allow licensed dealers to have a separate exemption. The concern is that, while the majority of licensed dealers may well administer the process in a sensible manner, given the huge number of licensed dealers in this area, there could well be pressure, particularly with commissions, et cetera, for these sorts of offers to be made.

The final few comments I would like to make relate to the due diligence defences for prospectuses. In proposed section 731 there is a due diligence defence which provides that, if the person proves that they had made all enquiries, if any, that were reasonable in the circumstances, there is a concern here that it does not actually give effect to the way due diligence programs operate in practice. The way they often operate is that you would set up a due diligence committee which would be authorised by the board. The scope of the due diligence program would be examined, and the board would have input on that process, but they would not personally have made all of the enquiries. So we have a problem with the director potentially not being able to satisfy the personal obligation to make the reasonable enquiries. The institute believes that the proposed legislation should be amended to give more effect to the current operation of the due diligence programs.

Senator GIBSON—Do you have any proposal for a wording change there?

Mr Forster—We have not got a specific proposal for the fine drafting, but we could examine that. Finally and related to this issue is proposed section 733, which sets out that, in undertaking the preparation of the prospectuses or information statements, a person would not be liable for misleading statements if the person proved that they placed reasonable reliance on information given to them. However, excluded from that process is information which is given by employees or agents of the company. It is a similar concern here because, again, in the normal due diligence process you would set out questionnaires to management, the non-executive directors particularly would rely on the program and the scope being set appropriately and then information being provided by managers as well as the parties. So the institute would recommend that that be amended to facilitate that process. That concludes the formal comments I want to make.

CHAIR—Thank you very much, Mr Forster. Questions?

Mr Elliott—Would it be easier, Mr Chairman, for me to continue and finish the accounting issues or would you prefer to ask questions on the matters so far?

CHAIR—I think we will finish your presentation.

Mr Elliott—I will keep an eye on the time and hopefully leave enough time for questions. On the accounting issue, it is fair to say that, on the 'realisticness', usability and user-friendliness in current accounting standards, the institute continues to receive complaints from the business community that accounting standards do not reflect business reality nor do they provide the markets with an accurate forward looking picture of a company's financial health. The AICD will be calling for accounting standards to be more user-friendly, informative and forward looking.

On the issue of international harmonisation of accounting standards, the institute supports the approach in the bill. However, it has continuing concerns with regard to some of the AASB's interpretations of CLERP's objectives in the harmonisation process. The institute is very keen to see that Australia does not put itself at a competitive disadvantage, as I said in our overall policy objectives on business regulation, by adopting certain international accounting standards where they have not been accepted by major markets. We are generally for international harmonisation but not on individual standards which are not accepted by major capital markets.

Regarding the funding of the proposals for the accounting changes under CLERP, it is important that the institute put its previously stated position again. Under our reading of it, an approximate $9 million per annum would be required to fund the proposals on accounting changes here. The institute is aware that under current revenues obtained from filing fees—approximately $300 million per annum from the corporate sector—only one per cent of that funding that is already supplied to the government would be adequate to provide the business community's one-third of the $9 million per annum. We would not be keen on seeing a double dip or a second levy on the business community to fund the changes in accounting standards, given that the business community is already contributing $300 million per annum through filing fees and given that only one per cent of that would cover our contribution—on the assumption that one-third is from government, one-third is accounting professions and one-third is from the business community.

In the Financial Reporting Council and the AASB's reconstruction, again, like the panel in the takeover matters, the success or failure of the proposed changes in this area will depend on the make-up of that Financial Reporting Council. We believe it is absolutely crucial that the make-up of that Financial Reporting Council is balanced. The institute seeks to have a representation from the business community—not only from professional accountants, bureaucrats and academic theorists in the area of accounting standards. We feel it is such a crucial area for business that business should be represented on it.

Perhaps bearing in mind the time, I will leave it at that, other than perhaps to say that we plead for a simple, holistic approach to business regulation. We are aware that the CLERP process is looking at the economic side. We applaud that. We are concerned with duplications or layer upon layer of legislation which governs the same factual situations. With the best will in the world and the best drafting, it will inevitably lead to potential

conflicts of law and situations where directors and companies are in effectively a no-win situation, where under one set of circumstances they are liable under two pieces of legislation, sometimes with a defence in one—that is, if we are looking at the Corporations Law, a defence of due diligence or safe harbour—and, under the Trade Practices Act, no defence under the other for exactly the same circumstances with the same behaviour of the directors.

Linked to that and further to Ron's point regarding the approach to strict liability, it would be fair to say the institute in no way wishes to see directors who have failed in their duties—not conducted themselves with due diligence or not monitored management—get away with escaping liability. The institute wants to see directors who have not done the right thing prosecuted. The institute does not, however, believe that it is fair for directors who have acted properly, have done all that is required of them and acted due diligently and monitored management to be found guilty without defence for having done the right thing.

Having said that, we acknowledge that there is a need for those who have been aggrieved to have some form of redress. We believe that, in those circumstances where the directors have acted properly and someone has been aggrieved through the actions of management or employees acting on a frolic of their own outside directors' directions and procedures put in place, the company in those circumstances should still be liable. We differentiate here between the liability of the corporation and the liability of its directors, where the directors have done all that they can to ensure that the company has done the right thing. With those wrap-up points, I am ready to answer questions.

CHAIR—Thank you. In relation to the accounting standards, you said some feelgood words like 'should be user friendly', 'forward looking' and so on. What does that mean in practical terms, in actual accounting issues? Are there any issues there or standards that need to be applied or changed to bring that about?

Mr Elliott—To get to specific standards? Do you want to get to the level of specific accounting standards?

CHAIR—It might be a bit difficult to do that here but even if you put something in writing to us—

Mr Elliott—Certainly. We are continually putting in submissions to the AASB on areas where we believe the harmonisation program would possibly lead to Australia being at a disadvantage to the rest of the capital markets of the world. Let's face it: at the end of the day, this is all about the cost of capital—how expensive money is and where you can get it from. Australia is only one per cent of world capital markets. We do not think that it is necessary for the business community to go instantly in one jump—or that it is possible to go in one jump—to US GAAP. We applaud the two-step approach to going to international standards, but there are some examples where we feel the consultation process has been thorough but the end result of these accounting standards does not seem to reflect the public consultation documents.

We are getting into a difficult area here but perhaps, without stepping on too many toes, the AASB or the AARF could state, as we firmly believe, that the make-up of the Financial

Reporting Council—which will, as we read the bill, act as an overseeing, monitoring, or, if you like, corporate board to the management in the development of accounting standards—is crucial. That is why we call for practising directors on the FRC who can see what the accounting standards, once in place, might mean to businesses in their adoption.

It has been put in the past that current accounting standards on occasions are technically perfect nonsense. They make beautiful academic sense in accounting theory but, when you put them in place in the real world, they can lead Australia down a terrible slippery slope.

Senator GIBSON—In their two submissions of July and November, the Securities Institute say that, instead of referring only to IASC standards, the term 'international accounting standards' should be amended to read:

. . . standards for financial reporting made by an international or other standard-setting body which are accepted in the world's major capital markets . . .

Has your institute given consideration to those words that the Securities Institute has put forward?

Mr Elliott—Not specifically to the words, but we would endorse the general sentiment. I think what they are getting at is that they do not want to see Australia disadvantaged by a slavish adoption of international standards where those standards may be of a lesser quality in the eyes of the large capital markets than what we already have. Selective harmonisation—picking the very best so as to improve our current standards—is better than, if you like, having a race to the bottom by slavishly adopting harmonisation.

Ms JULIE BISHOP—I just have questions on two areas. The first one, Mr Forster, is in relation to section 657G where an order of the panel is contravened and ASIC is the one to apply to the court for orders of compliance. You suggested it should be extended to parties affected. As it is a compliance enforcement issue at this point, would it not be more appropriate to leave it to the regulating body, to ASIC, to apply to the courts, considering it has the resources, the information and the experience, and would be an appropriate entity to do so—to prosecute, if you like. Otherwise you are leaving it not only to the parties to the proceedings but to persons affected. If there are delays in the hearing, questions about costs or if it is a contested application, would not the more appropriate entity be ASIC?

Mr Forster—Go back a step. The process, having had a wider class of people that could make application to the panel, is that you then have the people before the panel and the panel orders are made. If those panel orders are then flouted, whether it be by the offerer or the target, and you leave it up to the ASIC, they then have a lot of internal issues that they need to satisfy themselves on as to whether or not they should enforce. One of them, no doubt, is costs. The other is whether it is a test case. It is not so much a prosecution issue because the panel's orders, in these cases—

Ms JULIE BISHOP—I used the term loosely. I meant the prosecutor, in the sense of the applicant. Aren't you then leaving it to a person affected to actually take the panel's orders as their case and apply to the court to have the panel's orders enforced? What happens in costs orders or costs awards?

Mr Forster—I do not see that many dangers would arise from it. It is not dissimilar from other provisions in the Corporations Law where, for example, a party affected by a breach in the Corporations Law could seek an injunction to prevent that breach being carried out.

Ms JULIE BISHOP—Sure, but we are getting to the enforcement of a panel's orders.

