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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Company Law Review Act

WEDNESDAY, 16 JUNE 1999

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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Wednesday, 16 June 1999

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

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

Terms of reference for the inquiry:

To examine whether:

directors of a listed company should be elected by a proportional voting system;
companies should be required by the Corporations Law to report on compliance with environmental regulation;
listed companies should disclose information, which is disclosed to, or required by, foreign exchanges;
companies should be obliged to report any proceedings instituted against the company for any material breach by the company of the Corporations Law, or trade practices law, and, if so, a summary of the alleged breach and the company's positions in relation to it;
an application to register a proprietary company should include a copy of its constitution;*
listed companies must give at least 28 days notice of a general meeting;
listed companies should be required to disclose more information relating to proxy votes;
whether listed companies should be required by law to establish a corporate governance board and an audit committee;
whether the directors and executive officers of a company should be obliged to report to the auditor any suspicion they might have about any fraud or improper conduct involving the company;
whether a director of a listed company should have the power to call a meeting of members;
whether listed companies must specify a place, fax number and electronic address for the purpose of receiving proxy appointments;
whether listed companies' annual reports should include:
(a)discussion of broad policy for determining the nature and amount of emoluments of board members and senior executives of the company; discussion of the relationship between such policy and the company's performance; and
(b)details of the nature and amount of each of the emolument of each director and each of the five named officers of the company receiving the highest emolument.

**This includes consideration of the proposed amendment to Part 2A.2, Section 117 (2)(k) of the*

Law "Applying for registration" namely, that:
(ka)for a company limited by shares or an unlimited company, a statement that the written agreement referred to in subparagraph (k)(i)

i. includes a summary of the rights and conditions attaching to the shares agreed to be taken up;
ii. sets out the total number of persons who have consented to be members and the information referred to in subparagraphs (k)(i) and (k)(ii);
iii. contains a statement that, if a constitution has not been adopted, the Replaceable Rules will apply and that they create a contract between the members the terms of which may alter if the Replaceable Rules change after the company is registered.

WITNESSES

Committee met at 9.08 a.m.

MEADE, Mr Gerard Michael, Chairman, Legislation Review Board

MIFSUD, Mr Richard, Representative, Legislation Review Board

PARKER, Mr Colin William, Director, Accounting and Audit, Australian Society of Certified Practising Accountants; and Representative, Institute of Chartered Accountants in Australia

CHAIR—I declare open this public hearing of the Parliamentary Joint Committee on Corporations and Securities and I welcome all the witnesses who will be appearing before the committee today. The purpose of this hearing is to take evidence on certain matters arising from the Company Law Review Act 1998. This is the second public hearing on this inquiry and the committee expects to conduct further hearings in Sydney and Perth at least, if not in other areas.

The committee has received 85 written submissions which it will consider, along with the evidence it receives during its public hearings, in preparing its report.

The committee prefers to conduct its hearings in public. However, if there are any matters which witnesses wish to discuss with the committee in camera, we will consider any such request. I also remind witnesses that the giving of false or misleading evidence may constitute a contempt of the parliament.

I welcome the representatives of the accounting bodies to today's hearing. Is there anything you wish to add about the capacity in which you appear?

Mr Meade—I am a partner of the accounting firm Deloitte Touche Tohmatsu. I am representing the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, and I am attending in my capacity as Chairman of the accounting bodies' Legislation Review Board.

Mr Parker—Today I am representing both the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia.

Mr Mifsud—I am a Senior Project Director with the Australian Accounting Research Foundation. Today I am representing the Legislation Review Board of the two accounting bodies.

CHAIR—Thank you. The committee has before it your written submission. Are there any corrections or alterations that you would like to make to that submission?

Mr Meade—No.

CHAIR—Do you wish to make an opening statement to the committee?

Mr Meade—Yes, we would.

CHAIR—Please proceed. At the conclusion of your statement, or statements, there will be some questions from the committee.

Mr Meade—Thank you. In general terms, the accounting bodies certainly support the changes to the Corporations Law brought about by the Company Law Review Act 1998. In particular, the Company Law Review Act contains appropriate changes in terms of corporate governance and also changes in terms of increasing the accountability by corporations to stakeholders of companies, largely being shareholders, and other parties interested in the activities of companies.

You have a copy of our written submission. Perhaps we might highlight a couple of areas that we believe are certainly of importance in terms of this hearing. Firstly, in relation to the disclosure of directors' and executives' remuneration, which is covered by section 300A, the accounting bodies are not opposed to the existing disclosure requirements under section 300A. We believe that they are appropriate in terms of providing good corporate governance disclosure and also in terms of accountability to stakeholders. We would point out that there are requirements in existing accounting standards which govern the disclosure of directors' remuneration. They are contained in accounting standard AASB 1017: related party disclosures. There are also disclosures in terms of executives' remuneration contained in AASB 1034: disclosure in financial reports.

In terms of this particular issue, it is important to make sure that disclosure requirements are not duplicated. We understand that the Australian Accounting Standards Board has a project under way to revise the related party disclosure standard to pick up the changes contained in the Company Law Review Act. One point that we would note is that, unfortunately, the wording that ended up being in the Company Law Review Act is probably not as clear as we obviously would have liked. This resulted in the Australian Securities and Investments Commission issuing Practice Note 68. This practice note did contain some quite important interpretative issues on the Company Law Review Act; some examples of the particular items to be included in the determination of directors' and executives' remuneration; and how particular items should be measured. One area which is still causing quite some concern in practice is the measurement of options and shares issued to directors. Another matter which was not clear in the legislation was whether the disclosure requirements apply simply to a company, whereas ASIC is saying that the interpretation and the intention are that the disclosures should cover both a company itself and also the group of companies, that is, consolidated numbers.

The second area that we would like to briefly discuss concerns environmental regulation. This is covered in section 299(1)(f). Whilst the accounting bodies do have some reservations about the particular disclosure requirements contained in the law, the accounting bodies believe that disclosure of environmental matters is certainly worth while and that the requirements contained in the section are a necessary first step in coming to some sort of appropriate disclosure requirement. At this stage it is very hard to assess what effect the law will actually have. I think what we will see is that, when companies report for 30 June 1999 year end, we will have a much better feel then as to whether the existing requirements are appropriate or whether any changes may be required.

One particular concern we do have is in relation to the requirement in the law that a company disclose its performance in terms of applicable environmental regulation. Our view is that the term 'performance' is very hard to define, and it is probably desirable to have some sort of framework in place within which the term 'performance' could be measured. Perhaps a better terminology might be to talk about an entities compliance with environmental regulation. That would be a more straightforward means of assessing how an entity has performed—that is, has it complied with its requirements under relevant environmental regulation.

The next area that we will talk about concerns corporate governance. In particular, there were two matters that were raised. The first was the requirement for listed companies to have a requirement to establish a corporate governance board. At this stage the accounting bodies believe that a strong case has not been mounted to support the establishment or for making a requirement for a corporate governance board to be mandatory for listed companies. We believe that further work would need to be undertaken to justify forcing companies into this particular requirement. At this stage we support the approach adopted in the Australian Stock Exchange listing rules whereby companies are required to disclose details of their corporate governance practices in the annual report.

In terms of audit committees, the accounting bodies support the concept that listed companies should be required to establish audit committees and that this should be best practice for other forms of disclosing entities. This would also bring Australia into line with requirements in major overseas jurisdictions in capital markets where mandatory audit committees are a requirement. In situations for perhaps the smaller listed companies which may run the argument that it may be impractical or inappropriate to establish a separate audit committee, we believe that the board, as a whole, could really undertake the functions that an audit committee would ordinarily perform.

The fourth area that we would like to make specific comment on is the reporting of compliance with environmental regulation. It is the reporting to auditors of suspected breaches of legislation, fraud or suspected other illegal acts which would be required to be reported by directors, executives and staff members of an organisation. The accounting bodies support this particular requirement, and we note that the proposed requirement is consistent with a recommendation that was contained in a document entitled *Audit expectation gap* which was produced by a working party established by the two accounting bodies. The point we would like to emphasise is that, notwithstanding that directors, executives or staff may be required to report suspected breaches to the auditor, that management continues to retain ultimate responsibility for the prevention and detection of these types of irregularities.

The final matter that we wanted to discuss was the requirement in section 323DA in respect of the disclosure of information required by foreign exchanges. The accounting bodies agree with the disclosures contained in this particular section and believe that the requirement to require listed companies to provide information disclosed to foreign exchanges is consistent with the process of international harmonisation of accounting standards. We also believe it is appropriate that Australian shareholders and other people interested in a company's affairs receive the same information that would have been received

in respect of that company by an overseas exchange. They were the particular matters we wanted to bring to the committee's attention.

CHAIR—Thank you, Mr Meade. Do your colleagues have anything to add to that?

Mr Parker—No.

Mr Mifsud—No.

CHAIR—Perhaps as a general principle, where do think the line should be drawn between the black-letter law, the Corporations Law in regard to these issues in particular—and more generally if you want to comment—and issues that are determined by the listing rules of the ASX?

Mr Parker—The government of the day has the responsibility to set broad principles for corporate reporting, Corporations Law, that are applicable to all companies. The ASX, at the end of the day, is only interested in the listed companies. So, by that very market, there is a delineation in the rules between those. I would think as a minimum we have a platform set by the Corporations Law. The ASX should overlay that wall with best practice requirements and the requirements of its own listing rules to make sure that those entities that are listed on the Australian Stock Exchange are providing quality financial reporting that is world's best practice. It is only in that way that Australia will continue to attract foreign listings and the like.

CHAIR—With regard to directors' remuneration, you referred to AASB1017 in relation to section 300A. Could you clarify the interrelationship between the accounting standard and the black-letter law as it currently applies.

Mr Parker—There are two accounting standards that deal with the issue of related parties and executive remuneration: AASB1017 deals with the disclosure of related party relationships; AASB1034, disclosure of financial information, deals with the disclosure, amongst other things, of executive remuneration. The related party standard deals with disclosure of directors' remuneration. Basically, these standards in part apply what was previously in schedule 7 of the Corporations Law, so that has been picked up and put in an accounting standard, AASB1034. Those accounting standards are shortly going to be revised to have an exposure draft out on directors' and executives' remuneration based upon the changes made to the Corporations Law. So what the accounting standard is doing is implementing the requirements of the Corporations Law.

What we are concerned about is that the requirements of the Corporations Law itself might conflict with what the standard setters consider to be an ideal standard. For example, you might use terminology in the Corporations Law that would not be used in the accounting standard. What we would like to see is the boards develop an accounting standard on directors' and executives' remuneration. And if the board feels—the board being the AASB—that there are changes necessary to the Corporations Law, because the boards cannot issue a standard in conflict with the Corporations Law, then the law would be amended so that we do have a top quality accounting standard on this issue.

CHAIR—So the accounting standard requires the disclosure of individual remuneration, or is it still the old provision?

Mr Parker—It is still the old provision.

CHAIR—For bands of remuneration?

Mr Parker—Yes.

CHAIR—So the law now goes further than that?

Mr Parker—Yes, it does. The standard setters want to, if you like, flesh out what the requirements of the law are in an accounting standard.

CHAIR—Our purpose is to review the law as it stands, particularly some of the amendments that were not in the original drafted legislation. What is the view of the accounting bodies with regard to that more stringent requirement for disclosure?

Mr Meade—I think the accounting bodies would certainly support the more stringent requirements. Once again, that is bringing it into line as well with requirements in major overseas jurisdictions, where disclosure is required by an individual director and disclosure is required of the senior executives in an organisation. We would support that. As I mentioned in the opening address, the unfortunate thing is that we need to clarify some of the matters which remain uncertain and unclear as a result of the wording contained in the law as it currently stands. We would certainly hope that those matters would be able to be resolved, certainly when the accounting standards are revised on this particular matter.

Mr Parker—One of the reasons why we support the disclosure of remuneration of individuals is that it is becoming best practice in the major capital markets. Secondly, as far as shareholder accountability is concerned, we believe that shareholders are entitled to know the remuneration of key individuals within the organisation and the policies regarding their remuneration.

CHAIR—You refer to the subjective nature of assessing it an entity's performance with regard to reporting of compliance with environmental regulation. You also indicate that there are other examples of non-financial information that are in a similar vein. Do you ever think it will be possible to develop a non-subjective form of analysis of those non-financial issues?

Mr Meade—I think it will be. Developments are required to establish some sort of a framework within which one can measure the term 'performance', if that is possible. As we said, ideally, the terminology 'compliance with environmental regulation' would be desirable, but in terms of other financial information in the generic sense, it should be possible to provide some sort of meaningful reporting on non-financial information. One of the projects that the accounting body should be undertaking, the AASB, is establishing a framework within which one can determine and assess the adequacy of non-financial information in its generic sense.

Senator GIBSON—The Victorian parliamentary public accounts and estimates committee is currently undertaking an inquiry into environmental reporting. That was one of the recommendations of the accounting bodies to that particular inquiry as well, that it would be desirable to have a framework in place before more prescriptive forms of reporting were to be mandated by parliaments, either the Commonwealth or the state parliaments.

Mr Parker—We believe that the requirements in the directors' report as they exist at the current time are a first step. They did cause a fair bit of uncertainty within the corporate community because they were introduced as a late amendment. While I understand the reasons for the late amendment, the corporate community and the accounting bodies would much prefer these issues to be flagged as part of the due process for developing the Corporations Law. In that way, we can take those ideas and provide comment on what is the most appropriate way forward based upon our expertise. We have said that we might have problems with the word 'performance'. We have seen that ASIC has had to fill the void by providing some guidance. A better approach may have been to have some of these issues fleshed out as the legislation progressed so that everyone knew when the legislation came in precisely what was required.

Getting back to the principle, we think it is important to start talking about environmental issues as part of accountability for entities. This is a first step. There is work being undertaken by the Victorian parliamentary committee, which we think will add significantly to the debate. Accounting standards by themselves do pick up some of the financial implications of environmental accounting. Getting back to one of the things that we championed previously—but we did not have too much success with it—was the requirement to have mandatory management discussion and analysis in the directors' report. We believe that such MD&A type of disclosures would pick up environmental risks as well as other risks. We still linger for the day when MD&A will be a mandatory requirement under the Corporations Law for all companies that have to prepare accounts rather than just as an ASX listing rule requirement.

CHAIR—Do you believe that should be part of the black-letter law?

Mr Parker—The accounting bodies have always believed that to be the case. We understand why the compromise was made with the ASX to require it only of listed companies. As a matter of principle, we believe that it should be a black-letter requirement. We had very little difficulty with the six points that were featured in the earlier simplification legislation.

CHAIR—Given your comments on the environmental aspects that you just made, do you believe it would be better to remove that requirement from the legislation until more accurate measures were available, the sorts of developments that you have referred to?

Mr Parker—No. I think we have to take a step at a point in time. There is not a lot there in terms of precedent to require this type of disclosure. It is getting directors to focus on an issue. Whether or not it is a binding agreement or totally effective, we will have to look at the passage of time. If it is not producing sensible information, then let us have a look at refining it or withdrawing it, but it is a bit too soon to know. As I said, you have to

start somewhere and it seems to us to be a reasonable first step, although we have some problems with the word 'performance'.

Senator CONROY—Has the ASX listed that yet? I know that, for most of last year, it did not get to be listed, but I have been distracted on another issue for the last few months. Has it actually been listed?

Mr Parker—No. The listing rules on management discussion and analysis come into play, I understand, from 1 July this year.

Senator CONROY—Is it going to be one of the requirements under the listing now?