Mr Forster—In the context of the enforcement of the panel's orders, the panel does not have criminal force. We are concerned about a situation where the panel has made an order. The ASIC may not move quickly enough. In some respects that is one of the major concerns. The panel is empanelled by professionals in the industry who are familiar with the issues and can hopefully deal with them quickly and efficiently. If it is then left to a regulatory body that has a lot of issues to consider before it seeks enforcement, the process is likely to be slowed down. The protagonists are much more likely, if the orders are not being properly complied with, to approach the court. The ASIC, of course, can be a party to that action in any case. It would have a right to participate in any court action.

I hear the concern that you are making reference to, but I think the concern on the other side is perhaps a stronger concern. You have set up the panel process and it is working efficiently, but if the orders are not enforced efficiently then the whole process falls over.

Ms JULIE BISHOP—I am just uncomfortable with the onus of enforcement falling on parties affected who could be mum and dad shareholders.

Mr Forster—It could be mum or dad shareholders, it could be the offerer or it could be the target company. If it is the mum and dad shareholders, it is more likely the target company will take the action. Bear in mind that all they are doing is taking action to bring the matter before the court.

Ms JULIE BISHOP—If the party against whom the order is made contests that it is in contravention of it, it could be a drawn out hearing. It is just an area that I feel needs more thought.

Mr Forster—We are happy to provide some more detailed submissions on that issue, if that would assist.

Ms JULIE BISHOP—I think it would. It is something that concerns me. My second question was on the business judgment rule. You suggested it be extended to a far wider area. Obviously there are separate regimes currently in place in relation to other areas of liability such as trading while insolvent, effective prospectuses and the like. You suggested insider trading. I have a bit of difficulty with that one because one of the fundamentals of a business judgment rule is that the party not have a material personal interest.

Mr Forster—If I said 'insider trading', I did not mean to. I meant to say 'continuous disclosure'.

Ms JULIE BISHOP—You said that as well.

Mr Forster—I certainly would not suggest that there be a business judgment defence to insider trading.

Ms JULIE BISHOP—Okay.

Mr Elliott—That is probably the one area where the institute would not see a business judgment defence.

Ms JULIE BISHOP—That is why I have about 14 question marks next to that on my piece of paper here.

Mr Forster—I am glad you raised it.

Ms JULIE BISHOP—Perhaps I misheard you, but I wrote it down. Do you see continuous disclosure extending beyond that particular area? I think it is going against the trend towards strict liability, of course.

Mr Forster—The issue that we are really raising here is that the business judgment rule be focused on the duty of directors to exercise proper care and diligence in the conduct of their duties. That is sprinkled throughout the Corporations Law. The two examples are the continuous disclosure regime, where listed companies have to report material matters immediately to the stock exchange, and insolvent trading. They are both covered by other detailed provisions in the Corporations Law. They have their mixture of defences. They are overlapping. They are different. The idea was to streamline those defences and have an umbrella business judgment rule.

Ms JULIE BISHOP—You would have the business judgment rule, then, in virtually every aspect of corporate governance, except for insider trading. It is such a contradiction it could never be in place.

Mr Forster—Absolutely. Yes, that would be the aim: to have an umbrella defence, effectively. At the moment, for example, in the continuous disclosure regime there is liability on directors if they are found to be reckless. But what is reckless? A broad business judgment rule would assist the directors in knowing that, if they instituted a policy within the company, there was a proper framework for continuous disclosure. They could then satisfy themselves that they were not being reckless. But at the moment it is very uncertain.

Dr SOUTHCOTT—The bill proposes to exempt financial services from section 52 of the Trade Practices Act. What is the Institute of Company Directors' view of that? We have not got a full submission here, but I understand you have some problems with that not going far enough.

Mr Elliott—Most certainly. We do not believe it goes far enough. It gets back to those points of simplicity: the business community understanding what they should be doing without having at every turn to go to professional legal advisers. It links into the previous question regarding an umbrella, consistent defence that enables directors, the general community and the markets to know what is expected. It leads to sensible business risks being taken and sensible, consistent approaches to risk management being put in place.

Certainly it is a good step to exclude financial services from section 52. We cannot understand why it would stop at that. We do not really understand the logic in policy behind fencing off that carve-out, if you like. If it is good enough for that area and if it is good enough for the existing provisions of the fund raising area, why is it not good enough for continuous disclosure? Why is it not, similarly, adequate protection in all of the other areas of business activity—with the exception of where there are conflicts of interest?

Dr SOUTHCOTT—Are there any conflicts between the Trade Practices Act and the Corporations Law for those other areas of business activity that you would like to see exempted from the Trade Practices Act?

Mr Elliott—Where do I start? We see the Corporations Law as the body of legislation which governs companies. We see the Trade Practices Act as a piece of legislation which is aimed at protecting consumers.

Currently, we have an extensive overlap between the two, which we do not believe adds to any further protections. We do not believe it adds to a greater understanding by the business or the investing community. In fact, we believe it leads to conflicts, differences between defences, confusion and a great deal of covering of butt—if I might put it that way—in that directors and senior management are going to extraordinary lengths to cover themselves under, currently, two different pieces of legislation with different defences, which is really jamming up decision making.

We are not seeing what is needed. I know that entrepreneurialism got a dirty name after the 1980s, but without sensible, quick decision making being made at a corporate level we do not see the generation of jobs, we do not see the generation of wealth. Really, the institute is not about open slather on the community. It is quite the reverse. By allowing business and the markets to operate efficiently, we see international competitiveness for Australia at a crucial time being enhanced, which surely must lead us to a better standard of living and greater jobs. There are a number of overlaps between those pieces of legislation.

Ms JULIE BISHOP—I take it you are saying that the Trade Practices Act was not designed to regulate the corporate regime of takeovers and behaviour in that sort of environment?

Mr Elliott—Precisely, and that is why the Corporations Law has extensive sections and divisions covering these areas.

Ms JULIE BISHOP—The TP Act has been a very exciting piece of legislation though for lawyers, hasn't it?

Senator COONEY—In truth, not only in corporate law but in industrial law as well. I suppose you would be happy to get rid of it in that area?

Mr Elliott—We recognise the terms of reference of this committee as the 'CLERP legislation'. But yes, we see overlaps in environmental legislation at the state and federal levels. We see them in occupational health and safety.

Mr Forster—That is right. It is the first section pleaded in any action. Whereas the Corporations Law has various defences sprinkled all the way through it, the Trade Practices Act has none.

Senator COONEY—You probably do not want to answer this now. Take, for example, this issue of where people are obliged to surrender their shares after a company gets 90 per cent. As you said, greenmail is a problem if you do not have that new provision in. We have heard some, I thought, very good submissions this morning saying, 'Well, that overlooks the issue of how people get to the point where they are now able to demand that you get the two sides', which you have no doubt heard argued. You have also, I think, spoken about the load-up of law and, as you say, a lot of this comes from the 1980s.

It seems to me that one point might well be this: what is the image of directors, what is the image of politicians or cricketers, or anybody these days? Can you give us an idea of what the institute itself does in terms of the ethics and the morals of those that are members of it? As you say, you have a great deal of responsibility and you have a lot of people in it, as you say. It might sound esoteric, but I think it is pretty relevant for a committee like ours, in judging what the law ought to be, to ask what does the body that represents, if you like, the directors do in terms of the morals and the ethics of this body.

Mr Elliott—I think it is a fair question. It is fair to say—and we have never been contradicted—that the Australian Institute of Company Directors runs the longest running, oldest and best regarded company director education course in the world. It has been going longer than those in the United States and the UK in terms of educating directors on their responsibilities, their ethics, what they should and should not be doing. Not only that: the institute has a code of conduct and all fellows—which is our senior level of membership—must, when they sign up each year, agree to be bound by that code of conduct. Less directly and internally, we run our usual wide range of education and briefing sessions. We keep directors up to date and put out publications on everything from duties and responsibilities and changes to the Corporations Law to quite detailed financial skills reading, et cetera.

It is very important, wherever possible, that the AICD work with the regulators—the Stock Exchange, ASIC—to encourage anybody who takes on the role of being a director for the first time to be aware of the institute. We stop short, because we do not believe in governance terms, of prescribing, of saying that they should, or must, be an institute member. Obviously the institute would be delighted if its membership ranks swelled to include all the directors in Australia. The investing community would probably be feeling a little more comfort as well. Certainly the insurers, in the directors and officers liability insurance area, recognise that members of the institute are a lower risk, as is reflected in the reductions in premiums for members of the institute. We encourage and we try to educate. It has been put to us—but this is not policy and I am not going to make it on the run—that listed company directors should be members of the Institute of Company Directors. That is not something that is our policy.

Senator COONEY—I understand that, but it would certainly be reassuring. One of the elements, I would have thought, that would lead to advances is peer pressure: you really need people to be in the institute to be able to exert this to the extent that it needs to be.

Mr Elliott—The Institute of Company Directors, as I again stress, is all about raising the quality of Australia's company directors. We are not about protecting poor performance—quite the reverse. All of our submissions are really based on that premise.

Senator GIBSON—I have to say that, as a fellow of the institute, I should declare my interests to fellow members of the committee.

Ms JULIE BISHOP—I am a member of the institute.

Mr Elliott—We have seen a radical increase in the number of directors from the public sector in the establishment of boards of government instrumentalities. We do specific in-board, unique training sessions for government instrumentality boards which are tailored programs for those particular needs. This is not an advertisement, just a plea for all directors to be aware of this.

CHAIR—As there are no further questions, I thank both of you for your presentation to the committee this afternoon. It has been very valuable.

Proceedings suspended from 1.17 p.m. to 2.00 p.m.

ROFE, Mr Alfred Edward Fulton, Chairman, Australian Shareholders Association Ltd

CHAIR—Welcome. Do you wish to make an opening statement?

Mr Rofe—Yes. Also, if I may, I would like to comment on some of the points raised by some of the previous witnesses. First of all, I will say something about the Australian Shareholders Association to give you a perspective on where our views are coming from. The Australian Shareholders Association is an independent non-political organisation which was formed in the early 1960s to represent the interests of individual, as opposed to institutional, investors. It is financed principally by member contributions. It has members in all states of Australia, with a national office in Sydney and branches in Queensland, Victoria, South Australia and Western Australia. Like most professional and industry representative bodies, only our executive officer and his small support staff are paid employees. The directors and all the members of our various committees and our various consultants provide their time on an honorary basis. As Senator Gibson may recall, I was also a member of the Corporations Law Simplification Consultative Group, so I have had quite a long interest in this company law reform process.

As I said, I will comment on some of the points raised by some of the previous witnesses. Mr Fielding referred to perceived problems with the funding and operations of ASIC. As you probably know, I have written to Mr Nugent about the committee's review of ASIC's annual report. Perhaps it might be possible for Mr Fielding's submissions regarding ASIC to be considered in conjunction with this review.

I will now move to Mr Jarrett and the SIA. One point which I think Mr Jarrett put fairly clearly in relation to accounting standards was the distinction between harmonisation, on the one hand, and the adoption of international standards. Like most people, we would certainly support the concept of harmonisation. However, we would be concerned about the indiscriminate adoption of international standards. I can remember back to 1972 when the International Accounting Standards Committee was established in Sydney following an international congress in Sydney on that date. As a number of speakers have said, the international standards tend to be a compromise between the views of different bodies. They often allow alternatives. It is not appropriate for Australia to adopt them until they are adopted by our major trading partners, including, for example, the United States. In this regard, I remind committee members of the quotation by Mr Arthur Levitt in the AASB submission No. 11, where he makes some comments. They are quite pertinent.

I support Mr Jarrett's comments in relation to the powers of the takeover panel, particularly its power to declare conduct acceptable as well as not acceptable. I would certainly approve the availability of access of bodies other than ASIC to the panel. The fact that ASIC has in the past acted as a gateway to the panel has meant that it has not been able to achieve what was initially hoped when it was established.

Mention has been made of section 52 of the Trade Practices Act and, in particular, the NRMA decision. Personally, I do not think there is anything wrong with the NRMA decision. There was some panic among some lawyers at the time that it opened up a whole new area of litigation. My recollection, though, is that the judge at the time suggested he

would have come to a similar conclusion under the corresponding provisions of the Corporations Law. My own view, I must say, is that it is inappropriate for there to be two parallel systems of law. The Corporations Law does provide a code for regulating companies, so I certainly will not oppose the exclusion of companies from section 52 of the Trade Practices Act. The situation of people investing in companies, particularly in equity investments, is that by nature they are taking some sort of a risk which you do not expect to take when you go into Woolworths and buy a packet of cornflakes or something like that. So it is appropriate for there to be a different regime.

I mentioned international accounting standards. My preference would be to omit proposed section 233 from the bill, which is the one that says that the minister may give the ASB the role of international accounting standards. I would prefer to leave it entirely to the Financial Reporting Council to decide whether or not it was appropriate.

There are some other points to be made about accounting standards. Again, I support the view expressed by the SIA that there should be adequate user representation on the Financial Reporting Council. After all, the whole purpose of financial reports is to provide information that is useful to the users of the statements in making financial and other decisions. So I suggest that perhaps 50 per cent of the membership of the Financial Reporting Council should consist of users. Appropriate bodies to represent those would be IFSA and SIA, representing institutional investors and advisers, and the ASA, representing individual investors.

I also agree with what was said on behalf of the AICD about there being appropriate representation of the providers of financial statements. By that, I am talking about the corporates and other bodies as distinct from accountants. I suggest that appropriate bodies would be, for example, the group of 100 and the AICD. I certainly do not think that the Financial Reporting Council should be dominated by accountants. One of the criticisms of our existing process which has led to these new provisions is that we have accounting standards that are technically excellent—I think Australian accounting standards compare very well with overseas standards—but which in many cases do not sufficiently reflect the needs of users and the problems of the industries which are reporting. That is why I suggest there should be a strong representation of users and preparers and perhaps just some representation by the accounting profession to provide some guidance in formulation.

In terms of the funding of accountant standards setting, again, I support what was suggested by the AICD about ASIC fees. If you look at the role of accounting standards, you will find that they mainly apply to listed public companies and disclosing entities. So it is appropriate that those bodies should contribute to the cost of formulating standards. ASIC, rather than the ASX, is the best mechanism for doing that. On the other hand, in so far as they are going to be applicable to public entities, statutory bodies and so forth, there is a role for a government contribution to funding.

Secondly, in so far as improved accounting standards will lead to increased efficiency in Australia's capital market, there is a role for a government contribution. I suggest that the main contributors should be the government and corporates through ASIC. I do not think that accountants through the accounting profession really should be asked to fund the development of accounting standards. The original process for establishing accounting

standards was started by the profession in the 1940s in Australia. It was reasonable in that case for the profession to pay the cost. Now that accounting standard setting is to be done by essentially a public body, one really should not ask accountants or the profession to pay the costs. That is all I want to say about those points.

I should now turn to the compulsory acquisition provisions, which are the main things I want to speak about. I will adopt Dr Elkington's written submission in this regard. It says most of what I would like to say in relation to the problems of this legislation. It probably says it more concisely and elegantly than I could. I do not know that there was a motion that it be incorporated in the transcript or whether that is appropriate. As I say, I would certainly like to adopt it on behalf of the Australian Shareholders Association.

The only point which he did not specifically mention in his submission, but I think he did cover it in his oral presentation, was what is now section 667A(1), which deals with the scope of the expert's report. I think it raises the same problem as section 661E(2), which deals with what the court can consider. Section 667A(1) states:

(1) An expert's report under section . . . must:

(a) state whether, in the expert's opinion, the terms proposed in the notice give a fair value for the securities concerned . . .

The problem in relation to both that section and section 661E(2), as Dr Elkington and others have suggested, is that it restricts inappropriately the matters that the expert can consider. We would argue that what is involved is whether the acquisition or buy-out, as the case may be, is fair and equitable, not just in relation to price but in relation to the whole proposal.

I will mention the written submission of Mr Arthur Willis from two points of view. First of all, I think it is important to bear in mind that we are not just talking about abstract principles; we are talking about specific cases and companies. Dr Elkington mentions two examples in his written paper. One is Webster Limited and Clements Marshall. The other is Australian Consolidated Investments Ltd. Mr Willis refers to the statement by Texas Utilities in relation to the proposed takeover of Allgas Energy Ltd. When you read through that letter, you see that it is obviously intended to be intimidatory on the part of Texas Utilities. That is one of the problems that needs to be addressed in the legislation.

I agree with most of what Mr Willis says, but you will recall that in the conclusion of his submission he suggests two proposals. One is that the proposed amendments be rejected. That is certainly one possibility. The second is that they only apply to companies formed after the date of promulgation of the legislation. I would strongly oppose that on the basis that it is going to create two classes of companies and will lead to complications. A third possibility, I would suggest, is that it will be possible to amend these provisions to rid them of their unsatisfactory aspects to make them apply in a way that is fair to both minority and majority shareholders.

I would like to tender in confidence a document which I think has been circulated to members of the committee. It alleges some possible breaches of the Corporations Law. As the parties referred to are not present today, I think it should be treated in confidence. A copy has been provided to ASIC. Whether or not there is sufficient evidence to establish

breaches of the Corporations Law I do not know, but the relevance of it is that it provides a current illustration of some of the problems that can arise. We have here a situation of a company which was subject to a takeover offer which was only partly successful. In fact, it was subject first of all to a scheme of arrangement and then to a takeover offer which was only partly successful, so we currently have a situation where the controlling shareholder has about 78 per cent of the shares. The controlling shareholder has said that it intends to creep up by three per cent every six months.

The concern that is held here is that within the next couple of years the controlling shareholder will have reached 90 per cent and, if this legislation is passed, it will be able to buy out the remaining 10 per cent at what they would believe is an unreasonable price. I have attached to the submission a graph of the share price of the relevant company over the last year. You will see that the share price has been falling. To some extent, no doubt, that is influenced by the industry in which the company operates. But certainly the person who made this submission argues that it has also been affected by the fact that the controlling shareholder has deprived this company of opportunities which would otherwise have been available to it.