Mr Parker—It talks about management discussion and analysis. Environmental risks would be one of those matters that they would comment on under the best practice guidelines produced by the group of 100. That information would be disclosed.

Ms JULIE BISHOP—On the question of disclosure requirements in relation to directors' and executives' emoluments, I wanted to raise with you the issue of privacy, particularly as it concerns the executives. Their remuneration, terms and conditions are not voted upon by the shareholders; they are set by the board. Do you have any concerns about the extent of the disclosure that this is proposing in the context of the privacy issue?

Mr Meade—In the public arena, and bearing in mind that we are talking about listed public companies, I think it is appropriate. I think it is recognised as being accepted practice in major overseas jurisdictions and I do not see any reason why we should differentiate ourselves. I understand that concerns have been raised by some parties that it may actually force up executive salaries, in that someone will see that someone else has paid a higher salary and therefore they will say that they should be paid the same or more. So there may be some pressure that way.

In terms of accountability, these people are running large listed public companies. They are being paid by those companies and they are having an impact on the earnings and dividends that shareholders derive. I do believe it is appropriate for listed public companies to disclose those details.

Ms JULIE BISHOP—In relation to the executive officers, to what end? You say that it might be used as a comparison to raise salaries, so we are certainly not talking about shaming them into lower salaries then.

Mr Meade—The only thing there—and I think it is a good point in the legislation—is requiring the correlation between the emoluments or remuneration of executives and the company's performance. There has been some criticism in the past that executive salaries may have been increasing at a rate much higher than inflation or whatever else. There is a view that there has been a lack of correlation, and even though companies' profits may have declined, executive salaries have increased at a greater rate than one would have ordinarily expected as being a normal rate. I think that is certainly a positive slant on executives' remuneration.

Ms JULIE BISHOP—I have just one question for Mr Parker. In relation to environmental regulation reporting, either you or Mr Meade said the phrase 'meaningful reporting'. I always find the use of the word 'meaningful' quite meaningless. I wondered where we draw the line in terms of this subjective reporting, as it must necessarily be at this time. We are talking about environmental, not industrial relations, not occupational health and safety. Where does one draw the line?

Mr Parker—You are right to raise those other issues. Environmental reporting can be seen as just a flavour of the month, and there are other types of compliance of legislation that perhaps are equally important to other organisations. Environmental reporting would be more important to a mining company whereas, to a service organisation, those issues that you raised are more important in that context. That is why the accounting bodies have supported management discussion and analysis of the risks that individual entities face and how they have addressed those risks. Those risks are generic to the entity that is facing them. A mining company would naturally enough contain emphasis on environmental matters but also employment activities whereas other types of entities would be placing their risks on the human factors that you identified. To get back to your question, yes, environmental is one risk. There are other risks. Should the legislation address other risks? We would say that the government had the opportunity to address management discussion and analysis and took a route to require that type of generic disclosure only to listed companies.

Ms JULIE BISHOP—If you reversed the position, though, and talked about whether it has complied under relevant legislation, the companies are already required to provide material information. If a company is not complying with environmental regulations or legislation, then it would be required to disclose that under existing requirements.

Mr Parker—Yes, you are right that under the continuous disclosure requirements of the legislation, where the entity breached an environmental legislation that had a material effect on its share price, it would be required to disclose that. Secondly, accounting standards do pick up the effects of non-compliance with environmental legislation in that, if it results in a liability, it will be recorded in the accounts; if it results in some form of contingency, that will also be disclosed in the accounts.

Mr Meade—I might add that that would also be the case for other legislation. If the company had an action in respect of a material health and safety issue that had the potential to have a material adverse effect on the company, once again, that particular matter would have to be disclosed in the company's annual report as a contingent liability or, if an adverse finding had been handed down, the company would be required to book a provision for the amount of the payment required.

Ms JULIE BISHOP—Thank you.

Senator GIBSON—I have a question about the disclosure of remuneration for directors and senior officers of the company. Am I assuming from what you have been saying that you would prefer the law to be written in more general terms and leave the detail to be reviewed from time to time in the accounting standard?

Mr Parker—Yes, we would like to see that route followed but, again, I guess we are a little bit wary of putting the standard setting process under significant pressure from interested parties on this particular issue to the extent that the AASB might not be able to resolve the issue. What we would like the government to do is set a clear direction about what their intention is and leave the level of detail to the board to flesh out rather than perhaps the government setting very specific rules on the issue.

Senator GIBSON—Another issue is the matter of whether a director of a listed company should have the power to call a meeting of members. It would be a relatively rare event, of course, but I would have thought from some of the boards I have been on that there would be a bit of potential for it to be misused. What is wrong with the present arrangement, where 100 members or five per cent of shareholders can call a general meeting anyway?

Mr Meade—Your reference there was to shareholders. It may well be that the directors are aware of issues that the shareholders are not aware of. The director may well be aware of an issue that the director believes is relevant to the body of shareholders, and at present the director would not have the ability to call a meeting in that situation. The change to the law provides an avenue by which that director—once again, providing the director is exercising reasonable skill and care and acting in the interests of the company—would be able to validly call a meeting of shareholders to consider the particular matter.

Mr Parker—We also think that properly empowers the individual director in those circumstances to act in the company's and the shareholders' best interest. Like most things, there is always a dark side, and a director could use that to other ends. We would rather look on the positive side of the proposal.

Senator GIBSON—You say that you support the proportional voting system, whereas others are in favour of a majority rule system. Could you explain your views about that?

Mr Meade—We are not really fussed either way. We have no problems with the concept of the proportional voting system. We are saying that the most important thing is that, if it is going to be included, it should be a replaceable rule. The members, as a body, can then determine whether they believe it is appropriate for their particular company. It is really putting the onus back on the members to determine whether that is what they want to be bound by, because it is a rule that governs the internal operations of the company. The ultimate decision should be made by the shareholders.

Senator GIBSON—It seems to me that one of the problems with the idea of proportional voting is that you are going to get representatives of various groups on the board whereas, as you know, an effective board is only one where they are working together as a complete team to make the entity work. It is not really about representation; it is about making the company work. I am a bit surprised at your agreeing to that idea.

Mr Meade—It is probably not an issue that we have a great deal of major feeling for. We are saying that we support it in principle, but we do not have a very strong view on it.

Senator GIBSON—We have had evidence that the 28-day notice period is inappropriate. Why is it 28 days? You are basically supporting it, aren't you?

Mr Meade—Yes, we are. Our view, certainly in terms of Australian companies, is that there are a number of Australian companies that have substantial overseas shareholders. The matters to be considered can be quite significant. They can be quite complex. Resolutions put to members can be quite detailed. Our view is that, for a listed public company, the decisions to be made are complex and that shareholders, including overseas shareholders, should be given sufficient time to adequately consider matters and then come to a meeting prepared to vote and knowing where they stand. Our view is that 28 days is an appropriate period.

Senator GIBSON—Today, compared with five years ago, everyone is using email or fax. It does not matter where you are, does it?

Mr Meade—No. It certainly helps, and we support the changes contained in the Company Law Review Act in terms of electronic methods of communication. They certainly do assist. But we do not have any major problems with the 28-day notice period.

Mr Mifsud—We do however state in our submission that in certain circumstances where the Australian Securities and Investments Commission considers it appropriate, it may wish to grant either specific or class order relief to those companies which feel that this is an onerous requirement. Notwithstanding that, as a general principle we support the 28 days.

Senator MURRAY—Firstly, my party and I thank you gentlemen and the supporting ladies and gentlemen behind you for the continuing input you provide the parliament. It is very helpful for the advancement of our own knowledge.

Starting with the environmental issue, I think we have all been victims of extremely bad reporting on the question of the amendments made to the bill last time. It was in fact only the environmental amendment which was last minute. Every other amendment had either been signalled by this committee in previous reports or in the minority reports at least three or four months prior to the consideration of the bill. For those people who insist on repeating that all the amendments were last minute, I want to put on record that it was only the environmental amendment which was last minute.

Before asking you questions, I want to say that the chairman, the secretary and I were at a Victorian review of the environmental legislation, at which I was interviewed as the proponent of the amendment—on my interpretation. I made it clear that it was a narrow view that we were taking, not a broad view. Therefore, I want to offer you the opportunity to let us, as a committee, have proposed amendments to ensure that the wording and the narrowness of that view are reflected. The principal purpose was to establish material financial or other risk, not some of the wider aspects that have been considered. The environment falls into that, as does the question of legal proceedings being mandatorily reported. My question to you is: are there any other areas of significant commercial risk which you believe should be mandatorily reported which are not as yet?

Mr Parker—Commercial risk will change as the Australian economy and the world economy change. So if I had a crystal ball and knew which risks would come up in future, I would be a millionaire. We have to address that issue from having a set of generic rules that tackle all the types of risks that an entity would face. Coming back to my earlier comments,

that is why the accounting bodies supported the requirements of general discussion and analysis, as I think it was referred to, in the corporate law simplification. We believe that those generic rules on the risks that the entity face during the period—the trends, what happened to that entity during the period—would address the issues of concern that would come up in the future, the unknown risks; for example, the Asian financial meltdown over the last two years. There is another risk that would have been reported under that particular regime.

Mr Meade—Another example, which is very much a contemporary issue, is the year 2000 problem. We are all aware of that issue. Unfortunately, we are left in a situation where it is up to the ASX to try to make listed companies make disclosure to the ASX on their corporate governance practices. One of the unfortunate situations is that there is nothing in the listing rules which says that that information needs to be disclosed in the annual report. So what has happened is that companies have made disclosure to the ASX, but unfortunately that information is not necessarily made available to shareholders. That is a very large and substantial commercial risk that will exist in the next short while and has the potential to cause major problems and disruptions for a large part of the Australian economy and the world economy. We really have not addressed that in any legislation as such.

Senator MURRAY—Would you suggest any tightening of the general disclosure rules to reinforce the requirement to report on such periodic but really significant commercial happenings, such as Y2K?

Mr Meade—In terms of listed companies, once again we have the general ASX continuous disclosure rules. They are embodied also in the Corporations Law for listed companies and disclosing entities, to disclose any information which they consider would be material to the company's share price. Once again, the unfortunate thing is that that is going to be very, very subjective and what one company may view as having a material effect; another may not.

That is a general requirement that ideally should cover these situations. However, logistically I am not quite sure how we would go about tightening up that rule beyond what it actually is, or, as the ASX has done, to introduce requirements as and when required to cover specific issues as they arise.

As Colin said, the impact of the Asian economic crisis is a classic example. It would have been ideal for listed companies to show the extent to which they had operations in various countries in the South-East Asian region and the degree to which they were exposed to currency movements or significant bad debt write-offs. That would have been another example.

Senator MURRAY—Moving on to the voting system for directors, a general criticism of our directors class, if you want to determine it that way, has been that it is self-perpetuating, it is hierarchical and it is confined rather narrowly. You have a problem really whereby it is the board which recommends their successors or their replacements. It is very difficult to change that environment.

Recommendations such as proportional voting just seek to make it more possible to introduce fresh blood, which may be male or female—a wider variety of talent, if you like—into the directors club. How do you react to that possibility of using the alternative voting system, because I agree that the shareholders have to determine how their constitution should be? How do you react to that proposition?

Mr Parker—Your observation about how some boards work is probably a reasonable proposition and a proportional basis would open up the boards to new blood there. Like most propositions there are some pluses, and Senator Gibson has identified some minuses. It is where on balance you believe that they should go.

Senator MURRAY—Turning to the corporate governance board, the proposition that lies behind that—and as you know, it is established in law in some American states, and maybe elsewhere, I am not sure—is that the existing board structures are riddled with conflicts of interest and having separately elected corporate governance boards enables those conflicts of interest to be separated out.

With simple things like determining the remuneration of directors and senior management, at the moment those directors do not want their remuneration disclosed, which they themselves determine. It is an astonishing proposition. There are other conflicts of interest, such as the appointment of auditors who may reflect on the very ability and operation of the directors.

There is a view that if corporate governance boards were introduced you could diminish the Corporations Law significantly because you would no longer have to have all the mechanisms which are there to try and control people who at the moment have conflicts of interest. Conflicts of interest could be resolved through the corporate governance board. How do you react to that proposition?

Mr Meade—Perhaps I will make a couple of points. One of the disclosures at present under the ASX listing rules is what particular sub-boards, if you like, of the board of directors do exist. One of the conflicts you mentioned was appointment of auditors. Certainly, a large number of listed public companies would at present have an audit committee. That particular committee would ordinarily be delegated authority to review the audit process, both internal and external, and also to consider whether the audit should go out to tender or whatever else and to make a recommendation back to the board. So that is one board which is already in place that would cover that particular requirement. As we have indicated, we certainly support—

Senator MURRAY—Can I interrupt you there? You did say it is a sub-board committee. A corporate governance board is a separately elected body—it is entirely different.

Mr Meade—Right.

Mr Parker—The problem with a separately elected body means that there is the potential for dispute, for gridlock, between the corporate governance board and the board of directors. You have mentioned corporate governance boards being set up in some parts of the state. I must admit I am not familiar with how successful those boards have been, but I just

have this voice inside of me that says that, if you have two boards with different responsibilities, you have the chance of heightening tensions rather than trying to work smoothly. I would much prefer to see improvements made to existing boards to make them more effective and more aware of corporate governance issues, rather than having a separately elected board having responsibility for those issues.

Senator MURRAY—Mr Chairman, I had better stop it there. Perhaps I could just make one remark: if any of you wish to have more material on that, if you want to look at it professionally, I am able to give it to you.

Mr Meade—Thank you.

Senator CONROY—I was interested in the mention you made earlier, and there has been some media comment over the last few months, about the question of whether options should be included. I do not invite you to go and have a look at the debate that took place at the time in the chamber—it was a fairly frustrating debate for all concerned, in a very tight time schedule—but, if you did look at the debate, the intent of the people who were involved in the debate and of the movers of the amendments was to include share options and other attempts to disguise other parts of emoluments, remuneration, call it what you will. I am intrigued as to why people think share options would not be included. I only did one year of accrual accounting, so I am happy to defer to your explanation, but I would have thought that options should be disclosed in the year that they are awarded, or some mention made of them. I do not understand on what basis companies have started to not include their options packages in their remuneration disclosure.

Mr Meade—I will just make a very general comment. In terms of the reasons, what some companies are saying is that it is very difficult to measure the value of the options at points in time. The typical scenario may well be that an option is granted now at an issue price to be determined in two or three years time, and there may be various benchmarks put and attached to the exercise of the option. It may be conditional upon the company achieving certain levels of profitability. It may be conditional upon the company share price exceeding the all ordinaries index by a certain amount. The companies are saying that, in those situations, a normal option does not have those restrictions placed on it and therefore it becomes very hard to measure.

There are certainly various pricing models in the market that could be used to measure options. My personal view is that those models could be used. However, in view of the difficulty involved in measuring—and this is an issue that has been faced in the US and not adequately resolved—the answer is providing the details of the option plan as disclosed in the financial report. People then can make their own assessments. The most important thing is that there is full disclosure in the report of the option and share issue arrangements in place. That should be sufficient for the time being at least.

Senator CONROY—In terms of requirements under the law though, we are talking about a potential liability of the company for payments down the track. I do not understand why people take the view that it is not required. I accept the argument that it should be. I do not understand why people think there is not a requirement right now.

Mr Meade—There is a debate happening within the accounting profession at the current time about whether or not the granting of options is really an expense of the company or is diluting the existing shareholders once those options are turned into shares. That is the accounting issue. The Americans see the option, as I understand it, as expenses. The Financial Accounting Standards Board set a standard that options should be treated as an expense which leads to picketing in Silicon Valley and outside the FASB.