From memory, there are currently about 2,000 shareholders still holding shares in this company. I think it is probably fair to say that they are people who invested in the company with long-term confidence in its future. They realised that the share price of companies goes up and down, but they saw this company had long-term potential. They are not greenmailers or anything like that. They just want to hang on to their investment. They do not want to be squeezed out by an opportunistic majority shareholder when the market price of the shares may be depressed below their true value.

I would like to turn next to submission No. 15, lodged by Norman Waterhouse on behalf of Mr Geoff Stewart. I support what is said there about some of the practical problems that can arise. I think in one of his many submissions Mr Fielding included a list of a dozen or more companies where there is a major shareholder with between 80 and 90 per cent of the shares where there is potential, if the legislation is passed, for the minority shareholders to be bought out. The point I am stressing here is that this is not an academic question. There are companies right here and now—or minority shareholders—who are potentially affected by this legislation.

I have a couple more comments. In relation, again, to some of Mr Jarrett's comments, he referred to compulsory acquisition as involving a balance between the efficiency of gaining full ownership, the rights of shareholders and the role of greenmailers. I will come back to greenmailers in a moment, but he went on to comment that the current provisions make the acquisition of 100 per cent difficult. He suggested that there were sufficient protective mechanisms in the new compulsory acquisition provisions. I would disagree with him on that. I must say that when I first looked at the legislation and saw there were things about referring things to court, shareholders having a right to object and so forth, it looked okay. It is not until you look at the actual wording of the provisions that you see just what the problems are. That has been discussed earlier on. I will not say more about that.

There is one other thing in relation to Mr Jarrett's presentation. I would strongly support what he says about the need for CGT rollover relief. The Shareholders Association is very

conscious of the attitudes of a lot of the individual shareholders in these companies. I think he mentioned Advance Bank, St George, Westpac and the Bank of Melbourne. Mr Fielding has referred to Milton Corporation, and other people have referred to AMP and GIO. One of the major factors of concern to shareholders whose shares were or may have been acquired was the potential capital gains tax consequences. Advance Bank and St George are particularly relevant here, because you had two companies of more or less equal size who wanted to merge. Because the acquiring company was St George, it meant that the Advance Bank shareholders paid the capital gains tax and the St George shareholders did not. If it had been the other way around, it would have been the reverse. What you had was a merged group with a common group of shareholders who continued holding equity in the merged group. They had not sold their shares; they were just forming part of a larger group. As I say, I think most people in Australia would strongly support the need for CGT rollover relief.

To go back to the AICD submission, in relation to the legislation Mr Forster said, 'The balance is weighted too far in favour of minority shareholders, thus enabling greenmailing. Currently there is no mechanism available to take out minority shareholders.' I do not believe that is true. If you have a look at the CASAC report on compulsory acquisitions, you will see that in paragraph 1.5 it lists 11 methods of compulsory acquisition of minority shareholders' interests. Some of them are more relevant than others, but I suggest that what Mr Forster was really saying was that there is no mechanism currently available which allows majority shareholders to squeeze out minority shareholders at an unfair price.

There has been a lot of talk about supposed greenmailers and how this legislation is meant to deal with the problem of greenmailers. Mr Fielding has said that it will not do away with greenmailing; it will just create a new class of greenmailers. What do we mean by greenmailers? I suppose you could say that we are dealing here with a conflict between so-called greenmailers who buy shares at what they believe is an undervalue, on the one hand, and controlling shareholders, on the other hand, who want to buy out minority shareholders at an undervalue. Most people who invest in the stock market are looking for undervalued securities. If a so-called greenmailer sees a particular share selling at what he believes is significantly less than its true value and seeks to sell that share for what he believes is his fair value, that is not a heinous crime. You could say in a sense that what he is doing is providing a service for minority shareholders in enabling them to get a fair price for their shares. It is really just a process of the market operating efficiently.

I have had a fairly close look at the decided cases over the years dealing with compulsory acquisitions. I really cannot find one case where a so-called greenmailer has been able to receive an inflated price. As Dr Elkington pointed out, where there has been a proper offer at a fair price which has been accepted by an overwhelming majority of shareholders, that is not going to be set aside by a court.

Look again at paragraph 2.75 of the CASAC report. It lists a number of the grounds on which courts have exercised their discretion to prevent compulsory acquisition. I think you can summarise it by saying that—an expression used earlier was 'clean hands '—some element of fairness has been involved. Rarely is it a question of price. That is only when perhaps there is a problem with the expert's report or something like that. As I say, if a fair price is offered and it is accepted by an overwhelming majority of shareholders, no court is

going to block the compulsory acquisition. By purporting to restrict the discretion of the court to only deal with price, you are really cutting out 90 per cent of what the court does in cases like this.

Let me say in closing that, firstly, I hope Dr Elkington, Mr Fielding and others have demonstrated to you that the legislation in its present form is unfair to minority shareholders. I suggest, secondly, that in fact it is unnecessary. The existing compulsory acquisitions provisions in the Corporations Law are capable of being used—for example, the selective capital reduction provision, particularly following its recent amendment by the Company Law Review Act, or the scheme of arrangement provisions.

I return to the role of the court. I mention in paragraph 2.75 the factors that a court can take into account in blocking a takeover. You will see in paragraph 2.76 that CASAC issued a discussion paper before issuing its report. In paragraph 2.76 it is said that the submissions received in response to that discussion paper supported the existing judicial guidelines. Why, then, are we trying to change them? The answer, I think you will find, is in paragraphs 1.21 and following of the CASAC report.

You may remember that, following the High Court's decision in the Gambotto case, there was a bit of a panic among lawyers that the judicial guidelines were going to be changed to make it harder for controlling shareholders to buy up minorities. In fact, in the four years since the Gambotto decision, there is no evidence that the courts have changed their attitude. That is why I say that it seems this recommendation by CASAC of this new compulsory acquisition provision was not supported by the submissions it received in relation to the existing guidelines. It seems to have been motivated by the panic submission by the Law Council, which is referred to on pages 1.21 and following, as to the possible effects of the Gambotto decision.

I will conclude. Let us look at the reasons why a majority shareholder might want to acquire 100 per cent ownership. Various people have prepared lists, but I suggest to you that there are three main reasons. One is the reduction of administrative costs. The second is the benefits that arise from the grouping of companies for tax purposes which are currently only available where you have got 100 per cent ownership. The third is the reduction of potential for conflicts of interest.

As far as the first one is concerned—the reduction of administrative costs—that is really just a commercial issue. I suppose you could say that if you have more than one shareholder in any company you have administrative costs. If you are listed on the Stock Exchange, you have costs. It is a question of balancing those costs against the benefits that can be derived by getting rid of them. So that is really a commercial point.

In practice, the most significant factor is this question of grouping for tax purposes. I suggest that the answer there is not to change the compulsory acquisition provisions but to change the tax legislation so that you can get these benefits of grouping with, for the sake of argument, 95 per cent ownership rather than 100 per cent. A lot of this tension about getting rid of the minority shareholders would then go away.

As for the third one—a reduction in the potential for conflict of interest—again, it is something we just have to face up to. If you have partly owned subsidiaries, you obviously have the potential for conflicts of interest. Indeed, in many companies in Australia, because of the fairly small number of skilled company directors, there are always conflicts of interest which arise. It is up to the people involved to resolve them. The answer is not the draconian one of getting rid of the minority shareholders. It is to deal with those problems as they arise. I should stop there. I have gone on for longer than I intended to. If there are any questions, I would be happy to answer them.

CHAIR—Thank you very much, Mr Rofe, for that very comprehensive presentation.

Senator COONEY—I want to tease out the business about the minority shareholders and the reaction to it. A lot of it seems to be a reaction to the legal system rather than to the rights and wrongs. If people could get the matter on quickly and disposed of and they had sufficient funds and lawyers to do whatever had to be done, that would solve some problems, would it?

Mr Rofe—Under the normal takeover provisions, if you have a reasonable offer, it is going to be accepted by a significant majority of shareholders. You are going to be able to have compulsory acquisition except perhaps in occasional, rare cases—this probably applies particularly to some resource companies—where you have a tail of lost shareholders who perhaps have very small shareholdings, the company has not been doing well and they have not bothered to notify their change of address. Again, as some of the previous witnesses have said, very often when a majority shareholder has not been able to compulsorily acquire the remaining shareholdings, in most cases it is the fault either of the company concerned or its advisers.

Senator COONEY—And the minority shareholder should not bear the burden of that?

Mr Rofe—That is right. Take AMP and GIO. Certainly the capital gains tax consequences were one element. But if AMP had offered another 25c per share or something like that, it probably would have got 90 per cent. It is a commercial situation. There have been other cases where perhaps advisers have not been as astute as they might have been and they have missed out on opportunities to get to 90 per cent. But, as I say, in a high proportion of cases, it is the fault of the majority shareholder that they are in the position they are in.

Senator COONEY—Would there be many small shareholders that had portfolios in companies that might well get to the point where somebody else had 90 per cent—in other words, where you had a series of shareholders holding shares in a series of companies that could be subject to takeovers? What I am getting at is that that would make them even more unhappy, I should think.