I am not too sure that we would want to see that in relation to the AASB. It is very much an emotional and political issue. We have just had to let our standards setters provide us with guidance on whether it is an expense or just a re-allocation of equity amongst new equity participants. The boards will have a due process associated with that which will give everyone the opportunity to express their views. People's views vary. That is why you are not getting some of those disclosures that you think are required at the current time.

Senator CONROY—I accept the point about expense versus dilution of capital. I accept the point you make about accountants having a debate about it. But I would have thought the law was reasonably clear. Certainly the intent was clear if you read the debate. I am just intrigued that people think they can redefine something to take it outside the scope of what we were trying to achieve when the parliament debated and passed the amendments. I accept the necessity for the board to make various discussions, but I would be very shocked if the board came down with a decision that took something where clearly the intent was for it to be inside the disclosure regime and then said that it did not need to be because they had defined it as something else.

Mr Parker—I think we are just buying the lawyers. If there is a lack of clarity over what parliament intended, then this committee should make explicit what parliament intended, so that those that had some uncertainty around the edges are now clearly informed about what parliament decided.

Senator CONROY—Sure. I know an ASIC note has been circulated to some members to try and clarify some of these areas. We would certainly welcome from your organisations any amendments you felt could tidy up any of the anomalies that have arisen—I do not know whether you have the time or the opportunity—any amendments that you felt would take away some of the more straightforward anomalies that have arisen. This would be an opportunity for the committee to have a look at them and say, 'This would actually help to fix up unintended consequences.' I would have to say that I think share options were an intended consequence but that other unintended consequences have come up. Equally, in terms of the calling of meetings of a director, you indicate that there could be some safeguards. I do not think there was any intention or want for frivolous meetings to be called. The committee would welcome any amendments you could suggest along the lines of clarifying or introducing those safeguards.

Mr Parker—We will accept that challenge.

CHAIR—Any further questions?

Senator COONEY—Just one matter. In the paper it says that directors and executive officers should report suspicions of fraud or improper conduct to the auditors. On the face of

it that is clearly a good thing, but it is also loaded with dangers—the err and share-it dangers. Wouldn't there be some problem then with people informing on each other, which would then cause enmity within the board? I think obligation to report anything is fraught with danger. Have you got any thoughts on that—on how far you would limit it? For instance, somebody could report maliciously or be in a position where they think they ought to report, but that is going to cause great difficulty if they do. They have got to assess the quality of the evidence and there are difficulties with it. Have you got any thoughts about that?

Mr Parker—One, I guess, is that we believe it is important for auditors to be well informed about the entities they audit. An unfortunate fact about the excesses of the 1980s was that directors and senior executives—in a very limited number of circumstances—withheld information from the auditors. Staff that processed certain transactions knew or at least had suspicions about what was going on. A number of these companies continued on for a number of years, and shareholders and creditors lost as a result of that. So the concept of those parties—mentioned in our submission—reporting to the auditor is designed to have a beneficial effect in empowering the auditor by having further access to information and giving those parties an obligation to report their suspicions to the auditor. The auditor, under requirements of the Corporations Law, has then various options to consider: whether or not the matter can be adequately addressed by bringing it to the attention of the directors to resolve, whether or not he should comment in his audit report, or whether or not he should refer that matter to ASIC. So there seems to be plenty of opportunities for the auditor to use his discretion. He is now informed; he has to do something; and he can weigh up the benefits of what he has been told.

Yes, it is quite possible that some of it may be malicious and some of it may be ill-informed, but the auditor being a professional will make a professional judgment as to what course of action to pursue. It is far better to have the auditor informed by placing requirements on the parties mentioned rather than having the auditor not informed, as happened in the past decade. We know that the economy goes in cycles and we will have a series of corporate collapses in the future. We are just trying to learn from some of the lessons of the past.

Senator COONEY—Doesn't it depend very much on the quality of the auditor in those circumstances? Have you got anything to say about that? What you are dealing with is the quality of the information. I suppose it is not only in corporate law but in any law that the information is given by informers and there is always a problem in assessing that information. Your proposition seems to be predicated on the idea that the auditor cannot make a mistake. If the auditor does make a mistake and this information gets around town, it is not good. So is there any sort of criteria by which the auditor himself or herself should be bound?

Mr Mifsud—Can I make a comment on that point? Under section 311 of the Corporations Law as it currently is, the auditor is required to have reasonable grounds to suspect. There is a practice note which was issued by the Australian Securities Commission, as it was—practice note 34—which provides some guidance. It has not been updated as yet to reflect the new wording of the law in section 311, and I believe there is an equivalent provision in the managed investments chapter of the law. Auditors are required to abide by

professional auditing standards. I do not think that auditors, in general, make hasty decisions, and one would expect that an auditor confronted with this sort of situation would exercise his or her professional judgment and report accordingly.

A point that I would like to add is that section 311 and its equivalent in the managed investments area of the law, are only concerned with breaches of the Corporations Law. Here the suggestion concerns breaches of laws generally and also more general acts of fraud and what have you. If the parliament were to consider going down this track, it might be suggested that section 311 perhaps needs to be reworded accordingly in terms of to whom the auditor should be reporting—whether it is appropriate to report only to ASIC and/or to other authorities. But that is obviously a matter for the parliament to consider.

Senator CONROY—Did the bands that previously existed for reporting remuneration, which had the amounts in dollar figures, usually include share options? If there was a share option package, was that disclosed in the band?

Mr Meade—It is probably fair to say that practice did vary. Once again, the issue is really the measurement. I can recall seeing a number of reports where I know for a fact that they were included. I know a number of companies where they were not included, and the footnote disclosure specifically mentioned that options were not included and gave the reasons why, that is, that there were terms and conditions and it was difficult to measure. However, it disclosed quite clearly the terms and conditions of those options. I would have thought that that was the absolute minimum that should be shown in the event that the number is not included. But I think it is fair to say that practice, at present, is varied.

CHAIR—I thank all of you for the evidence you have given to us this morning.

[10.13 a.m.]

WILKIN, Mr John Graham, General Counsel, Corrs Chambers Westgarth

Mr Wilkin—I was invited by Senator Campbell to make a submission on some points raised by the Treasurer last July and did so and will speak to that.

CHAIR—We have your submission, which we have numbered 21, before us. Do you wish to make an opening statement in relation to that submission or, prior to that, any alterations or corrections to the submission?

Mr Wilkin—I have practised in company law for 30 years or so and have acted, in particular, for banks and financiers lending money or extending credit to companies. So I really approach company law reform from the perspective of making it easier to deal with or invest in companies. I have made submissions before to the Attorney-General's Department, some few of which have been accepted into the Corporations Law. Would it assist if I simply spoke to this in the order that it came?

CHAIR—Certainly, if you wish to comment on your submission.

Mr Wilkin—With regard to whether directors should be elected by a proportionate voting system, I go back to thinking that this is Corporations Law for the regulation of corporations, as opposed to people. The regulation of corporations, I think, proceeds on the assumption that it is for the shareholders, to enable people to invest in and not be defrauded by companies. For that reason, I think it is up to the shareholder to choose their own voting system rather than anybody else choosing it.

With regard to whether companies should be required by Corporations Law to report on compliance with environmental regulation, again, I think Corporations Law is for regulation of corporations, as opposed to individuals, and there is no point in requiring them to report on compliance with environmental regulation or any other regulation. If they are complying, they are complying. If they are not complying, no doubt they will be prosecuted. There is no reason that you should report on your compliance with environmental regulation simply because you are a corporation.

I agree with a listed company having to disclose information which is disclosed by foreign exchanges. I think the ASX and probably most law bodies would not agree with it. I agree with it because, according to my recollection, IOSCO, which is the International Organization of Securities Commissions, has been working for 10 years, at least since 1988, on trying to get the rules for prospectuses made the same in different countries so that countries have the same approach to the lodging requirements for prospectuses and issues of shares and whatever. I believe, for that reason, that some uniformity in disclosure is a good thing. I think for some time it has been possible to find, where companies do issue prospectuses for junk bonds or whatever in America, that the American disclosure system is greater than Australia's and that you can get the disclosure from America which is not available in Australia, which is not a particularly adequate system.

The second reason is that if I ring the Commonwealth Bank and pay $29 it will buy shares for me and that it is possible to buy shares on the Internet. You would really want a uniform world disclosure system for that reason. The Commonwealth Bank, when it is going to charge me only $29, is not going to tell me anything about shares—what it knows, whether it is a good buy—or give any advice. I would have to get that from brokers. There is a double system growing up: one of trading electronically in shares and one of getting advice and paying more to brokers. There does not seem to be any reason why the law should not move towards uniform disclosure.

With regard to matters of complaint or concern to the business community, I refer to companies reporting any proceedings for breach of the Corporations Law or trade practices law and 'a summary of the alleged breach and of the company's position in relation to it'. Again, I look at this as regulation of companies. Individuals are not required to report to anybody—the police, for that matter—as to what laws they have broken and what their position is. It is a matter for the courts to assess what the company's position is in relation to what it has been charged with, when it must plead and whether it will be brought to trial.

I endorse as strongly as possible that an application to register a proprietary company should include a copy of its constitution. The difficulty in dealing with companies, extending credit to companies or contracting with companies is that you have to find someone who will be able to bind the company to the contract. I have included in my submission examples of decisions as to why the present law does not seem to be particularly satisfactory.

What sets out who may bind a corporation to a contract is the constitution of the corporation and who may contract on behalf of it. Unless there is some authentic place where you can search and discover the means of appointment of these agents and who may bind the company, you are really starting behind scratch. I think it is essential that this should be done as it has been done for over 100 years, so that you do get a chance to find out authentically who can bind the company. It is not enough to ask the company, obviously.

With regard to listed companies giving at least 28 days notice of a general meeting, I think that outraged everybody, because it was brought in for the current year. I see nothing in favour of the change. I do not know the reasons for the change. With regard to listed companies being required to disclose more information relating to proxy votes, I think what is necessary, again, is that you have a voting system which is fair and which can be checked up on to see that it is fair, rather than have particular rules.

With regard to listed companies being required by law to establish a corporate governance board, I think the board has an obligation to govern itself properly, and appointing a committee to do it would not necessarily solve that problem. With regard to listed companies being required by law to establish an audit committee, I think if you go back to the debacles of the 1980s and the actions against the auditors for billions of dollars, some of which have been successful, and if you look at the mistakes made by the auditors—and some of them are quite appalling; I refer to the National Safety Council, Linter or Tricontinental—you do find that the auditor in a lot of the cases has been overborne by management. The auditor's remuneration and often the remuneration and contracts of his or her firm depend upon the goodwill of the management.

In my experience as a director or a member of a board, the auditor is often anxious not to upset the board or lose the possibility of remuneration or other emoluments for his firm. I think what is necessary is not so much an audit committee, though an audit committee with its own expertise or that is building up its own expertise would be useful, but rather an assurance that the auditor is to be independent of management. That was considered by the working party on registration of auditors which discussed the systems in the other parts of the world, where either the auditor is appointed for a long term or the auditor is separately appointed and the auditor's firm is unable to have any remuneration from the company in the contract. I think the only way to have a sensible report by auditors is to have the auditor independent of the company and not beholden to management.

On whether directors should be obliged to report to the auditor, again, if the auditor is under the control of the management, that would not help much. On the other hand, I think it would be desirable to at least give directors the possibility of absolving themselves from later blame by reporting to somebody, but I think the 'somebody' should be ASIC or some government body rather than the auditor.

On whether a director of a listed company should have the power to call a meeting of members, I think in some cases it may be his duty to call a meeting of members. After all, he is supposed to represent the members. If the members should make a decision, it should be their duty to do it. It may be in the performance of his duty to call a meeting.

On whether a company must specify its fax number and electronic address, I think there is a difficulty with email in relation to authenticity of signatures and who is actually sending it. But, in relation to faxes, that should be no problem and would be useful.

On the issue of listed companies and remuneration of directors, basically, you would like to know what your employee is being paid, I would have thought. If you are supposed to elect them, you would like to know what is in it for them. I also raised the question of the reduction of share capital because I think there are technical difficulties with those provisions. Basically, there is a provision that it is an equal reduction of share capital if you pay the same amount in proportion to the number of shares. In the case of part paid shares or one cent paid shares, that seems to produce an inequitable or unfair result, which would mean that you would have to apply to the court. I will answer any questions you put to me.

CHAIR—We are starting to run a bit behind schedule so, in opening it up for questions, I ask that both the questions and answers be as succinct as possible.

Senator MURRAY—Mr Wilkin, Corrs is a very considerable firm in terms of size. Do you represent here your own views, or do you represent the views of all the partners?

Mr Wilkin—I would not say that I represent all their views, but I represent the firm.

Senator MURRAY—I was interested in your comment about auditors. How do you think companies can make auditors independent?

Mr Wilkin—There are systems suggested in the report of the working committee on the registration of auditors. From recollection, if you appointed an auditor for five years, the

auditor would be more independent than in this situation because he has the job for five years. Another system is that the auditor must change every three years; you cannot have the same firm for all time. Another system is that the auditor's firm cannot have any contracts or get any money out of it, so that it is only the auditor's remuneration. Another system is that which applies to official liquidators, where they are appointed by rotation.

Senator MURRAY—Which is your preferred model?

Mr Wilkin—Probably the last.

Ms JULIE BISHOP—In relation to proportional voting, you commented that it would be your preference that shareholders choose their own voting system. Could proportional voting be an option that they would consider?

Mr Wilkin—Yes, if they wanted it.

Ms JULIE BISHOP—Perhaps you could comment on any of the consequences that have been raised as possibly arising from proportional voting—that is, directors being elected by, and therefore being beholden to, specific interest groups, when their duty is to act in the interests of all the shareholders?

Mr Wilkin—Yes, that is true. If all the shareholders choose that system, that is the case now where you have a company holding a large block of votes in another company and appointing a director. There is a potential conflict of interest between looking after the interests of the company that appointed that director and—

Ms JULIE BISHOP—I am trying to get to the dangers of proportional voting.

Mr Wilkin—Yes, I think there is that.

Ms JULIE BISHOP—Is there the danger of minority interests outweighing majority interests. Could that arise under proportional voting?

CHAIR—Are you suggesting like in the Senate, Ms Bishop?

Ms JULIE BISHOP—That is an interesting analogy! Is there perhaps scope for misuse? The example that has been given is company employees electing a representative to achieve a particular outcome—for industrial relations purposes, for example—rather than for advancing the interests of the company.

Mr Wilkin—I think with the present system you have minority interests though, don't you?

Ms JULIE BISHOP—I am trying to ascertain why proportional voting would not be—

Mr Wilkin—As I said in my submission on that matter, one of the difficulties is that it might take as long to count the votes as it does for the Senate. But in the sense of

representing minorities, you get that danger now. I think it is a matter for the shareholders to choose their own system. There are probably dangers in any system.

Ms JULIE BISHOP—My other question related to your comment about companies having to report proceedings against them for breaches of Corporations Law or trade practices law and 'a summary of the allegations'. This additional reporting requirement beyond what we currently have, and where directors' reports or annual reports contain details of foreshadowed or current court cases, could lead to situations—and I presume this is what you are suggesting when you say that it is absurd—where allegations, however ill-founded or vexatious or even bizarre—and I have seen them all, as no doubt you have, in statements of claims against companies—would have to be disclosed. Yet as we know, statements of claim can be ever-changing feasts of allegations and, from time to time, allegations are struck out or the statements of claim change in their entirety. Is that then one of the problems you see with this additional reporting requirement?

Mr Wilkin—I think the reporting requirement says that the company has to state its attitude—

Ms JULIE BISHOP—To each allegation.

Mr Wilkin—to each allegation. In other words, it has got to put in a defence, a public defence or something like that, which I would regard as absurd. It seems to me contrary to the due administration of justice to require somebody to put their legal defence on the public record.

Ms JULIE BISHOP—Obviously once an allegation has been aired—and it may well have been subsequently struck out by a court—it could have an ongoing impact on share price, investor confidence and the like?

Mr Wilkin—It could have an effect upon the proceedings against it, surely. If it made a breach of trade practices law, then it can have proceedings against it. Depending on where it is, it might have class actions, that type of thing, against it; and its report would be discoverable, I suppose.

Ms JULIE BISHOP—And having stated its position—which, as you say, could be its public defence—that could well be used in evidence against it at a later time, that it had admitted, denied or not admitted something?

Mr Wilkin—That is right. That is one of the difficulties at the moment, that you do not want to report insurance claims because they can be discoverable in later proceedings.

Ms JULIE BISHOP—Your defence counsel would then end up settling your report?

Mr Wilkin—Yes.

Senator GIBSON—Thank you, Mr Wilkin, for your submission and your comments today. Your obvious wide experience with directors and with companies shows through. Thank you for your submission.

Mr Wilkin—Thank you.

Senator COONEY—On the question of proportional representation in relation to the voting, if you leave that to the company, as distinct from putting it into the act, aren't you going to have the majority selecting a method of voting which is going to suit them? In the interests of the smaller shareholders, shouldn't we put it in legislation, because if you leave it to the discretion of the company it is going to end up with the company putting in a system that suits the majority?

Mr Wilkin—I probably think that is what company law is about, that it is government by the majority—something like parliament.

Ms JULIE BISHOP—It is called democracy.

Mr Wilkin—In a way I think they should be protected, but it is basically for the shareholders to choose their method of voting, not for the company to choose, if I can put it that way.

Senator COONEY—I think the idea of the amendment is to try to get everybody to have a say. It obviously does not give the majority to the minority, but it gives the minority a say. The only way you are going to get that in reality, I think, is to have it in the act. That is not an argument that persuades you at all?

Mr Wilkin—There are some things, such as the majority should not oppress the minority, the directors should be honest and diligent and have duties of care and fiduciary duties to the shareholders, that I think are necessary. But the method of voting does not seem to be as important as those things, to me at any rate. I think it could lead to difficulties which may be there now but it would have its own difficulties.

Senator COONEY—The only other issues I wanted to raise were the environmental obligations. Is it your position that you say that it is a useless thing to have, a clumsy thing to have, or rather not the sort of thing that company law ought to deal with in any event?

Mr Wilkin—I think it is not a matter for company law to deal with. If you look at annual reports, you will see companies being good citizens and saying what they do about the environment, and so forth. But I do not see it—myself, at any rate—as a matter that companies should do, any more than a large partnership should.

Senator COONEY—Doesn't the question become: why shouldn't partnerships do it, if corporations are looked upon as citizens?

Mr Wilkin—Indeed, but you would make a law in relation to the environment, rather than making a law in relation to corporations. That is the point that I would make.

Senator COONEY—Given that corporations are very much the dominant sector in economic development, shouldn't company law perhaps shift? This is really an impressionistic question that I am asking you. You are shifting the basis of what it is trying to do, and, rather than simply looking at the economic returns, you also look at the other

duties they might have as a company. Therefore, that should be comfortably put into company law.

Mr Wilkin—You might say that, if you can force it on corporations, then do it, even though that is not a view I share myself. I have forgotten the figures now, but when you have something like 800,000 or 900,000 companies—of which a very small proportion indeed are listed companies—a lot more people are having an effect on the environment than listed companies. If you take the view that it is better to do something than nothing, then this is something, but I do not share that view myself.

Senator COONEY—The only other comment I want to make in that regard is that companies are very much the creation of legislation, whereas perhaps partnerships are not so much, in the sense that there are laws regarding partnerships, and people can act as persons in a joint sort of a way.

Mr Wilkin—Yes.

Senator COONEY—Given that companies depend completely on parliament to give them an underpinning, shouldn't parliament look at the method and conditions by which it creates companies? Environmental laws are part of the parliament's concern. Shouldn't it do something about that?

Mr Wilkin—Subject to the Constitution, it can do something about that. Yes, they are the creatures of parliament, but I regard it as the functioning of the Corporations Law, therefore, and not for imposing environmental views or criminal procedure views about reporting breaches upon corporations.

Senator COONEY—That is an issue that you have clarified. It is not the company being a judge in its own cause, but against its own causes, which is an usual approach.

Mr Wilkin—Yes.

CHAIR—Any further questions? If not, thank you very much for appearing before the committee and for the evidence you have given us this morning.

Proceedings suspended from 10.45 a.m. to 11.05 a.m.

FAST, Mr John Claude, Partner, Arnold Bloch Leibler, Solicitors and Consultants

CHAIR—Welcome. In what capacity do you appear before the committee?

Mr Fast—I am present in my capacity as a member of the firm, and the views which I express here are my own, which I have canvassed with some of my partners, particularly those in the commercial area. I would not mislead the committee by telling you I have canvassed every one of my partners in the litigation or property departments, but I think they generally reflect views that we hold, as a firm that works extensively in this part of the law.

CHAIR—We have before us your submission, which we have numbered as 23. Are there any alterations or additions that you wish to make to the submission we have received?

Mr Fast—I do not wish to make any additions to it, but I would like to make some additional comments on matters which are not specifically dealt with by the submission.

CHAIR—I invite you now to make an opening statement and, in the course of that, you may also make your additional comments before we move to questions.

Mr Fast—Thank you very much. I come to this committee and make submissions as a consequence of some 26 years of practice in this area of the law. We work with it from the inside and advise clients on how one deals with these provisions and what they mean. It seems to me that, when one looks at the matters that are before this committee, the thrust of the matters under consideration suggests that there is not enough information being provided to shareholders, that directors are being overremunerated in some instances, and that current legislation fails to provide adequate mechanisms for information to filter through to shareholders. My approach in terms of the submissions I have made is that I favour transparency, accountability and best practice—and so, as a principle, I favour things that improve the operation of the Corporations Law and that have a practical and useful consequence for shareholders.

Some of the matters that are before the committee at the moment do not, to my way of thinking, assist the corporate process. They do not assist it because, in some instances, they do not provide any additional information that is meaningful to shareholders. In other instances, they do not really tackle some of the problems which I think are identified and which are sought to be remedied by these proposals but which the proposals do not actually get to. These additional matters that I wish to raise with you arise from the matters which are listed for consideration, but there are some practical ways that some of these goals can be achieved without imposing overlays of additional costs and requirements for corporations to comply with.

I am looking at issues 2, 3, 4, 8 and 9 from the list of matters that the committee is dealing with, and they are all what I would call information issues. They are all proposals which, in one way or another, are designed to provide further information for shareholders. These are environmental regulations, disclosure of material before foreign exchanges, proceedings instituted against the company, corporate governance board and audit

committees, and suspicions that directors or executive officers are required to provide to the auditors.

If one wanted to deal with what is actually before us, there are some alternative ways that I would suggest that some of these goals could be achieved. The first one is that the reporting requirements between the Australian Stock Exchange and the Australian Securities and Investment Commission can be strengthened. At the moment, we have a rather loose arrangement, in that there are provisions in the Corporations Law about breaches of the listing rules or the business rules but the mechanism does not necessarily take you anywhere, in a practical sense. There is no automatic requirement for the Stock Exchange to report to ASIC any breaches of the listing rules or of the business rules, in circumstances where the ASX has not granted a waiver from the particular rules; and I think there should be.

That then takes you to, I guess, a second part of the proposal, which is that, once reported to ASIC, if there has been a breach then ASIC should be in a position where they ought to then prosecute the breaches and introduce a regime of penalties for companies. Those regimes do not exist. Instead you have a rather loose arrangement where the court can make an order and it has a range of remedies. They are to be found in sections 777 and 1114 of the Corporations Law where, on application, the court may make certain orders, but it does not seem to me that there is any flow of cause and consequence. Therefore, in a sense, whilst, yes, you are obliged to comply with the ASX's listing rules or the business rules, if you do not then nothing necessarily flows from that nor is there any sort of penalty regime that comes into being.

The reason that that is important is that it then takes you directly to the question of disclosure of material information and of what is material. In a self-regulating sense, where there is a consequence for breaching the rules, it seems to me that there is a greater incentive for people to be careful about how they do or do not comply with the listing rules. If you look at provisions in the Trade Practices Act, some of the penalty provisions are very high. If you look at the Income Tax Act, there are penalty provisions for non-disclosure, inadequate disclosure, et cetera. Many of them are, in a sense, self-regulating but the consequences are there. When you look at these provisions you then see that by strengthening those provisions you can achieve a lot more in the way of meaningful and adequate disclosure and make companies better citizens without introducing an overlay of further reporting.

If I can talk just briefly about the audit and corporate governance committees, I favour the establishment of these boards or committees. On the other hand, it seems to me the proposal does not take you anywhere in terms of what happens once you have established them. What is their function? What do they do? Whom are they answerable to? One of the suggestions that I might put forward is that perhaps the audit committee and the corporate governance committee or the board should either provide its minutes or provide a report to the auditors of the company who should then incorporate in their audit report the deliberations, the functions, how the audit committee has conducted itself or how the corporate governance committee has conducted itself. Again, to me that is an efficient way of using resources because you already have the auditors who are preparing an audit report and it just becomes one additional component of that report.

Some of the proposals, in terms of provision of information—for example, that you have to supply all of the information that you lodge with foreign exchanges—can be quite problematic. I do not know whether it has arisen yet but if anyone has seen the form of reporting that takes place, for example, in the United States, there are a number of problems that you have immediately. Firstly, the form of the reports is different. The terminology and the language are sometimes different. The method of calculation of certain things differs and you have got different accounting years and periods. If you can imagine filing all of that information here and then trying to compare it in a meaningful way to the form of reports that the ASX requires you to lodge, you will find that there will be differences. There will be differences because of the way this information is put together; there will be differences because it will cover different time periods. I am not sure, again if you think through the consequences, what happens when you have two pieces of information lodged which, on the face it, appear to be different from one another? Does it then follow that the company has to then provide explanations of why something is provided in the overseas lodgment notice or the information appears in a different form? How does one reconcile it with the information that appears in the Australian form? I think these are all real practical problems. What it has the potential to do is to create quite a significant overlay of additional costs and additional time that has to be spent in dealing with these issues.

I do not think it is sufficient to say, 'You have to file everything you file overseas.' I do not think that really gets you anywhere unless you then start relating what you are filing with what you are required to file in Australia. If the ASX feels that the form of notices that have to be lodged elsewhere contains information which it would ideally like to have included in Australia, I think it is for the ASX to change its reporting requirements and to require companies to provide that additional information on a best practice basis. I do not think it follows that you should automatically file everything that you file overseas for that reason.

The final issue that I want to address very quickly is the issue of the remuneration of directors and executive officers. In an earlier discussion—and I am not sure whether I understood what was being said correctly, because it was occurring just as I walked in—there was a suggestion that companies were not reporting options. Was it an issue that they were not reporting the value of the options or that they were not reporting the existence of the options?

Senator COONEY—I think it was really about the effect of an option—what it was and wasn't.

Mr Fast—Okay, I asked because there is a statutory requirement to provide a return on options and interest in shares. That is already in existence. The proposal at the moment, it seems to me, only adds one additional component. That is the actual level of remuneration separately from the option and/or potentially the issue of valuation of options, which I think is a pretty vexed issue.

I do not know that providing statements about the salaries of directors or executives is a meaningful measure of anything. Unless you can relate it back to some common basis, a director or an executive who is earning $1 million may be regarded as being highly overremunerated in some instances and highly underremunerated in others. It depends on

how you assess the contribution that a person makes. I think a statement by itself of what a director is earning—apart from being an invasion of their privacy in that sense—does not provide anything meaningful to the debate on whether a shareholder should or should not invest in the company.

Again, as a proposal for consideration, instead of going to the raw numbers, maybe the way that one should look at this is by setting up some form of an index or a matrix where companies are required to report—on a confidential basis—salaries and provide information on an annual basis where they set out the details of the company in terms of earnings, profitability, assets et cetera. A matrix or an index is created and the auditor then reports, in the audit report, on the relativity of salaries and emoluments that are being paid to the directors and/or the executives by reference to the index. You could have an index of top companies. You could have an industry index or you could have some sort of a measure. For example, if you were a company with a market capitalisation of a billion dollars and your earnings were X amount and your price-earnings ratio was so much, you could look at comparably where you stood in the overall spectrum of directors and executives without having to actually disclose, dollar for dollar, what the particular executive or director is being paid. Those are in the nature of fairly broad comments that I want to add to my submission.

CHAIR—Thank you very much. In relation to the issue of reporting in Australia information that is required to be reported overseas, can you give me a practical example of where that would not be appropriate? What is required to be reported, for instance, in the United States? Why do they require a particular piece of information to be reported that is not required to be reported here?

Mr Fast—I would be happy to provide that to you subsequently; I do not have that information but I am happy to provide that. I work a lot in the takeovers area. We were recently involved in the takeover where there were shares issued on NASDAQ. We were required to file information through the US attorneys. I can tell you that the form of the reporting and the material that was lodged was so completely different—putting aside issues of terminology and language—that I am not sure that it would be meaningful in the context of anyone who looked at it in Australia.

The practical one that comes to mind is the issue of relating matters in foreign currencies versus Australian currencies—the issue of how one relates a result in the US dollars versus Australian dollars at a given point in time? What exchange rate does one adopt? How does one deal with different income years or periods for reporting requirements where you may be halfway through a year in Australia and be at the conclusion of a financial year in the United States? They are just pragmatic issues, but I am happy to look at some specific examples and provide those subsequently.

CHAIR—That would be useful.

Ms JULIE BISHOP—Is the United States the best example in that regard? Are there other foreign exchanges where the requests are so vastly different from the requests that we would have? Is the United States the best example or is there a—

Mr Fast—The United States is probably the most common example and perhaps Britain. But it seems to be the fashion these days to have shares listed on NASDAQ more so than elsewhere. I could not profess to tell you what the requirements are in other jurisdictions, although I notice the legislation requires you to lodge irrespective of which jurisdiction you are filing in.

Ms JULIE BISHOP—On that foreign reporting aspect, obviously, behind all of this, there is the sentiment that we are going global, so in terms of globalisation, it would seem to be a step in that direction. But are you saying that essentially different information is being provided to foreign exchanges because they ask for different information—or that it is essentially the same material information but open to interpretation in a number of ways?

Mr Fast—I think it is more of the latter. Essentially, you would be providing similar information or the same information. The way you compile the information may be different. The way you arrive at certain disclosures may be different. But, if you look at an Australian company file and you see that it has filed copies of material disclosed in the United States and the form of that material is different, I guess what I am asking this committee is, 'Where do you go from there?' Is it the intention that you then have a mechanism by which interested parties can start requiring reconciliations between the two, and explanations? That adds yet a further overlay of administrative and other requirements which, at the end of the day, all have a cost. I am not sure that anyone is ultimately completely satisfied with the explanation.

Ms JULIE BISHOP—I also have a question in relation to the corporate governance board proposal and exploring the relationship between the corporate governance board and the main board. You mentioned that potentially the corporate governance board would report to the auditors. Did you envisage that there would be a reporting relationship between the corporate governance board and the main board?