Mr Rofe—I suppose there are some shareholders who perhaps tend to invest in lesser known companies that get into this situation, but I would not suggest that is a very widespread thing. On the other hand, I would suggest that quite a lot of shareholders are in a minority position in one or more companies. Some of the examples that have been mentioned today are examples of that.

CHAIR—I have reached the conclusion that what you are saying is that the law should remain as it is. You are not in support of any of the changes in relation to the 90 per cent—

Mr Rofe—I would certainly oppose the proposed cutting down of the role and discretion of the court and the proposed cutting down of the professional judgment of the expert in making a report. Under existing section 701 of the Corporations Law, dealing with compulsory acquisitions after a takeover, the court may block the takeover. It does not lay down any criteria at all, but over the years the courts have developed their own criteria and they are quite satisfactory in most cases. I would argue, first of all, that you do not need to fix something that ain't broken but, if you do, and if you put something specific in the legislation, it should be something to the effect that the courts can stop a takeover or compulsory acquisition which is not fair and equitable—it is not just a question of price, but in general.

Senator GIBSON—The evidence is that takeover and merger activity in Australia is lower than in the United Kingdom and the USA. I refer to an article this morning about the rates of return by major companies, listed companies, in the USA, UK and Australia and that Australia has a substantially lower rate of return than both the UK and the USA. There is a thesis that those two things are related and that if there were higher activity of takeover and mergers the rate of return on all investments in the listed area would tend to rise and that, therefore, the law should be freed up to allow greater merger and takeover activity. You do not subscribe to that view?

Mr Rofe—Let us say that I would not give it as much weight as some people do. I know that John Jarrett raised it on behalf of the SIA. I have had endless debates with John Green who, as you would probably know, is an advocate of this theory. I think that takeover activity tends to go in cycles. Reference was made earlier to Henry Bosch's comments. I do not think you can blame the fall-off in takeover activity in Australia on changes to the Corporations Law. Takeovers are an important mechanism in improving company performance. That is quite true.

Ms JULIE BISHOP—In relation to the example that you provided, are you going so far as to suggest that there ought not be common directorships where the company is a non-wholly owned subsidiary?

Mr Rofe—No, I cannot go that far because, obviously, the majority shareholder must have representation on the board. What I think is most important in such a situation is that there should be independent directors to represent the interests of the minority shareholders. In that company—

Ms JULIE BISHOP—Proportionately?

Mr Rofe—Well, yes. I do not think you can have an arithmetical formula that covers everything. But let us say that I think there should be adequate representation. In most cases, even if you have 90 per cent and one per cent, I do not think one independent director is enough, because if you get on a committee or something and you are the still small voice, as it were, you need a bit of moral support. The problem with the company that I mentioned is

that there are no independent directors—they are all either associates or executives of the controlling company.

Ms JULIE BISHOP—But that in itself is not necessarily a bad thing if they abide by appropriate standards.

Mr Rofe—I have heard plenty of corporate lawyers saying, 'Of course, the law is there. Everyone knows about their fiduciary duties,' but human nature is also important.

Ms JULIE BISHOP—You cannot legislate against human nature.

Mr Rofe—It is just like parliament. You need to have an opposition to make the system run, don't you. It would be great if you could get rid of the opposition and the minority parties. I have been quoted publicly as saying in relation to AMP and GIO how it is essential that there be independent directors to represent the interests of the remaining 32 per cent or whatever it is—the 50,000-odd—of shareholders in GIO.

Ms JULIE BISHOP—It is interesting, isn't it, because there seems to be a trend away from people taking on directorships. So if one is seeking greater and greater numbers of independent directors, we have to look at other issues as well.

Mr Rofe—Yes. There is a growing awareness, though, that there are people with the potential to be independent directors. I do not say that it applies to Sydney companies, but I suppose there was a feeling in the old days that you had to be a member of the Melbourne Club to get on the board of any worthwhile company. I think that attitude is going.

Ms JULIE BISHOP—There also seems to be a trend in the United States where certain boards discourage their directors from being directors of any other companies of a similar size. We limit it to one or two. Let me give an example. If you are a director of Intel, you cannot be a director of any other major US corporation. In Australia, it is quite a different scenario, where a smaller group of directors are directors of any number of our large companies.

Mr Rofe—Certainly in the past we have had this problem where a fairly small group of people was seen to be eligible for appointment to the boards of Australian companies.

Senator CONROY—When did that change?

Mr Rofe—I think there is a process of change going on. I do not say that it has changed completely, by any means, but I think there is a growing trend to recognise that times have changed.

CHAIR—In your submission you have included a graph of the share price of North Flinders Mines. I wonder how it compares with the movement of the Normandy prices in the same period. Do you know whether it is a similar trend?

Mr Rofe—I do not think I should comment any further on that at this stage.

Senator CONROY—You have privilege.

CHAIR—Any further questions?

Senator CONROY—In the report, there are some criticisms of the existing management. They seem to have taken decisions to be conservative—I think that is the way to summarise what is stated in here. Would it be possible for them to argue that they have taken all reasonable steps and information in looking at these things and that, therefore, they made a perfectly reasonable business judgment not to proceed?

Mr Rofe—Yes. Another reason why I did not really want to comment on that in detail is that the people concerned are not here to put their point of view. I put it forward more as an illustration of the sort of problems that can arise. Whether in fact they have arisen in this case, I do not want to comment.

Senator CONROY—Sure. I am looking at the macro situation. I am concerned that it is possible for a director to behave in perhaps a manner described here or in a similar manner in another company. They argue that they have done everything reasonable, but the shareholders' interests have not benefited as much as they otherwise could have. The introduction of the business judgment rule will protect them from any action by a shareholder.

Mr Rofe—They always do argue that they have acted reasonably and in the best interests of the company concerned. Whether you have a business judgment rule or not, the practical problem is to establish whether or not that is true. That is why I suggest that the practical answer to that is to make sure that you do have independent directors—directors who are seen to be independent and who can, from the inside as it were, review those decisions.

Senator CONROY—I fully support you in that instance. I am interested in your opinion on this matter: under the current law as it stands right now it is possible for some of those minority shareholders in this particular instance, or in a similar instance, to take action, but if the new legislation goes through in its current format they would not necessarily have access to that redress.

Mr Rofe—Even at the present time minority shareholders are in a difficult position because they do not have access to the inside information, the management information, concerning a particular company, so they really do not know whether they are being dudded or not. That is the reason for having independent directors on the board who do have access to information.

Putting that in the context of the compulsory acquisition powers, under the existing legislation if you are going to use one of the existing mechanisms—whether it be a takeover scheme or a selective reduction of capital or scheme of arrangement—there are requirements in the law there that there has to be disclosure of relevant information. So they are to that extent protected if a move is made to acquire their shares.

CHAIR—As there are no further questions, thank you, Mr Rofe, for your presentation to the committee.

Senator CONROY—Mr Chair, can we clarify the status of the supplementary submission? We should either accept it as a public submission or as a confidential submission.

CHAIR—I think it should be a confidential submission.

Resolved (on motion by **Senator Conroy**, seconded by **Senator Gibson**):

That Mr Rofe's supplementary submission be received as a confidential submission.

CHAIR—Thank you.

[2.50 p.m.]

HANLEY, Mr Denis Michael (Private capacity)

CHAIR—Welcome. Do you wish to make an opening statement before we proceed to questions?

Mr Hanley—Yes, though not as extensive as the previous opening statements. I would like to contexturise what I am going to say. For about 14 years I was a director, and then chairman of directors, of an Australian technology company—Memtec Ltd. Memtec Ltd started with four persons and some technology from the University of New South Wales and, over 14 years, grew to be a company which achieved a market capitalisation of $660 million, with 1,800 employees. So we were doing fairly well. In the last three years of our independent operation we had a compound earnings growth of 30 per cent per annum. Then we were taken over, in a hostile takeover, by a US corporation, US Filter. They paid a price of 50 times trailing earnings. You might think that is a fairly princely sum, but Memtec Ltd two years later would have been a billion-dollar company. And when you are growing at 30 per cent compound, 50 times trailing earnings is sometimes not a big premium.

There are significant weaknesses in the Australian takeover code which became evident during our defence. It is impossible to defend an Australian company successfully against a US corporation where you have the laws of both the United States and Australia prevailing. The laws relating to what directors can do in Australia versus what they can do in the United States are very dissimilar. This is particularly the case where you have one month to reply to a part A, basically—plus or minus a few weeks—and the attacking company can have six to 12 months to prepare.

This is particularly true when you are a technology business, because a lot of the value of a technology company is in the future earnings associated with the research that is currently ongoing. Research by its nature is not something that is public at an early stage. It thus takes some considerable time to get out and to look for counter offers to recognise true shareholder value. You cannot do that in one month.

In Memtec's case, we managed to get the price up by 20 per cent. Everybody said that was wonderful but, frankly, I think that the company was sold for maybe a little more than half of what it could have got. It had a technology for purifying water that can turn waste water into drinking water. It had not lost a bid in the United States on new drinking water systems of the type that we were supplying. We had over $US100 million in backlog. As I say, it would have been a billion dollar company. The people who took us over were our principal competitors who knew that they could not continue to participate in the market successfully if they did not acquire this technology. So it was just not possible for us to generate that value in that short term.