Mr Fast—I think they would report to the auditors as well as the main board—if it is a committee. It depends on how it is structured. I can say this because I am a professional. But one of the problems is that, 20 years ago, it was very common for most reasonably sized public company boards to include their lawyers as non-executive directors. Now, of course, you have related party transaction issues which have resulted, in many instances, in a professional person with a deeper understanding, perhaps, of the legal requirements than some of the other directors—making an economically driven view that it is not in their interest to remain on the board because, by being on the board, you raise the whole spectre of related parties transactions and you do not necessarily want to be deprived of the ability to act for the client or be involved in that discussion.

I suppose some of those skills—if one can refer to them as skills—may no longer be as immediately available to a board, and it is a problem, I think. I think the other problem is that a lot of persons accept directorships without really having a proper understanding of fiduciary obligations and duties, particularly when there are issues of conflict of interests.

Ms JULIE BISHOP—We were talking about the practical consequences of some of these issues. Obviously, the relationship between the corporate governance board and the main board could give rise to conflicts in terms of how the corporate governance board sees

compliance and policy and how the main board sees it, and of course the main board is charged with that duty. Could you comment?

Mr Fast—I think you are right, if I can make that comment. How you solve the problem is a matter which I do not think has yet been addressed by the proposal. When you talk about setting up a corporate governance board or a committee—I call it a committee, you call it a board; I deliberately call it a committee because I think a committee can include persons who are not members of the board, and that may or may not be an advantage depending on how you want to structure that particular committee—you need to work through, as I said at the outset, what the function of this corporate governance board is going to be. If you are going to establish it, who are you establishing it for? Are you establishing it so that shareholders can feel that the company is being conducted properly, or are you establishing it to ensure that the company complies with its legal obligations?

Ms JULIE BISHOP—Is it a watchdog for the shareholders?

Mr Fast—Or is it a watchdog for ASIC? The answer is that it is probably both, but the difficulties are that you need to also work out, 'So what?' It sits, it meets, it makes its recommendations, it forms its views, et cetera, but where does that take you?

Ms JULIE BISHOP—Is it binding on the main board?

Mr Fast—Is it binding? Does it report to anybody? Does anybody actually ever find out what this board or committee does? And, ultimately, if it is a watchdog for shareholders, how do you satisfy shareholders that it has actually performed any functions or been effective? The answer is, 'I don't know,' because I do not think that issue has been fully developed.

Senator MURRAY—Mr Chairman, I wonder if I could just assist the witness and Ms Bishop in this matter. The references committee was very specific and the amendment was specific and has been dealt with already, just so that you understand that in your responses. The amendment said the following: that the corporate governance board would be separate and distinct from the main board; that it would be composed of at least three non-executive directors who could not be directors of the main board; and that the corporate governance board would have specific and limited duties. Those duties would include determining the remuneration of all senior executives and all directors; resolving all matters of conflict of interest, including those such as related party transactions; and the appointment of auditors, valuers and other professional appointments where there could be some conflict with the way in which they operate. In other words, it was specifically in the fields of governance and was not to interfere with the main board provisions. I want to make it clear to you that the references committee is not about a subcommittee of the board; it is about a separate corporate governance operation which separates out the two.

Ms JULIE BISHOP—I am well aware of that and I think it makes it worse.

Senator MURRAY—That does not mean that some of the comments you make and some of the queries you have are not worthy of being developed. I think it is very important

not to confuse the proposition that was put to this committee to explore with the audit committee or the existing form of governance which we all understand.

Mr Fast—I understand that, Senator. If I may respond, I would say this: the issue of a conflict of interest is of itself a matter that begs a certain question. There may be a view amongst some board members that there is a conflict and a view amongst others that there is not. The question then is: how do you determine that issue before you get into the substantive issue of actually making a determination about the subject matter?

What I am really saying is that I am not sure there is a mechanism yet that I have seen which enables you to resolve those difficulties. Whilst I accept what you say as far as the corporate governance board is concerned, I am not sure that it has actually taken us to the realms of how one practically makes it work with the main board in the areas where there is no clear issue.

Senator MURRAY—There are practical examples, but I will defer back to—

Senator CONROY—I am probably drawn more to the arguments which have been put strongly to the committee by a range of shareholder groups, not only the shareholder association but also IFSA—which represents large managed funds that have many shares in many companies—and their arguments to do with good corporate governance leading to good performance. So, while I have been supportive of Senator Murray in this area, I am drawn to it not so much by this watchdog for the shareholders or watchdog by ASIC but by the belief that there is a demonstrable economic argument that good corporate governance leads to better performance for companies. I get a little frustrated when I hear the debate being described as just a watchdog on this or a watchdog on that. I think there are broader economic arguments for it.

Mr Fast—I understand.

Senator CONROY—I accept that many of the points you raised are very constructive in terms of where it goes from here. You have a board: what does it do; how does it practically work? I think there are very constructive questions for the committee to talk about and discuss. Going back to your discussion with Ms Bishop on the disclosure of material, again there were some very constructive points. I will read from the CPA. The second-last presenter's submission talks about the fact that they supported their disclosure questions in terms of harmonisation. Ms Bishop made the point that we are moving towards harmonisation. I have seen a lot of speculation that NASDAQ may actually end up as an affiliate or partner with ASX. I am presuming they would then have to work through some listing requirements that were harmonised.

Mr Fast—I would think so.

Senator CONROY—This change may actually put us ahead of what most people expect. No matter who wins the argument with the ASX, et cetera, at some point there will be some partnership tie-up with some of the international equivalents. This could put us ahead of the game in terms of the fact that you are worried that the material provided is not consistent. I

think that is a very valid point, but that is a valid point that may have to be addressed through market change over the next 12 or 18 months. They suggested:

> For example, the Securities and Exchange Commission of the United States prescribes the filing of additional information, especially in respect of non-financial information, which may or may not be reported to Australian investors. This is because disclosure rules concerning the reporting of this information in Australian company annual reports are very broad and generally do not prescribe the reporting of specific information, such as past share price information, historical financial information, or a description of the business.

That seems to imply that that is the sort of information that is provided in America. You said you have had direct experience on NASDAQ. Is that the sort of information you had to provide to NASDAQ?

Mr Fast—In the context of the takeover rules, it was a little different. It was addressing issues of control and management. If I may just respond to those comments, once you have a process of harmonisation and a process of cooperation between various exchanges, obviously the difficulties of information that is produced in a different form at a different time and in a different language can disappear in whole or in part. So my comments were not addressed specifically to not providing the information but rather to providing information that may appear in a different form, to what happens next and where it leads you. Does it then lead to the ASX being able to issue a whole series of requests for further information and who is going to ultimately pay for the privilege and the cost of time, et cetera. I do not have a problem with providing that information; I have a problem with providing inconsistent information.

Senator CONROY—I am interested in pursuing the question of the remuneration argument. I accept your points about privacy. The US and a number of other international countries already have these provisions. How do they work around the privacy aspects? Can you give us any information about how they address those concerns?

Mr Fast—I do not think they have the same issues of privacy as we do. That is the first comment I would make. I am very drawn to the argument that there is a certain investment by a company in confidential information, particularly as it relates to the remuneration of its key executives. However one wishes to provide information that is meaningful to shareholders, one ought not to do it in circumstances where its consequence may be detrimental to a company where, through a process of disclosure, other potential suitors for executives are placed in a position which they would not otherwise be in. Hence, I come back to the proposition that it is not so much the quantum that is important as the relativity of that quantum to others, and how one assesses them relative to other companies that are either in the same industry or are of the same size—essentially to maintain a certain level of anonymity about those specific amounts.

Senator CONROY—I am interested in your comments but I am not just interested in the dollar level. I am probably drawn to the need of a shareholder, when they are being asked to vote on a rise—and I cannot remember the last time we suggested that they were voting on a decrease—to have full information to be able to make an informed judgment at a meeting where they have to cast a vote, particularly if there is an increase proposed at a time when a company's performance is declining. I am probably not all that interested in the

actual level. I agree about all the arguments to do with this—and there have been, and will be today, some colourful arguments about why there is not a need to disclose this.

In terms of being able to judge performance, the best way to judge an executive's performance, I would have thought, would be to look at the performance of the company. I am interested in your comments not so much about the level—as I would probably agree with you about the actual dollar level, although I do not know how else, and I am interested in your matrix and those sorts of issues—as about the question of how you judge whether an increase is appropriate.

I am probably looking more at the question of whether attempts at an increase in a director's salary are appropriate if the company has had a 20 per cent fall in its profits. There may be a whole range of perfectly valid reasons that may mean that it is not appropriate, but I am sure that a director would be willing to take up that discussion with the shareholders at an annual general meeting to explain why they deserve an increase and that they are performing well at the same time as profits are down. They may be able to take the shareholders through all of those points. But it is about information and transparency, as you talked about before. I am interested in your comments in that area.

Mr Fast—Firstly, let me say that performance is a very hard and subjective issue. A company's performance can be adversely affected because the board has taken the view that it wants to invest a substantial amount in capital and expansion which will affect its short-term profits versus its long-term existence and profitability.

Performance as a measure, I suppose, depends on why you are there as a shareholder: if you are there for the dividends, you might like high dividends and not be terribly interested in capital growth. My own experience suggests that smaller shareholders these days are more drawn to the question of capital share value and the increase in the value of shares, which often can be achieved by sacrificing long-term growth and investment.

I do not have a problem with a director having to justify, in response to a shareholder's question, a proposal for an increase in their remuneration. Equally, one needs to assume—and maybe it is a giant leap of faith—that the boards will, if they are conducting themselves with the proper consideration of their fiduciary obligations, not make recommendations in circumstances which are inappropriate.

I am not naive enough to suggest it does not happen, but if you wanted to look at properly managed companies, and there are many that are very well managed, one has to assume that there is an element of responsibility and there is an element of accountability and that, in circumstances where the company is performing poorly and has a history of poor performance in terms of profitability, dividends and value, there is not going to be an appetite there for huge increases in remuneration. Having said that, I think I read about one in Western Australia in the last two days, but I was referring to certain companies and not necessarily to all of them. So it is a little difficult.

I think it is a matter of striking a balance. I do not have a perfect formula for it but I do not ultimately have a problem, because that is what shareholders' meetings are for, with a director being asked to justify—and indeed justifying—their performance. Maybe the answer

is that your annual report ought to tell you a little bit more about what the directors have done during the year. Rather than say there were 12 meetings and they attended six and were absent at one and did not bother to do anything about the rest of them, maybe the answer is that they actually have to talk a little bit more about what it is that they did, and that ought to be provided as part of the annual report.

Senator GIBSON—In your submission you are quite strongly against the 28 days.

Mr Fast—I just think it is a very long period of time. What happens practically is that the 28 days effectively becomes five weeks. I have been involved in umpteen reconstructions and schemes of arrangement and, yes, you have got to give 21 days notice, but, being ever cautious and allowing for bits and pieces that can arise, you tend to err on the conservative side, and my experience is that more often than not you tack on a number of days to begin with. The difficulty is that some of the information can become quite stale, particularly if there is a long lead time. If you have a very complex scheme of arrangement, the lead time in preparing the documents means that, by the time you have been to court and applied for approval of the court to implement the scheme, a lot of the information can become pretty stale. The longer you stretch it out, the more you run that risk. Also, from a point of view of just function, 28 days is a long period of time. It is a long time for the business of corporations to be at a standstill.

Senator GIBSON—What should it be?

Mr Fast—I think 21 days was probably the right mix. That is just a practical view, based on the fact that in our experience we tend to always err on the side of allowing a few extra days anyway.

Senator MURRAY—The proportional voting recommendation put to this committee was quite specific, and that was that listed companies would be obliged to ask their shareholders whether they want to move to such a system—not that it be imposed on them but that the obligation to ask their shareholders would be put to them. One of the driving influences behind that is not to do with minorities being represented but in fact majorities being represented. There are frequent cases where, say, a shareholder with 30 per cent effectively controls the whole outfit and ends up running the show: the directors are appointed, perpetuating the directors, et cetera. I note that you say that that proposition will not necessarily solve the problem. How do you feel, though, about the proposition that shareholders should perhaps be asked whether they want to go down that route and that they be obliged to ask? The reason I put that to you is that, as you know, many listed companies had been established way back with old constitutions, and they are kind of set in their ways, if you like, and it may be the function of parliament to try and encourage a re-look in that area.

Mr Fast—I am not in favour of changing the system and therefore I suppose I am not in favour of proportional election of directors. Taking on board your comments in connection with large companies, where you can control a company with 30 per cent of the shareholding, BHP was a classic example during the 1980s where I think about 34 per cent would have put you in control. But I suppose that if you have a 34 per cent interest in a company like BHP you also have a huge investment in terms of money that is tied up in

your shareholding. So, whilst the percentage appears low in one sense, it nevertheless represents a huge investment in terms of money that is tied up in your shareholding. Whilst the percentage appears low in the one sense, it represents nevertheless a huge investment on the part of the person who has it.

My problem with proportional representation—or one of the problems I have—is that it only works if you have all your board being elected annually, because the very formula that you put forward only gives you the opportunity to cast the votes if you have a large number of persons seeking re-election. If you had one director standing for re-election, then it would make no difference. It only becomes relevant if you have a large number. It encourages you to have the re-election of your board at least annually or every two years. That is quite a wasteful and debilitating process for a company.

Once you have directors who are elected for a year at a time, you are perhaps not encouraging them but you are putting in place a mind-set which says, 'I should really only worry about pleasing my shareholders for this year, because I have to be re-elected at the end of this year and if I make a decision which is going to be detrimental and affect profitability, and I go ahead and spend a billion dollars on the plant and therefore do not declare a dividend this year, I am just as likely to be voted out as not.'

It has that kind of destabilising effect. If I can say this with respect, it is the same argument that is put forward about extending the terms of parliaments for longer periods so that you can actually see the fruits of whatever it is that you bring into play. It is the same argument on the side of corporations. They are not working on a year to year plan; often the strategic plans are much longer than that. I am troubled by any process which requires directors to stand for re-election on an annual basis, because that requirement is driven by the requirement for proportional voting rather than by the requirement that it is necessarily in the interests of the company for that to happen.

Senator MURRAY—I understand your criticisms, but if we remain with the problem that shareholders are sometimes disadvantaged because those with large shareholdings control the company—that is, the problem that somebody with 30 to 40 per cent effectively has 100 per cent control—do you have a proposal as to how we could deal with that problem? It is a problem.

Mr Fast—No, I do not at the moment.

Senator CONROY—The example you gave of BHP is probably the best argument for supporting all of these amendments. If you were a BHP shareholder, you would probably say that maybe Robert Holmes a Court might not have halved our share price by now.

Mr Fast—I cannot comment for Robert Holmes a Court and that takeover.

Senator MURRAY—Do you think it is inappropriate for the parliament to require listed companies to ask their shareholders whether they want this system? That amendment actually said 'and the two sides of the argument had to be put'. So the side which you put very clearly would be put and the alternative side would be put to address that problem.

Mr Fast—Can I answer that question by asking you a question? Would the shareholders decide this by a majority vote?

Senator MURRAY—It would have to be that way.

Senator GIBSON—Good question.

Mr Fast—If it were by a majority vote, I would not have a problem.

Senator MURRAY—That is fine. I would never agree that it should be any other way.

Ms JULIE BISHOP—Taking the practical consequences of the implementation of some of these proposals, and the one where companies are to report proceedings that have been instituted against them for breaches of the Corporations Law or trade practices and are to provide a summary of the allegations and the company's position, I am trying to think how this reporting would take place in circumstances where a statement of claim in the Federal Court or Supreme Court or wherever had been instituted. Between the time of institution and the time of trial, statements of claim and allegations can change dramatically.