If you take a helicopter view and you climb up out of the situation you get when you are looking at jurisdictions—and I realise jurisdictions are important—Australia is two per cent of the world capital market and Australia is a minuscule per cent of the technology capital market. It can never be any different, because the major technology companies are listed in the United States. Why are they successful there? They are successful there because the

markets are made there and the markets are made there because all of the peers are on the same exchange operating under the same rules. So it is possible to compare and contrast Intel versus Cisco versus any of the things that you want to think about.

In the case of Memtec, we had six or seven international sell side analysts who covered the stock and they covered all the other environmental stocks relating to water, and they were able to compare and contrast. There were no analysts in Australia who could value the company because they did not compare and contrast that group. The ASX has to be recognised as a monopoly. It is the only Australian exchange. So what you are dealing with is the rules relating to, in public company terms, a monopoly. It has to be possible to get above that monopoly if you are a technology company.

So I am certainly of a view at this point in time that, if I were involved in a technology company from Australia again—and I hope to be—I would not incorporate that company in Australia. I would incorporate it in Delaware in the United States, and that would put me on an equal footing with all of the other technology companies with whom I compete. I would get access to the same defence mechanisms that they have and I would have access to the same capital raising that they have, and I do not care whether the US system is better or worse. It is a bit like the argument as to whether Apple computers are better than IBM PCs. I could argue that Apple computers are better, but everybody has a PC and therefore it is really important to be involved with US generally accepted accounting principles and quarterly reporting, SEC reporting, the US analysts and the NASDAQ type coverage.

One of the important issues with NASDAQ that people often forget is that NASDAQ is a quote driven system, which means to say that people wholesale the stock. Therefore, if you have a low stock turnover, then there is always somebody to buy the stock as a last resort. The ASX is bid driven. If there is a seller with no buyer, the price just falls till the next buyer. So you have catastrophic variation in the valuation of the company on the sale of 6,000 shares, which is sometimes quite stupid.

Aside from that, all of the issues that you deal with in the technology world are global, and the best global technology market is the US. As far as I am concerned, at the present time I would incorporate in the United States and run the business from Australia. But if it became difficult to do that, I would move the company to the United States. I think you will find that that is happening very regularly in Australia with good technology businesses. They have to do that.

The Australian code continues to have a myopic view and continues to think about what individualistic facets of corporate law it wants to tinker with when the reality is that there is a perfectly good alternative in the form of what the SEC is administering—it works for 50 US states; I do not know why it will not work for a few others—then I think you are going to drive technology businesses out of this country. In Australia on the ASX with no technology analysts covering Memtec, we fell in value to the cash value on deposit in our banks—nothing for the technology, nothing for the buildings and all of those other assets, just the value in the bank. That is what we were trading for at at one stage before US interests started to buy in. In the end, when knowledgeable people were able to follow the company, we sold for a very considerable value.

I have listened to some of the previous discussions. I think there is a perfectly good set of regulations out there that work very, very well. The closer you can get to the US, as far as I am concerned, the better, and that is the way everybody else is going to go—although Europe has their own view of life. It does not really matter, because all of the technology businesses are fundamentally listed either on NASDAQ or the New York Stock Exchange.

There are other benefits in US tax codes and other things which I will not bother you with at this point in time, but all I can say is that you have to have a level playing field, you have to raise capital at competitive rates and, if you look at what technology businesses bring in the US and what they bring in Australia, you cannot compete if you try to raise your money in Australia under Australian law. From my point of view, if you would authorise, as an alternative, US safe harbours and US regulations, that would, for my mind, make Australian companies more competitive.

CHAIR—Thank you very much, Mr Hanley. Could you briefly explain to us how you see the difference between the Delaware law, as it relates to takeovers, and what is proposed in this legislation?

Mr Hanley—Specifically, the takeover code in the United States allows a number of defences which have evolved over the last 30 years in terms of their law. In particular, the one that was recommended to us by our very expensive US attorneys is the adoption of a shareholders' bill of rights, which has the effect of delaying the takeover offer. Other people call that a poisoned pill but, effectively, it is a way of delaying the takeover offer so that you can obtain full shareholder value.

What this leads to, in effect, is not so much a contested and lengthy takeover proceeding but it pre-empts a lot of hostile takeovers, and what you see is a full value offer at the very beginning, because it is in everybody's interests to have an agreed value. So instead of trying to enforce the elements of agreed value, it basically says that if you do not really agree up-front it is going to be a miserable and difficult time to try to take that company over, because you are going to have to sustain the attack for 12 months.

The 12-month period enables you, particularly in a technology business, to see some of the research play out and, as the defending board, you can protect shareholder value by getting significant alternative bits. You have time to go out and spend the same amount of time that the attacking company spent finding alternatives. Everybody knows that in the end they are going to have to pay full value so they make a full value offer at the beginning. I think that, more than anything else, is what enhances the US takeovers—the offers are full. People make a strategic offer in the full knowledge that they are not trying to rip it off, because they cannot.

Senator GIBSON—Who owns the company?

Mr Hanley—Memtec Ltd?

Senator GIBSON—Yes.

Mr Hanley—It is an Australian public company.

Senator GIBSON—Yes, I know, but mostly institution owned when you actually sold out?

Mr Hanley—Yes, but by global institutions—not only Australian but US institutions and European institutions. Most Australian institutions sold out early in Memtec's life.

Senator GIBSON—How come the company was not able to sell—

Mr Hanley—Because the law relating was the Australian law.

Senator GIBSON—I mean in persuading the people within the major institutions that were your major shareholders?

Mr Hanley—That is not the way the system works in the United States or anywhere else.

Senator GIBSON—I know. Congratulations on what you did with the company. I think it is just fantastic.

Mr Hanley—We did our best. I think we could have done better.

Senator GIBSON—I do not understand why your major shareholders did not get imbued with the enthusiasm that you are showing here today.

Mr Hanley—Because the attacker basically pointed out the Australian law, which gave 30 days for a decision, and it is generally known in the United States that if you cannot mount a defence it is very difficult to increase the price. So what happens in the United States and also in Europe is that people flip the shares to what they call the 'arbs'. That is typically because, with takeover offers occurring, major institutions do not follow the stock—that is, the long-term holders do not follow the stock once it goes into play because the nuances occur so quickly that only specialists hold the stock once the thing goes into play. So with people like Fidelity, or major institutions such as that, as soon as the company goes into play and they see that there is a 30-day response period they flip it to the arbs. So they are out. Then you are in the hands of short-term people who are playing a detailed game of maximising whatever they can get in the short term.

We could not respond to that, because Australian codes said that we were dead in a month, so there is no way you can keep your long-term shareholders if they think the whole thing is going to happen within a couple of weeks, because they cannot track it that closely. They have individual managers that are looking at $100 million portfolios, so they flip it to specialists who trade the exchange basically in stocks that are under attack.

Senator GIBSON—Isn't one of the fundamental strategic things here in Australia that most of the institutions and funds managers have not been willing to put much of their portfolios into technology stocks like yours?

Mr Hanley—I think they do put a reasonable amount into technology but they invest through the US market, typically through London or Edinburgh or the United States. They

would use another manager to invest in global technology but they would not do it on the ASX, which is why the ASX is not a place to be for technology stock.

Senator GIBSON—Sure.

Mr Hanley—Effectively, what happens if you invent something that has never been before—and therefore you are creating a whole new market and a whole series of follow-on things—is that the valuation of that requires people who are valuing that industry on a global basis. That means you have to get involved with the US market either through NASDAQ or the New York Stock Exchange. Memtec did both. But once you do that, if you are incorporated in Australia—and you are stuck in the ASX, and you are stuck with the ASX listing rules and the Australian legal system—you effectively have one leg on the American side but you cannot defend a takeover. That is what we have found. That is why I say that the result of that is that next time you could not incorporate in Australia.

Senator GIBSON—Another side of the coin is that, surely, the success of your company and your group and what happened has been a good lesson to the Australian market and provides therefore—assuming the government does change the tax structure so that we do not have this penalty with regard to takeovers and mergers with regard to capital gains tax—that more people would be willing to have a go with Australian R&D and get these sorts of companies going.

Mr Hanley—I would hope so, but all I am saying to you is that, based on that same experience, and as a person involved in the middle of it and not peripherally, people who try to do that would be mad to incorporate in Australia, because they could not defend what eventually will come. There is a point in time where the value of your stock is the potential it has in terms of impacting its industry. That is where Memtec got taken over. Before we even really completed our roll-out and had a market position, our competitors out of the US knew what value this particular technology was. They told me perfectly straight-up afterwards, 'We had to buy it because we thought someone else would.' We were naked—we had no defence.

The defence in the United States would typically be that you would be able to delay and get a better valuation for your shareholders, which means you would require a fuller offer, because nobody is going to litigate over a 12-month contested takeover fight. Effectively, why things happen better under the US legislation is that people make fuller offers. In general terms, you could expect to get a much greater control, particularly for a piece of technology. If you look at what IBM paid for Lotus or various other companies, people say it is unrealistic. It is not unrealistic if the piece of technology is going to be pervasive and is going to dominate certain aspects of what the world does.

I do not feel bad about it—we did not do too badly—but what we learnt from the process as one of the early Australian technology companies is that it would have been a lot better for us if we could have fought on the same terms and conditions as have evolved over 30 years in the United States for similar companies. We just found ourselves stuck. We have a culture in Australia to enhance takeovers, whereas in the United States they basically have many restrictions which, I think, in the end improve shareholder value. So I come with a different view, I am sorry about that.

Senator GIBSON—One of the problems here is that we are talking about two different groups of companies, really. There is a thesis, which I think I expressed before, that for lots of companies here in Australia there needs to be more pressure on management to perform and to get up to international best practice in both performance and rates of return, whereas you are talking about a small number of high technology stocks—and your example is just a beauty—which are growing like mad, and the Australian system does not cater for that basically.

Mr Hanley—No, because the Australian system is really built around a history of jurisdictional issues, and a lot of companies are—and historically were—Australian. If one Australian company is competing with another, then it does not make any difference, because you have the same rules and regulations whether they are good, bad or indifferent. But it is different once you get into an international game. There are a lot of Australian bankers, God bless them, that often make a lot of money with the defence, once a part A is out, of going and trawling the US for another offer based on the value of a US listing being slightly higher, in PE terms, than Australia. That was not available to us because we were already US listed. But a lot of people have made a lot of money out of that. Again, with the Australian PEs, it is very difficult to defend. It may be that that is appropriate. It may be that a market position in Australia is not the same as a market position in the United States. If you are talking geographic market positions, I think that is probably true. But if you are talking about global positions, they are exactly the same. Where technology and probably mining are different from a country based business it is working on a global plane and therefore has to compete on a global plane. You really have to think how best to do that to make these companies competitive.

Dr SOUTHCOTT—Even if Australia did have a second board which was devoted towards raising venture capital and high-tech start-ups and so on—

Mr Hanley—You still would not have the analysts that would know what they were talking about.

Dr SOUTHCOTT—That is one problem. And an Australian incorporated company will always have this sort of problem because of the difference between Corporations Law here and company law in Delaware.

Mr Hanley—That is my belief, yes.

Dr SOUTHCOTT—Is it true that about half the companies in the United States are incorporated in Delaware?

Mr Hanley—I believe it may even be greater than that. As you track down the eastern states there, Delaware is a little place and you either work for the chemicals industry in Delaware or I think you are involved in Corporations Law. It typically has what are considered to be pretty generic and reasonable securities laws. In most of the other US states you can still have what are sometimes quite onerous shareholder protection schemes. In fact, there are some states where you could argue that there is potential for entrenching management. But most of those states tend to be slightly ignored by investors because the

institutions prefer that there is a capability of there being a takeover—they just want it to be at a full price.

Dr SOUTHCOTT—Sure. We have talked about one of the important differences in takeovers in Corporations Law between the United States and Australia: are there any other differences that you would like to make the committee aware of?

Mr Hanley—The SEC regulations really require fairly standardised reporting, supposedly every quarter. It is quite onerous in terms of what the directors have to talk about. Typically, after your quarterly report issues—usually after New York has closed—as the chairman you generally host a shareholder phone-in. Out of the three and a half thousand shareholders, I would often have 150 to 200 shareholders on the phone. Typically it is 2 a.m. in Sydney, but what the heck—they cannot see me. Basically, they just read your quarterly release and they ask you a lot of pertinent questions. It is a public situation where anybody can phone in. All of the key institutional shareholders from all around the world do phone in. So a lot more shareholder communication goes on.

You can argue about accounting systems. You have to remember accounting systems are devised by humans. There is nothing unilateral or overarching about accounting laws. US accounting laws seem to work fairly well for a heck of a lot of companies. They are quite prescriptive. There is very little opportunity for playing fun and games. The other thing is that all of your competitors are basically subject to them. I found that just converting to basic reporting under a US GAAP was a very good idea because you did not have to keep arguing what your numbers were versus what someone else's numbers were.

Dr SOUTHCOTT—We have talked about high-tech companies, but could this be a problem for any Australian company—

Mr Hanley—I think any company facing a global market.

Dr SOUTHCOTT—like News Corporation which is—

Mr Hanley—I am sure News Corporation, if it were not for capital gains tax, would have some serious thoughts about the way that they operate. They are a global company. Anybody that gets to be a global business, raising capital on a global basis, has difficulties.

There are other things associated with News Corporation. You would have to shoot Mr Murdoch to acquire the company anyway, so I doubt that there is a significant concern about an open register. You have to sit down and say to yourself that more and more Australian companies will become global. They do not need to have one arm held up in the middle of their back by domestic issues which are not going to affect them to any significant extent.

Ms JULIE BISHOP—Mr Hanley, you mentioned the disadvantages you felt in having to respond within a month to the offer.

Mr Hanley—It takes two weeks to get lawyers in the United States and Australia. So, halfway through it, we have just got our lawyers. Thank God we had Mr Atanaskovic—

Ms JULIE BISHOP—You are obviously not talking to the right law firm.

Mr Hanley—We made a point of talking to the right law firm. He very much delayed things a little bit in his own inimitable way. If you have ever worked with him—

Ms JULIE BISHOP—Quite.

Mr Hanley—You do not have any time to really defend.

Ms JULIE BISHOP—Just let me put this to you. ASIC would say that we do not want long, drawn out, takeover battles. In fact they have said it here today; hence the time limitations. Yet in the states they have the mechanisms for delay. Clearly there are the shareholder bills of rights and the like. But what you are saying is—

Mr Hanley—That does not cause it.

Ms JULIE BISHOP—But what you are saying is the regime in the States in fact encourages expeditious takeovers because everybody in the game knows that if you do not make the offer of fair value at the outset you are in for a long battle.

Mr Hanley—Precisely.

Ms JULIE BISHOP—So it is a self-regulated system?

Mr Hanley—Yes. All I am saying is that the way we are trying to go about it here, by being prescriptive in terms of process, is not the way to do it. The issue is to force a full and fair offer as quickly as possible. What everybody was saying earlier is true. People will try to get away with something on a four-year low if they can. With quarterly reporting or short-term accounting you cannot value a company the way that the market goes, because everyone knows the markets are affected by an unbelievable number of things. Once people know that the whole business is going to move, you really need to force a full and fair offer. The Australian directors are underempowered in terms of enabling that.

I can remember a very fascinating presentation; I will have to ask Mr Atanaskovic to do it again. His comment was that if we considered some of the things that our US attorneys were recommending, not only would it be the first time it ever happened in Australia, but it would also be courageous beyond anybody's expectation, and it would be nice to see that we did not value our house or family very highly. This is what our adviser is telling us in terms of taking what would be a normal defence in the United States.

Ms JULIE BISHOP—It is surprising because it goes against our concept or perception of the United States being such a litigious society which uses litigation at every step of the way. But you are suggesting that, in this instance, even though they had the ability—

Mr Hanley—It is the threat of litigation which causes a reasonable person to make a decision. The Australian legal system tries to force the directors to fund another full offer. That is difficult, because, firstly, if you are running a company, you are not maintaining somebody out there looking to buy you out. So you have to start the process from the

beginning. Then you get a bidding war. We tried to solicit 40 different companies globally that might be willing to offer us other alternatives. We went through all sorts of mechanisms, but within a month we could not get anybody back. So it was really a poker game. We had no other bid. We managed to get the price up 20 per cent basically by 'bluffing'. But that is not the way to do it in terms of shareholder value.

I am pleased we were successful, but the reality is that there should have been a better mechanism. Under the US system, it is because the directors can thwart the offer that it causes the offer to be full. In other words, it is the threat of the litigation. So you do not have to go and find a whole bunch of other folk. You will get a pretty decent offer out of the guy who is going to make it. He has to show why it is a full and fair offer or he will spend a lot of time in the courts trying to get there. In the end, if you followed Hilton versus whoever the folk were who were trying to buy the Hilton—there were a couple of them; I cannot remember—you would have found that it escalated 40 per cent over the period of the discussion. Nobody is going to go back and try that again. There was a $30 million write-off or something for being so stupid. We need a helicopter view. In Australia, we look at things in minutia. We really are a pimple on a pumpkin in terms of the global markets. I do not know that we need to reinvent a lot of wheels when there are models that have been going for 30 years. They are not perfect, but they are not bad either. That is just my personal experience.

CHAIR—There being no further questions, I thank you very much, Mr Hanley, for your presentation. It was certainly enlightening and offered a great perspective. It was very useful.

[3.20 p.m.]

WHITLAM, Mr Nicholas, President, NRMA Limited

CHAIR—Welcome. Do you wish to make an opening statement?

Mr Whitlam—Yes.

CHAIR—Please proceed. We will then move to questions.

Mr Whitlam—As you are aware, the NRMA has previously submitted to the committee, the relevant minister and the parliamentary secretary our concerns about the threshold requirement for convening a special general meeting. We are very pleased that the substance of our concerns was acknowledged and that that acknowledgment is reflected in the draft legislation. The question we would now like to address is the threshold and striking a balance between the legitimate rights of members to call for special meetings on the one hand and the abuse of the process for frivolous reasons on the other. In reaching a view on this matter, the NRMA would like to draw your attention to some facts which relate to our two companies specifically and which differentiate us from most companies and the restrictions and obligations they impose.