Mr Fast—And the pleadings can change the allegations.

Ms JULIE BISHOP—The pleadings can change. They can be struck out. They can be amended voluntarily. There are all sorts of scenarios. Where does the reporting requirement begin and end? I am asking this rhetorically. Then when the company is required to state the company's position, does that mean it is having to disclose its public defence, because some statutory defences can be a mere denial, or is it meant to be putting its position, which is a non-legal defence position? I raised this with another law firm, Corrs, earlier.

Mr Fast—John Wilkin?

Ms JULIE BISHOP—Yes. I am trying to get a sense of how this would all work in a practical sense and how one would possibly comply.

Mr Fast—I do not think it works. I think it lends itself to potential manipulation of the shares and the market in relation to that company. I do not really see how, in a practical sense, it can work. Putting aside the issue of whether one is entitled to a presumption of innocence before being convicted or, alternatively, before an adverse finding is made in a civil suit—

Ms JULIE BISHOP—And would one be excused for thinking that is often lost in the reporting?

Mr Fast—I think the press has its own wonderful way of searching through court files which are, generally speaking, matters of public record. I have never seen a reluctance on the part of the press to print articles about litigation that has been launched. It seems to inevitably find itself in the public domain.

The problem is that being required to report it does not mean that it adds anything factually to the state of knowledge of shareholders. I do not think one ought to encourage a regime where shareholders may make decisions based purely on the question of whether proceedings have been instituted as opposed to whether they have been resolved and whether or not a company has or has not finally got a matter for which they are liable.

To me, it is one of the many things that you disclose under the disclosure requirements and the listing rules. I suggested earlier that those could be enhanced by tougher provisions; alternatively, if they are not material matters, they ought not to be disclosed. I think that when they become resolved, by whichever way, the company will have an obligation to make a disclosure if they are material.

Ms JULIE BISHOP—It comes down to this requirement for a summary of the allegations. Presumably, you would have to go through it and ascertain what is a material allegation and what is not.

Mr Fast—Correct.

Ms JULIE BISHOP—And what is a material position to put forward and what is not.

Mr Fast—My guess is that the public face of a company would say that it is a frivolous allegation and not material. That would be the most normal response in all these things, irrespective of whether it bore any resemblance to reality.

Ms JULIE BISHOP—I would have been interested in the view of your litigation partners, which, I understand, you did not canvass.

Mr Fast—No, I did not.

Ms JULIE BISHOP—There is probably a reason for that.

Mr Fast—They are in court.

Ms JULIE BISHOP—Fair enough.

Senator MURRAY—And you are running from them.

CHAIR—Are there any further questions?

Senator COONEY—Leading on from that last issue, you raised a fairly important question about lawyers being reluctant or less ready than they used to be to go onto boards because of the related issues. Is that becoming a problem in terms of having companies going to lawyers as a matter of assurance or do you just put that forward as an observation?

Mr Fast—I think it is an observation on issues of corporate governance. If you compare the Corporations Law today with the Companies Act of the 1960s and 1970s—and I am not that old, but I do remember the act from the 1970s—you find that the law has become very complex in the way the courts have interpreted provisions, particularly in relation to directors

duties. If you look at the NRMA case, and what that has done to the question of duties of directors, I do not think that generally a company board would necessarily understand it to its full extent.

The benefit of having that advice in the past may well have been that someone who had that information could impart it to the board fairly quickly at a board meeting. Most prudent companies will take extensive advice anyway, but they will not necessarily have the benefit, whilst they are deliberating on a matter, to have their advisers saying, 'You cannot make that decision,' or 'That issue raises an immediate conflict and you, sir, who are sitting on the board of another company, have a conflict of duty and should excuse yourself from the meeting.' They are quite difficult areas at times to work out.

Senator COONEY—If you do not have lawyers there, you are probably missing out on the instinct that something might be wrong. The lawyer might not necessarily know the precise law, but I would have thought the lawyer would have had an instinct that the board is moving down a wrong path.

Mr Fast—May have an instinct.

Senator COONEY—If the lawyer is not there, it might make the board's task a bit more difficult.

Mr Fast—It makes it just more difficult.

Senator COONEY—Can you see any way out of that?

Mr Fast—I suppose if I suggest you amend the related party provisions, you would regard that as probably a bit extreme, but that would be one practical way of dealing with it. That may raise other issues.

Senator COONEY—You are talking about the high penalties in the Trade Practices Act and the tax act. Should we be looking at that in terms of the Corporations Law? Are the natures of those pieces of legislation different in the sense that the tax act and the Trade Practices Act are regulatory in their thrust, whereas the Corporations Law might be regulatory to some extent but is also a facilitating act?

Mr Fast—It is, but when you talk about listing rules, in particular, you are talking about regulatory provisions. All I was really alluding to was that you have other pieces of legislation which impose penalties. I am specifically concerned at the listing rules because that addresses the issue of disclosure and the continuing disclosure obligations. It just struck me that, when one looked at the provisions in the Corporations Law, there was nothing which said, 'If you breach the listing rules, you are going to be liable for a penalty of X', and so on and so forth. There is power for the court to make that order, but you have to go through a process, and the court has to then exercise discretion to order that. It is a bit different in the way that it is formulated.

Senator COONEY—Right. Firstly, can I ask you about this issue of remuneration, particularly for public companies? Judges, politicians and public servants have their level of

remuneration known because it is public money. With public companies, don't you have a similar sort of problem? You have shareholders who actually own the company and directors comparable to a government. On that basis, shouldn't it be revealed? Secondly, since public companies are set up by public acts of parliament, in the interests of the community overall shouldn't you, as a matter of those two principles, have a regime where the remuneration generally of company directors is open to public scrutiny and declared?

Mr Fast—As to the first proposition, I suppose the difference is that it is much easier to dispose of one's shares in a company than it is to dispose of the judge. I say that with no disrespect intended. I think there is a distinction between a matter of free choice where you can or cannot choose to remain a shareholder in a company versus public officials who are appointed and guaranteed their remuneration in some way or other for their term.

As to the second proposition, I do not see why one class of individuals in the community—be they company directors or executives—should be singled out for a level of disclosure that is not otherwise required of other people in different walks of life. Simply because they are more prominent or visible is not, in my view, a sufficient justification. I think the issue of privacy is something that is fairly important to me as an individual. I think you can achieve the outcomes that you are seeking—that is to say, measuring whether the levels are too high or too low—by a process which still preserves a certain level of anonymity for those persons. That to me is a preferable way of going. It is just a subjective view.

Senator COONEY—The seemingly, in any event, high level of remuneration of some executives is in contrast to, say, much lower paid people. There seems to be an issue, I suppose, of community fairness. Isn't the community entitled to have the information to judge whether it is an issue of community fairness and whether that fairness has been violated in some way? If you accept what is reported, the salaries are very high.

Mr Fast—They can be very high, but I think the requirements, the pressures and the things that these people have to provide are often also very high and the responsibilities are pretty onerous. I am not sure that I would agree with your proposition, Senator. I guess my view is that there are a lot of people in the community, not just company directors or executives, who earn substantial amounts of money. There are people in private companies. There are people in partnerships. There are people in owner-run businesses.

Senator COONEY—Like sports?

Mr Fast—Sports are another example. Again, I am not sure why it is that, because we have a body of legislation which governs what is essentially the conduct of companies, that takes us then on an excursus to publishing and disclosing the remuneration of the people who work in those companies. I am just not sure that there is necessarily a causal link between the two.

CHAIR—There being no further questions, thank you very much, Mr Fast, for your evidence before the committee today.

[12.02 p.m.]

RENTON, Mr Nick (Private capacity)

CHAIR—Welcome, Mr Renton. In what capacity you are appearing before the committee today?

Mr Renton—I am appearing in a private capacity, but I am a shareholder in a number of companies. By profession, I am an actuary. I have been interested in shareholders' rights for many years. In 1960 I was responsible for founding the Australian Shareholders Association. I have also been involved in the institutional side of investments for two life offices in the course of my business career. I am currently a non-executive director of a financial institution with about a billion dollars in assets. For 11 years I was executive director of the Life Insurance Federation. In that capacity, I represented institutional investors.

With regard to the subject matter of the terms of reference, I have written about 30 books and some of them relate to the business you are interested in. Election methods are discussed in *Guide for meetings and organisations* which was published in 1961 and is now in its sixth edition. Some of the other corporate governance issues are in a book called *Company directors: masters or servants?,* which was published in 1994.

CHAIR—We have before us your submission which we have numbered 58. Are there any alternations or additions you want to make to that specific submission?

Mr Renton—I would like to briefly bring it up to date and also perhaps comment on some things I heard this morning.

CHAIR—Yes. Perhaps in your opening statement to us you can incorporate all of those comments together and then we will proceed to questions.

Mr Renton—I suppose my first reaction when I saw the terms of reference was surprise at some of the questions that were asked. When you are dealing with electronic submissions of proxies and the like, one of the questions asked was, 'Should there be a statutory requirement for the address for the electronic communication to be sent to to be included in the legislation?' I would have thought that was so axiomatic if you are going to have it that I was startled by it.

Another one that surprised me was one that got mentioned this morning—that is, the filing of information as disclosed to overseas stock exchanges. Again, once it is disclosed to any stock exchange in the world it becomes a matter of public record anyway and therefore to file it in Australia seems to be very little additional effort and it at least provides a formal mechanism for it to come to the notice of Australian shareholders by the front door instead of having to rely on backdoor means of the information flowing back to Australia.

One of the questions that I have addressed in the submission is the disclosure of litigation in annual reports. There was one interesting case study that came to my notice in the press reports of 3 June this year—just a few days ago—when a case was reported that was launched by Macquarie Bank to suppress the existence of an Internet site to discuss the

court case, and that seems to raise three issues of disclosure which were not thought of when I wrote the submission. One is if a company does not believe in free speech: shareholders might like to know about this company philosophy. If the accusation, as it was in that case, is that the company was engaging in delaying tactics as part of a deliberate litigation strategy, that is something I think shareholders should be entitled to know. I suppose there is also a public relations implication in that case that the lessons of McLibel have not been learnt. The best way to keep something secret is not to go to court and publicise it. I was not aware of that Internet site until I saw the attempt to suppress it. It seems to be backfiring.

Mr Chairman, can I just comment on the issue that seems to have got the most media attention, and that is the remuneration disclosure requirement. It may surprise you that somebody who is interested in shareholder rights should perhaps take the opposite view to some of the shareholder bodies that have spoken to you. I guess my starting point is that I do not like misleading information. I think it is better to have no information than to have misleading information. In fact, there are other parts of the statute where directors get punished for publishing misleading information, and here we have a statute which, I suggest, does require misleading information to be published. I am talking about both the older fifth schedule of the corporate regulations and the act that is the subject of your specific reference.

It tends to be misleading because it only gives one side of the equation. You can report how many dollars a director or an executive gets, but you do not get any measurement of what he is providing in value for that remuneration. Therefore, it can be utterly misleading. It may also be, in a proportionate sense, quite meaningless. If BHP spends $2 billion buying a copper asset in South America which is grossly overpriced, that $2 billion lost to the shareholders means that an extra $100,000 more or less to the directors is quite proportionately unimportant.

The effort that a director may put into his directorial duties has no direct correlation to the profits of any particular year or to the dividends of that year or to the market price which the stock exchange investors put on it. Share prices, even less than profit figures, as a measure of performance are very inadequate, because they are subject to booms and busts of investor psychology. Therefore, people's shares can go up in value not because the directors have been brilliant but because the herd goes mad, or vice versa. A director can work very hard in trying to overcome some unforeseen events such as the Asian meltdown, some adverse government legislation, some tax changes, or things like that, which have really nothing to do with the skills of the directors. But a performance indicator may suggest that options get triggered off and all that sort of thing. It worries me with options, in particular, that you can have the phenomenon that an option can go up very much in value proportionately, particularly if it was issued for zero. The market price of the shares can go up, perhaps because the market booms, and the particular company's shares may have only gone up 10 per cent when the market as a whole has gone up 20 per cent, and yet that means a fortune in the form of options.

There was a question asked this morning about whether issuing options to employees is of a revenue nature or of a capital nature. I think there is little doubt that it ought to be of a revenue nature for reporting purposes. You can see that very clearly by looking at the other side of the coin: how does the employee who receives the options think he has got off? If he

has $1 million worth of options given to him, that has the same effect as if he has had a cheque for $1 million. He would regard it as a revenue item in his mind. Seeing that we have a zero sum game means it is also revenue in terms of the company accounts. It ought to be reported to the profit and loss account, although, of course, it is not under the present accounting regime.

I think the small shareholders who get very excited about the disclosure of remuneration are not focusing on what company accounts are meant to do, which is to help investors make up their minds whether to buy shares or sell shares or hold on to shares. Information which is unrelated to that perhaps ought to be kept out of the annual report. That also applies to the things you were talking about this morning—about environmental issues. They are not investor type issues, not shareholder type issues. If the community wants reporting on environmental issues, then that ought to apply to the community as a whole—partnerships and unlisted companies equally with listed ones, as somebody suggested, in line with an environmental regime rather than a corporations regime. Certainly, disclosure for remuneration is unrelated to customer needs too, if it comes to that. People who decide to bank with Westpac do not really care what Mr Joss takes home. They are more interested in the service they get or the interest rate they pay or the fees they pay and that sort of thing.

I want to turn to several aspects of voting which I have not mentioned in the paper. It was suggested this morning that perhaps the voting method should be done by replaceable rule rather than by the statute. That still leaves the necessity to put a default mechanism in the legislation so that, even having it as a replaceable rule, it shifts the ground, but it still means that parliament has to put some default mechanism in place. I would suggest that the proportional representation is the better default mechanism, if you are going to go that route. If you leave it to the board—the incumbent board for an existing company or the founders of a company that is to be floated—then obviously in a practical sense the shareholders are not going to get a chance to vote on it. With a new company, of course, they may or may not subscribe if they do not like what the constitution says but, in a meaningful sense, they cannot really influence it, even if it is a replaceable rule.

The present method that is commonly adopted of voting effectively by resolution is particularly undemocratic. You can have the situation of six vacancies and eight candidates. If there are separate resolutions for each, you can get to the stage where the first six who get voted on get their 50 per cent, plus one vote majority and get elected. The chairman of the meeting after the sixth resolution says, ‘Under the rules we cannot make any more appointments and, therefore, the next two resolutions will not be put.’ That does not seem to me a very sensible voting system.

The advantage of proportional representation is that it does allow the minorities to get there as a matter of right. It certainly follows, as was said earlier, that you need to have a quota which is reasonable and, therefore, you have to have a reasonably large number of directors standing for election at any one time. It does not automatically have to be an annual election. You could still have a three-yearly election for the whole board. That has some other disadvantages in terms of lack of continuity, but I think it is important, if you are going to have proportional representation, to have at least five, and preferably slightly more, directors so that your quota is not astronomically large.

There is a variation to proportional representation which I think is the subject of some submissions to your committee. That is called cumulative voting, which is quite popular in some American companies. I describe it as an unrefined form of proportional representation. It tries to do the same thing, although the quota is slightly different. The quota is effectively one divided by the number of vacancies instead of one divided by one more than the number of vacancies. But it suffers from the defect, in comparison with true proportional representation, of not having a transferable vote mechanism for the excess of the quota, which I think is an advantage of PR. It does not have the preferential marking, which I think is also a useful function of proportional representation. PR does have one third advantage, of course, in that the community is reasonably familiar with it because of its use in the Senate and in some other parliaments of this country. Mr Chairman, I think that is all I need to say by way of opening.