The NRMA itself has nearly two million members—in fact, 1.8 million members—all of whom have one vote equally valued. This is because we are a mutual company. We also have a sister mutual, which has 1.4 million members—NRMA Insurance Limited—of which I am chairman ex officio. We do not have shareholding blocks. There is great ease in obtaining signatures because almost every household in New South Wales and the ACT has an NRMA member. In fact, 85 per cent of households do.

Yet to call an NRMA election—I am talking here of a special meeting; obviously we call annual meetings as a matter of course, and we plan for it—is a process, not an event. Posting out the notices for an annual general meeting requires negotiation between the NRMA and Australia Post. We have to negotiate a timeslot, and they refuse other mailings at the time. It is the fourth largest electorate in the country. The election for our board and the votes for such things as motions at annual general meetings are a process involving a smaller number only than the federal election and the New South Wales and Victorian state elections. There is considerable lead time involved, as you can understand, not just in logistics with Australia Post but internal management activities.

We have been successful in two special general meetings that were called in the last few years. On one occasion, it was called by a member who had been removed from the board 10 years before and had been consistently a candidate for the board but never successful since that time. In another case, the signatures were organised by him. We were successful on both occasions in having the special general meetings—they were called to dismiss board members—adjacent to our annual general meeting. As such, we were able to reduce some of the costs involved in calling the special general meeting. In one case, we had to go to the courts to arrange—otherwise we would have violated the law—a delay in calling the meeting so that it could be held on a day adjacent to the annual general meeting. In another case, we were lucky enough to have it fall within the regular timetable. The result of that is that we

reduced the cost of calling the meeting to about $½ million. Had we failed in that, it would have cost about $1 million per special general meeting.

The legislation now allows for reducing the number of signatures from 200 to 100. It thereby makes it that much easier to call requisitions such as a special general meeting. At the last special general meeting that was called, 560 signatures were procured. Although we had some doubts about the legitimacy of the signatures at the time and have since found that about 25 per cent of them were either forgeries or obtained by deception, clearly, there were more than 200 and would be more than 100 signatures now. We are suggesting that a threshold of one per cent would provide a reasonable measure of the importance of an issue for the general membership.

We are a mutual. We are saying that there is an exception for mutuals here. We are saying that we are different. However, we acknowledge that numerically that may provide too great a differentiation with other companies. Our primary objective is simply to find a balance, given our experience and the minimisation of unjustifiable costs to the company and ultimately to our members.

CHAIR—Thank you very much, Mr Whitlam. You said in your remarks that the draft legislation provides a regulation making power for the minister to deal with this issue. Are you satisfied with that provision?

Mr Whitlam—We are very pleased that that is there.

CHAIR—You really want to reinforce it?

Mr Whitlam—We hope that our submission allows the committee to argue the case to the minister to regulate along the lines we are suggesting.

CHAIR—Are there any other organisations that are similar to yours?

Mr Whitlam—Yes. Although they have not yet had the same difficulties that we have had, the RACV would certainly fall into that category—and the RACQ with the passage of time. We have talked about a threshold of one million members of a mutual. If it were 500,000 members of a mutual, then the RAA of South Australia would qualify, as would the RAC of WA. These are broadly based community organisations which, while companies typically, are mutual companies.

CHAIR—The examples you have given have all been within the automobile industry.

Mr Whitlam—They are all motoring organisations. You asked for examples. They are the only ones that come to mind. The distinguishing feature is that they are broadly based, indeed all pervasive, in a community. They are one member, one vote bodies and mutual companies.

CHAIR—You are not suggesting that the minister should exercise his regulation making power beyond your situation?

Mr Whitlam—No.

CHAIR—To other types of companies or structures?

Mr Whitlam—No.

Ms JULIE BISHOP—In your submission, there was some mention of the anger at the 1997 special meeting when there was a move to have a requirement that a number of the people who signed a specific form attend the special general meeting. Has that idea gone any further? Have you any comment to make on that?

Mr Whitlam—That came from the floor.

Ms JULIE BISHOP—Sure.

Mr Whitlam—There was great anger because, in fact, no-one at the meeting identified himself or herself as a signatory to the meeting that had been called, ostensibly by 560—although, as I said, at least a quarter of these were either forgeries or obtained by deception.

Ms JULIE BISHOP—Presumably they did not turn up.

Mr Whitlam—On going through the attendance list we believe there were a handful of people there who were signatories—none of them falling into the category of the 25 per cent. But the person who delivered the signatures—who described himself, on delivery, as merely a messenger boy, the same person who had procured the 1996 special general meeting, but was not a signatory to the 1997 meeting—took it upon himself to speak to the matter. That was not particularly well received, I might say—as you are suggesting—by the members who had taken the time to come to the meeting.

Ms JULIE BISHOP—Will your suggestion get around the scenario or the experience that you had in 1996 and 1997?

Mr Whitlam—We suggest that it would. Because, if there is a matter of genuine concern, there would be no difficulty, frankly, in getting that number of signatures. The 200 signatures, as it was, and 100 as it now is—given the membership that we enjoy and celebrate, as comparable organisations do, could be rustled up on a Friday night at the bowling club or the RSL, and they do. In 1996 and 1997, that is what happened.

Ms JULIE BISHOP—Yes, but there is still no suggestion that there be an attendance requirement?

Mr Whitlam—No.

Dr SOUTHCOTT—Are there any other mutual companies that you could think of that would be affected by this, other than the motoring organisations?

Mr Whitlam—No, they do not come to mind. There have been, as you appreciate, a number of financial mutuals which have demutualised. Indeed, our financial mutual, the

NRMA Insurance—it has been suggested in the press—may look to demutualise. Were it to do so, clearly our submission would not apply to it. I suppose it would have applied to the AMP, for example, in the past. The difference is that, unlike the motoring organisations that I have described, those financial mutuals—AMP and the like—when they were mutuals, and now as normal stock companies, do not go into every household; you cannot get 100 signatures at the bowling club on a Friday night.

Dr SOUTHCOTT—That is right. In the regulations, what would your definition be of the group that would require one per cent of their membership to call a special general meeting?

Mr Whitlam—I think we have actually given a text in 12. It is referring to a different section, of course, because you have enhanced the bill since its draft.

Dr SOUTHCOTT—Right, okay.

Senator CONROY—I am trying to work out what you said. Was it 1.3 and 1.4 per cent? Is that one per cent of the combined or one per cent of one of the two?

Mr Whitlam—In that they are two separate companies and a meeting would be called for one or the other, or indeed both, that would be 18,000 in one case and 14,000 in another.

Senator CONROY—You do not think that is a bit of an overkill?

Mr Whitlam—I made the point today that all we are trying to do is get a balance. We suggest that that would be appropriate but, clearly, it is a long way from 100 signatures.

When we have an annual general meeting every year and that annual general meeting is itself the process I described, and considering the cost involved in that process, there should be some imposition on those people seeking to have a special general meeting to ensure that it is a matter of genuine concern for a significant group of the membership. I simply assert to you that 100 is a long way from that.

Senator CONROY—What is the average return for one of your ballots? I know they are highly contested. We from other states always look on with some amazement at your electioneering—

Mr Whitlam—In the election, which is not necessarily a comparable event, 12 or 13 per cent of the members voted—or were successful in voting, because sometimes it is a bit complicated. When there was a matter of great interest to them, as there was in 1994-95—before my day—when there was a proposal to demutualise both of the mutuals, I think the statistic is about 80 per cent participation. Clearly, that was a matter of genuine, widespread interest. I am not suggesting that you have to have 80 per cent, but one per cent of the membership who would sign a requisition.

Senator CONROY—In your average election, you get 12 per cent, you said—not 12,000 but 12 per cent—

Mr Whitlam—Twelve per cent of the membership.

Dr SOUTHCOTT—Potentially, in some of the smaller states there is no reason why what has happened in New South Wales could not exist—and it would not be caught by this. As you mentioned in your remarks, Western Australia and South Australia would require a smaller threshold, like 500,000 members.

Mr Whitlam—Indeed, they are smaller. They typically represent about 70 per cent of the motorists in all states and are into 80 per cent of the households. But of course states are different sizes and, although these problems have yet to visit themselves to the extent they have in New South Wales—and that may have something to do with the fact that our twin mutual, NRMA Insurance, is such a large business; it is the largest general insurance company in the country—there is plenty of evidence that the sort of activity that we have seen, and suffered, will come to pass elsewhere if this question is not addressed.

Dr SOUTHCOTT—In terms of your suggestion—one million members—that would presumably cover RACV, NRMA and RACQ but not the other three states?

Mr Whitlam—That is right, and so on; graciously suggesting, for those from other states, that you may wish to consider a threshold that is appropriate.

CHAIR—Thank you very much, Mr Whitlam, for appearing before the committee. We appreciate your information. That concludes the public hearing.

Committee adjourned at 3.35 p.m.