CHAIR—Thank you very much, Mr Renton. Can I, not being an accountant, ask one technical question? You indicated that, in your view, options should be regarded as a revenue measure rather than a capital measure because, in the hands of the recipient, you thought they would be a revenue measure. Wouldn't options, which one assumes will lead to the purchase of shares, be regarded as capital? Certainly the dividends that might then flow from the shares would be regarded as revenue by the recipient, but wouldn't the options and the shares be regarded as a capital item?

Mr Renton—I think I perhaps was oversimplifying it. Let me go back one step. Before we get to the options, can I take a simpler case and that is shares issued at less than the market value? If you have a share with a market value of $2 and the employee, as part of a deal, gets them issued at $1.50, then the 50c is effectively a present to the recipient. The $1.50 is not. The $1.50 he has bought, but the 50c is a present. Sure, in the company's accounts, you should in logic keep the 50c as part of the capital account on one side of the balance sheet, but you should also regard it as an outgo in the same way as 50c worth of salary would be.

Yes, there is a capital component as well. It is desirable, I think, that it should be shown in the revenue accounts of the company because it affects the year's profit in which the award is made. Of course, by not treating it as an expense, there are also taxation implications. The company is not getting a tax deduction which it would get if in fact it had paid salaries. I am really advocating something which is the equivalent of paying the person a salary and using that salary to acquire the asset.

I think there is a lot of misunderstanding about what an option is worth. There seems to be the popular impression amongst many boards of directors and perhaps many shareholders that if the exercise price is equal to the market price, the option has a zero value. That is not true, because there is a leverage element to it, and an option, even with an exercise price of the current market value, if it were a listed security, would probably have a market price of perhaps 20 per cent or thereabouts of the face value of the option. I am talking of one option that has got five years to go. If an option has got weeks to run, then, of course, its value is much more obvious, being the difference between the market price and the exercise price.

It is true, as was said this morning, that if you have some complicated options in terms of performance hurdles—for example, that the company profit must be a certain figure by a

certain date or that the share price must be a certain figure—it becomes a more difficult animal to value. We have lots of assets on the balance sheet which are not easily valued. The fact that they are not easy to value does not excuse the directors from putting a value on them when they are doing up the assets and liabilities of a balance sheet. We have to make a bona fide reasonable approximation. We can do that in terms of an option equally. It may be a very large value even if, as I say, the exercise price is at or even above the current market price. To pretend for disclosure purposes that it has no value because it is difficult to value is an accounting nonsense.

CHAIR—In relation to proportional representation voting for members of the board, from what you have told us, my understanding is you support the very strict form of voting that is used for the Senate, whereas, as I understand the legislation, what it provides is that the number of vacancies to be filled is multiplied by the number of shares a person holds. For instance, if there are five board positions to be filled and a person owns 100 shares, they get 500 votes. They could plump all of those votes for one candidate and ignore the other four positions. That is different from what you are proposing.

Mr Renton—That is a system in America which is usually referred to as cumulative voting.

CHAIR—Right.

Mr Renton—It is a system for which a case can be made. I do not think it is a bad system. I just think it is not as good.

CHAIR—You prefer a quota preferential structure.

Mr Renton—That is right. If somebody chooses to put all the votes for one candidate, the effect is much the same as voting preference one.

Senator CONROY—You might have heard me earlier refer to colourful descriptions of some of the debates. I was probably referring to some of your articles as colourful. In the remuneration article that you wrote for *Chartac Accountancy News*, I was probably disappointed in some of your comments:

Rather, the intention seems to be that the compulsory disclosure of individual emoluments would force remuneration packages down.

You seem to impute motives—

Mr Renton—What is the word there?

Senator CONROY—Individual emoluments would force remuneration packages down. You go on to say:

This simplistic approach by those who do not like the status quo appears naive in the extreme.

As one of the people who debated it in the parliament—and I know Senator Murray also debated it in the parliament—I probably felt it a little unfair to impute a motive that what we

were about was trying to force salaries down. I do not think that, if you have listened to discussion this morning, which I know you have, or looked at the *Hansard* at any stage during the debate, you could have suggested that what either the Democrats or the Labor Party were about was trying to force executive salaries down. One of the arguments made by the company directors is that this will in actual fact bid salaries up. Have you had a chance to reflect on that since you wrote this article?

Mr Renton—When I penned that sentence, I was not thinking of the debate in parliament at all. I probably was not conscious of those specific things. But I do know from talking to shareholders at annual meetings and on social occasions that the feeling amongst many shareholders—quite apart from feelings that might be amongst employees—is that executive salaries are far too high. I may be reading people's minds incorrectly but the impression I get is that people think that if their companies have to disclose these remunerations then people will be so ashamed of drawing large packets that they will voluntarily take reductions. I just do not think the market works that way.

Senator CONROY—I will have to agree with you. You go on to make some of those points, perhaps a little unfairly. Perhaps I can quote from your statements:

> With the average age of individual shareholders being relatively high and with many retired persons now owning shares, their mental picture of appropriate salary levels probably refers to a relatively distant past period and ignores both recent inflation and market changes.

I think you are perhaps reflecting maybe a little unfairly on some shareholders. My dad owns a share in AMP by accident because he had a policy in it. He does tend to share some of the views you ascribe but I am not sure that he has reached the stage where he is not able to exercise any significant judgment on the state of the market, inflation and those things.

Mr Renton—I weep when I see the ignorance of shareholders in so many ways. You can see it even when they happily subscribe for shares under some rights issue where the issue price is above the current market value. They do idiotic things of that sort. When they come to ask questions at meetings, it is quite obvious that most of them have not the

faintest notions of economics, accountancy, corporate law or anything of that sort.

Whenever the stock exchange takes a survey of investor knowledge and investor attitudes, half the people who own shares—not half the people at random, but half the people who are active investors—do not understand dividend imputation or capital gains tax, which are very important if they are going to make sensible investment decisions. So to turn an annual meeting, as I said in that article, into a remuneration tribunal would be the height of absurdity because the people having the voting power really have no feel for what salary levels have to be.

Senator CONROY—I would probably take issue with you on one point. The organisations that have made representations to us here, including bodies like IFSA, which is a conglomeration of others, do not represent anything like the shareholders you are referring to, yet they have probably been the strongest advocates. They represent people who are well versed in all the issues you have just suggested that shareholders should be well versed in, and they have a very strong position. I am sure you are well aware of the old Australian

Investment Managers Association blue book, and these are the sorts of issues that that association canvassed for many years in the desire to have better information on these issues so that they could make an informed judgment. So it is not just that there is the mum and dad shareholder perhaps represented by the Shareholders Association—and I think if you looked at their submission you would be reasonably pleased with it even today. Certainly, the sorts of organisations that have made very strong representations to us have not been in the categories you describe in your articles.

Mr Renton—I think there is some validity to what you say, but I do have to remind you of the conflict of interest that arises. Executives of financial institutions are also part of the remuneration market and therefore the AMP executives—just taking AMP as a proxy for all institutions—have a vested interest in having BHP executives being highly paid because it becomes a precedent for their own salaries.

Senator CONROY—I think there is some argument about collective investments and whether or not people should be forced to disclose in those as well. I am happy to extend the argument into that area if that addresses your concern.

Mr Renton—I think we have covered it. I remind you that IFSA members are the same mums and dads if they are policyholders in a life office or contributors in a superannuation fund. So it is really only individuals who own assets. Corporations are just an intermediate step in the process.

Senator CONROY—My final comment to you, just to amend your final comment, is that logic and not emotion should govern debate about corporate law reform.

Mr Renton—Thank you.

Ms JULIE BISHOP—Mr Renton, in relation to the requirement to file information that has been filed on foreign exchanges, can we take it that you do not think that the continuous disclosure regime under the listing rules covers this sort of situation? My concern is with the practical consequences of this requirement, firstly, in relation to the point that Mr Fast raised that the information is being, for want of a better phrase, differently formatted because the request from, say, NASDAQ is different from that which we would require here. Does that cause confusion? Does that put an obligation on the company to then explain why it has presented its information in this way to NASDAQ and why the information is presented in this way in Australia? What are the consequences of that? Secondly, there is the suggestion as to whether the materiality threshold, or test, is met. If information that has been required to be disclosed overseas does not meet the material information test here, does it still have to be disclosed? What are the consequences of that?

Mr Renton—You have raised about six different issues in your question.

Ms JULIE BISHOP—I tried to make it two.

Mr Renton—It is perfectly true that the formatting of information is very different over there. I am a shareholder in a number of American companies and some of the documentation is staggering in its volume. I have had about 800 pages of printed material

accompanying a notice of meeting. Yes, their language is different, their rules are different and you may have a different accounting period. All the things that John Fast said are perfectly true. But you do not avoid that problem by pretending the document does not exist, because the document is filed in New York and the media get hold of it, it is on the Internet and so on. It is in the public domain anyway.

If the company finds a need to explain it, then it is free to do so. But there would not be a requirement to do so. I think you are probably technically correct. I am not a lawyer but I think, technically, the continuous disclosure regime would require the filing in Australia of an American prospectus or document of that sort. So, perhaps the existing regime covers it anyway.

Ms JULIE BISHOP—That was my proposition.

Senator COONEY—In the light of your vast experience, not only in this area but, more generally, about people, specifically shareholders, you say that the shareholders are not going to be particularly interested in the level of remuneration or environmental and industrial laws. But why shouldn't they have the opportunity of knowing all these things and voting as shareholders on industrial or environment grounds rather than on economic grounds? Shouldn't the whole thing be in the hands of the shareholders? The human heart can do all sorts of things. Why shouldn't all this information be available to allow the shareholder to make his or her mistakes if he or she wants to? 'Does' might be a better word to use than 'wants to'.

Mr Renton—I think my worry is not that information is disclosed but that misleading information is disclosed. Therefore, if you only tell half of the story, you can do more damage than if you tell no story at all. That is what worries me. As I said, I do not think shareholder meetings are appropriate remuneration tribunals. Once the question is before the meeting, you may get the meeting bogged down, as you do already, with arguments about remuneration. So, instead of focusing on the company as a whole, they tend to focus on one minor aspect which does not really advance the cause of the economic system.

Senator COONEY—I am just trying to tease out the principle. Do we say that the only thing that shareholders are entitled to be interested in is the economic wellbeing of the company or can the shareholders have other interests?

Mr Renton—I do not want to put it as black and white as that, and if that is what I said, it does not—

Senator COONEY—I am just trying to tease out a principle.

Mr Renton—I said earlier in my comments that information ought to be there for shareholders to make decisions whether to buy and sell shares or to hold them—that sort of thing. That, of course, is not the whole story. I think they are entitled to also have sufficient information to know whether to vote a particular way at an annual meeting and whom to elect and all that sort of thing. There are corporate governance disclosure issues and I think you could put all the things you have mentioned into that category. They are entitled to vote

for a board that believes in environmental things or not, as the case may be. To that extent, I think they are all legitimate issues.

But we also have the other practical issue. I mentioned the American documents that are 800 pages. Some of our annual reports and prospectuses are getting to be 112 pages and whatnot. This tends to then be counterproductive because the average shareholder is not going to wade through that. He has not the time, even if he has the knowledge. If he has investments in a number of companies, as he ought to have for spread reasons—and they all report in roughly the same time of the year because they all balance on 30 June—that is an awful lot of reading he has to do in a very short time.

Senator CONROY—Twenty-eight days.

Mr Renton—Whether it is 28 or 21, when you are dealing with people who have full-time jobs and families and so on, they have other things to do than wade through those documents. By making them that comprehensive, we are probably defeating the object of parliament of informing shareholders because they then take the view, 'This is far too hard.' Of course, these days, they have the option—and very sensibly, in terms of preserving trees—of not getting an annual report if they are not going to read it anyway.

Senator COONEY—What about an annual report with an executive summary, so it gives them that discretion?

Mr Renton—I think we are now heading in the direction where companies are producing these summaries and giving shareholders the option of taking a shortened version. I think that is very healthy, as long as the full version is available on request. The practical realities for most investors and for most mum and dad type investors is that they get somebody's advice, whether it is that of a stockbroker, a financial adviser or the bloke who delivers the milk.

Senator COONEY—The other question I am interested in is: what legitimate interest in a public company has the public got as distinct from the shareholders? What would lead on from that is the public demand for information about the remuneration of executives and the other matters we talked about—environment, industrial relations and things like that—given that it is a public company, there is an act of parliament and so on.

Mr Renton—I think I am very sympathetic to the philosophy behind your question. I think the privilege of listing is a privilege conferred by the community. It is a bit like the limited wavelengths we have for television broadcasting. The fact that some station proprietor has been given a licence means that he has a duty to the community. The fact that a company is listed means that it enjoys a privilege from the community of having that market. Even if it is by private sector stock exchange as distinct from a government department, I think it is still a privilege which the community collectively, through enabling legislation, has conferred on a monopoly or quasi-monopoly situation. To that extent, I think there is a duty on listed companies to have a higher ethical standard of performance than unlisted companies or private partnerships. Whether you need to do that through the Corporations Law or whether you do that through specific legislation dealing with specific

heads of power is perhaps much more debatable. I guess I would prefer not to see the Corporations Law cluttered up with non-corporations type issues.

CHAIR—Are there any further questions?

Senator MURRAY—I want to return to the issue of the companies having to report proceedings against them for breaches of Corporations Law or trade practices law. That recommendation in the 1996 corporations and securities majority report was not taken up by government but was then taken up by the Senate and referred to this committee. You would have heard an earlier witness say that he thought one of the weaknesses with it was in advising an auditor that the auditor may not or will not be independent, because they are appointed by the very board which may have their interests affected by this kind of thing. I just wondered, in view of your experience and the range of your interests, what views you have on how to make auditors independent and whether you have a particular mechanism whereby they could be taken out of the group of those very board directors whose interests are affected by a detrimental report.

Mr Renton—I think it is a very important question that you have raised there. I quite like the recommendation that the earlier witness gave of just appointing them by rotation. That takes away the influence of the board. I think it is desirable to have the auditors there for a reasonable period so as to get a bit of experience. Therefore, I would like to see them there for three, four or five years at a time but, after that, I would like to see somebody else step in who is appointed by some mechanism other than the board inviting them in. You have a complication these days, of course, because of the tendering on a fee basis. You have another superimposed issue. The other thing that worries me is auditors who do lots of other things for the company apart from auditing, whether it is giving taxation advice, maintaining a share registry, designing a computer system or things like that.

Senator CONROY—The blue book recommends around issues like that.

Mr Renton—I think auditors should not do anything other than auditing so that they have no even subconscious bias in favour of giving nice reports so they will get reappointed and so they will get other business.

Senator MURRAY—Who provides the list of auditors for the company to select from by rotation? Would ASIC do it on an accredited basis? Where does that rotational list come from?

Mr Renton—The precedent that was quoted to you this morning is probably as good as any that I can think of off the cuff—namely, that we have a mechanism for liquidators that get registered. I guess ASIC or some other body could register those auditing firms that are willing to do it and perhaps categorise them because, if you are a very large company, you should not be audited by a local suburban one-man practice. You may need to have different categories of auditors for different categories of companies. It is not only size but specialisation; some auditors may be better at auditing a mining company than others and that sort of thing. I do not think I have any very strong feeling on whether it should be ASIC specifically or some accounting board that is set up for that purpose, as long as it is done by some government mechanism. If that is of relevance to you, I guess you ought to invite the

accounting bodies to make a specific submission on that point, rather than a layman like myself.

Senator MURRAY—Like all things, companies could do that right now, but the fact is they do not. If we regard it as appropriate governance practice and if they will not do it, the parliament has to take a view as to whether they have a requirement to do it. What is your view? Do you think it should be left voluntary, as it is at present, or that the parliament should step in and make the independence of auditors a statutory requirement?

Mr Renton—As your question implies, it is really necessary in a practical sense for parliament to take the initiative because the free market is just not good enough in this sort of area. The quality of audits is something that always worries me. Shareholders theoretically vote for the auditors, but how do the shareholders know that the auditors are doing a good job? There is no way of telling. You get some clues which are pretty worrying.

One of the requirements of auditors is to audit what is published in the annual report itself. I can give you an instance of one of the notes to the accounts in News Corporation—which is a not insignificant company; I think it is at the moment the largest capitalisation company on the market—where the auditor has described one of the convertible securities of that company in words which are complete nonsense. The directors are at fault in the first instance for writing a nonsensical note, because the exercise price is defined in such a way that you do not know whether they are talking of the number of ordinary shares, the number of preference shares or a mix of the two. The directors should never have put that sort of note in, but then the auditor has certified that it is all right. I think that is very blameworthy, and it is also a bit surprising because that sort of clue is the only one that the shareholders have of whether the auditor is performing well or not. If the auditor has not performed well in something that is visible to the shareholders, it leaves open to question what he has done in things that are not visible to the shareholders.

CHAIR—Thank you very much, Mr Renton, for your evidence before the committee.

Proceedings suspended from 12.44 p.m. to 1.30 p.m.

CANTRICK-BROOKS, Mr David, Manager, Computershare Registry Services

CHAIR—Welcome. We have your submission before us which we have numbered 68. Are there any alterations or additions you wish to make to the written submission?

Mr Cantrick-Brooks—Although we do not wish to make any amendments to our submission, we would like to make some comments about electronic proxy voting.

CHAIR—Yes. I will therefore invite you to make an opening statement to the committee in which you can make those comments, and at the conclusion of your comments we will proceed to questions.

Mr Cantrick-Brooks—Thank you very much. Good afternoon everyone, and thank you for your invitation to appear before this committee. As I have said, we do not wish to amend our submission. I should say also that the views expressed in our submission are drawn from experience in conducting general meetings for small and large public companies, both listed and unlisted, including Westpac, Rio Tinto and Crown.

I would like to make some comments about the development and introduction of electronic proxy voting, an area of particular personal interest to me. What I would like to do now is to run very quickly through our submission so you are clear as to the issues in front of us.

Our submission can be summarised as follows: section 250L(4), where voting entitlements are worked out as at the midnight before a poll is demanded, and section 1109N, where the snapshot of holders is taken within 48 hours of the appointed time of the meeting, appear to be inconsistent; section 249Y(3), where a proxy's right to speak and vote is suspended while the member is present at the meeting, is impractical; section 250J(1A), where the chair must inform the meeting of the proxy votes, could be intimidating; section 251AA(1)(b), where an abstention could be interpreted as a vote, is misleading; and section 250A(7), where the later appointment revokes an earlier one if both could not be validly exercised, is flawed. We believe that the changes outlined in our submission are both necessary and desirable.

In terms of the additional comments I would like to make with respect to electronic proxy voting, the Corporations Law currently envisages electronic proxy voting in sections 249J(3) where notice may be given by sending it to an electronic address, by section 250B(3) where proxy documents may be received at an electronic address specified for the purpose in the notice of meeting, and section 250BA where listed companies may specify an electronic address.

Following on from that position, I would like to make the following comments and observations. Firstly, the legislation seems to support electronic proxy voting but stops short of facilitating it. Secondly, section 250A(1) requires that the proxy document be signed, and perhaps this could be redefined in section 9. Thirdly, we can subscribe for securities on the Internet but we cannot vote on the Internet. Fourthly, the CLERP proposals still seem to be a long way off. Finally, many of our larger clients are keen to embrace electronic proxy voting, but feel constrained.

At this point I would welcome any questions raised by the committee.

Senator GIBSON—What would you be recommending to us with regard to electronic voting?

Mr Cantrick-Brooks—I would like to see perhaps a definition placed in section 9 that gives support for those companies that wish to proceed along those lines. For example, there could be the recognition that a digital signature, whether that be in accordance with an overseas standard such as FIS189, which is used in the United States, or something like that perhaps could be fruitful. As I said, many clients have expressed a strong desire to proceed down that road.

Senator GIBSON—Thank you.

Senator CONROY—I am interested in the potential problem of intimidation, I think you described it as. I think the intent was more to try and ascertain how people voted on the public record rather than try and intimidate people. Shareholders know 'There is no point, the chair is holding all the proxies, it does not matter.' Do you think it could be got around, that intimidation potential, that intimidation problem, if the declaration was after the vote perhaps? Is there a way around what you perceive as a problem?

Mr Cantrick-Brooks—To some extent the Corporations Law already provides for that by way of section 251AA. That section is one which basically outlines how the proxy voting is to be reported to the exchange. I guess to a large extent that issue is already covered.

Senator CONROY—It may be that you believe that that is the way the law would work. I am aware of organisations that have submitted, and one is IGC, that one of the things they do is try and ascertain how proxies are cast. They are also interested in who does and does not bother to cast a vote at all. So even though you may believe that that is the intent, it is certainly not how it is applied at the moment—in my understanding.

I probably speak on behalf of Senator Murray and the Democrats as well. From the Labor and Democrat perspective, when the amendments were moved in the Senate the intent was to gain the information rather than to intimidate or not. Certainly, I do not think in practice it is working in the way you believe that it is working.

Mr Cantrick-Brooks—I do not believe so. The comments that we have received from chairman so far have been, 'Look, we'd prefer not to disclose the information to shareholders because we do believe that perhaps they may take it the wrong way and see it as being an intimidating way to push the way the voting goes.'

I guess there are two sides to that. One is that you say, 'Here are the votes, it is a fait accompli. Don't even bother thinking of voting against it because we've got 99 per cent of votes in favour.' Then there is also another way of looking at it, and that is that you put up the result and that may well influence the way people vote, which perhaps to some extent is a more serious issue.

Senator CONROY—That is a valuable point, that it could lead to intimidation, particularly of small shareholders. I think that is a very valuable point.

Ms JULIE BISHOP—It is a question of timing as to when the intention of the proxy votes is announced.

Senator COONEY—Am I right in saying this? You are happy leaving that decision as to whether they are announced and what to do with them to the chairperson, or do you think there should be—

Mr Cantrick-Brooks—I think that the chairman can exercise discretion as to when he wishes to disclose, or how he discloses those votes. I have seen circumstances where the chairman very politely explains what the position is in terms of the votes that he holds in his hands. I have seen other occasions where it is used perhaps not quite so pleasantly. I believe that there are already sufficient safeguards in there and disclosure avenues for people to know exactly what has happened.

Indeed, what happens is that where you have a poll, the results will be reported to the meeting after the results have been confirmed by the returning officer and then reported to the chairman. So the chairman will communicate that in any event.

Senator COONEY—At a time of his choosing, or do you think that should be—

Mr Cantrick-Brooks—That would be after the poll was taken. I do not believe that there is all that much to be gained by disclosing the proxy votes before the vote is actually taken.

Senator GIBSON—Does that imply that you are in favour of him still being forced to disclose?

Mr Cantrick-Brooks—No, I do not believe he should be forced to disclose.

Senator GIBSON—So you would sooner keep that option completely for the chairman?

Mr Cantrick-Brooks—Yes. The other point to this is that it is quite likely that the proxy votes are only one side of the equation because you have also got votes on the floor. The votes on the floor could be quite significant because if you have got a couple of large institutional holders on the floor who have come in with a corporate representative form, they could well swing the meeting either way. I am not sure what is really gained by disclosing the proxy votes to the meeting beforehand.

Senator GIBSON—What about the requirement of forcing disclosure after the vote is taken?

Mr Cantrick-Brooks—I am in favour of that. I have no trouble with it.

Senator GIBSON—So that everyone knows what actually happened.

Mr Cantrick-Brooks—That is fine. I am all for disclosures.

Ms JULIE BISHOP—In relation to section 251AA(1)(b) about abstention, you referred to the wording being misleading to the extent that an abstention could be taken as a vote. In (1)(a) there is also reference to a proxy abstaining on the resolution, then (1)(b) follows on from that. Do you see any need to change (1)(a) or, read in the context of (1)(a), do you think (1)(b) makes it clear that an abstention is not a vote?

Mr Cantrick-Brooks—I do not believe it is clear. Certainly the advice that we have given clients is that you should not really be disguising an abstention as a vote. That seems to be the way it is in the legislation. In terms of those two paragraphs, the first one should perhaps be revisited, and the second most definitely should be altered.

Ms JULIE BISHOP—In relation to electronic voting, you said that clients of yours felt constrained. Could you elaborate on that?

Mr Cantrick-Brooks—As I was saying before, there appears at the moment to be a door open for you to use proxy voting. For example, there is reference to sending out a notice of meeting, using an electronic address and receiving back a proxy form on an electronic address. But the missing link is in the requirement in section 250A for the document to be signed. That is a bit of a sticking point because you cannot actually sign it unless it is a digital signature or you have somehow or other taken it off the print-out, scanned it—and back again. So it is a bit messy.

Ms JULIE BISHOP—You might as well fax it while it is off.

Mr Cantrick-Brooks—Exactly. That is one aspect. The other aspect is that we have had a couple of clients who have tried it and got some fairly good results out of it, but they are a little reluctant to take it further because they feel as though they may get challenged if the result is a little close.

Ms JULIE BISHOP—Particularly on the signature aspect of it?

Mr Cantrick-Brooks—Yes; you could have someone coming up and suggesting to you that the proxy is invalid because it was not signed. I go back to my earlier point: if there were a proper definition of signing under section 9, that would cover that.

CHAIR—In relation to 250A(7), you query the wording of the legislation of the appointment of a proxy whereby you suggest ‘could not’ should read ‘could’.

Mr Cantrick-Brooks—Yes.

CHAIR—It reads:

A later appointment revokes an earlier one if both appointments could not be validly exercised at the meeting.

Isn’t that saying that the two appointments are mutually exclusive and therefore the later one overrides the former one? But if they are not mutually exclusive, and there is the capacity

for both to be exercised to some degree, then the later appointment does not revoke the earlier one whereas your wording would revoke an earlier appointment even if they were not mutually exclusive.

Mr Cantrick-Brooks—I believe that is the way it should be because, when you receive the proxy form, generally there is a presumption that the later one is the one that reflects the person's current thinking. So if I put in a proxy form for a particular meeting and then resubmit that proxy form a week later, presumably someone has the presence of mind to realise that I have changed my mind and would therefore use the later one. I think the way it is at the moment is flawed; it is a little hard to follow.

CHAIR—Are you saying there are no instances where, in effect, dual proxy is to be exercised?

Mr Cantrick-Brooks—There is the potential to split your vote so that you can have two people representing your holding. That is a completely different issue to the one that is raised under 250A(7).

Senator CONROY—I was interested in the commonsense point you made. In terms of 249Y(3), if a person turns up having already given a proxy, they are presumably overriding their previously given written proxy. You should not just sit there for half the meeting and, when there is a string of votes where the chairman thinks you have exercised your vote, then stand up and say, 'By the way, I am here.' It is commonsense to say that they should revoke it at the beginning when they register rather than the alternative, as you have described it, which would be unworkable.

Mr Cantrick-Brooks—There are a couple of points that I should mention here in relation to that particular section. The first is that we found most members wished to let their proxy stand. They come to the meeting, we tell them that there is this particular provision within the law, and most of them simply want to let it stand and attend the meeting as a visitor. It is as simple as that. We believe that section 249Y(3) removes that choice. It basically says, 'You are here; we are now forced to suspend the proxy,' which may not be wished. The other point is that I do not believe there is any mischief in allowing the choice.

Senator CONROY—So you would have to notify at the beginning that you were there and still wanted to speak or perhaps vote alternate to the chair. Say, for example, you were swayed by the arguments during the meetings. How would that work? I have signed you my proxy in the chair to vote any way you like on this issue, the chair is moving one way, and I am swayed by Senator Chapman's arguments from the floor and I want to vote the other way. How would that work if I have not already registered?

Mr Cantrick-Brooks—Presumably, to get into a meeting you have to be registered—at least as a visitor. What you would do is come out of the meeting and perhaps consult with your proxy and indicate to him that you wish to revoke that proxy. From a technical point of view, we would take the shares off the proxy and put them back in the hands of the member who would then go back in.

Senator CONROY—I apologise because I have never been to an AGM, but how workable would that be if the chair were my proxy and they were chairing the meeting and the debate was going on, and I said, 'No, I want to change my mind'? How would I then approach the chair? What would be the procedure you would follow?

Mr Cantrick-Brooks—In that particular case, the shareholder would come to us, at the point of registration, and we would make a note of it. We would not bother informing the chair, particularly if it was a very small holding. If it was a large holding, you might be persuaded to slip a note to the company secretary on the stage and indicate to him that his chairman has lost half his votes.

Senator CONROY—This is just like a Labor Party conference.

Mr Cantrick-Brooks—Otherwise, it can be dealt with within the system.

CHAIR—I am just glad I have the capacity to change Senator Conroy's mind.

Ms JULIE BISHOP—I took that on notice.

Senator GIBSON—From a practical point of view—you have a lot of experience with this—was the 28 days a good idea or is 21 days better? What is your advice?

Mr Cantrick-Brooks—My view is that 28 days is perhaps a little too long a lead time. It seemed to work reasonably well with 21. In fact, our clients did not have any problems. The problem, of course, with the 28 days, is that it is not just 28 days—it is the three extra if your constitution does not already provide for another period. There are very real difficulties in getting notice documents out because, as you are probably aware, a lot of them go through a process of evolution and changes when the directors consider the matters to be considered by the meeting. You are always working to a pretty tight deadline anyway. The 28-day rule just makes it that much more difficult.

Senator MURRAY—For clarification, could you explain the three days extra that you outlined?

Mr Cantrick-Brooks—Yes. Although I cannot quote it offhand, it might be contained within 239J(3). Basically, it says that, if your constitution does not specify another period for receipt, receipt is deemed to have occurred three days after the date of postage. So, effectively, you have got 31 days.

Senator MURRAY—So if it said 28 days inclusive of the three days, your people would be happier?

Mr Cantrick-Brooks—I am almost speaking out of school here because it is not part of our submission, but I believe that the 21 days is adequate for the purposes of notification to shareholders.

Ms JULIE BISHOP—Taking into account the three-day rule?

Mr Cantrick-Brooks—Yes, exactly. It is 249J subsection 4, where it says a notice of meeting sent by post is taken to be given three days after it is posted. It says a notice of meeting sent by fax or other electronic means is taken to be given on the business day after it is sent.

Senator MURRAY—To clarify that, you are suggesting that the argument is between 21 plus three, which is 24, versus 28 plus three.

Mr Cantrick-Brooks—Yes.

Senator MURRAY—But if it is 28 as the maximum number, then the difference is only four days, isn't it?

Mr Cantrick-Brooks—Yes. I do not have a quarrel with 249J(4). I suppose I am yet to be convinced by an argument as to why we need that extra seven days for a listed company under the 28-day rule.

CHAIR—It was suggested in earlier evidence today—and you said it is not just the 28 days, it is the process of preparation—that there was also sometimes court involvement in clearing documents if something had to be sent out.

Mr Cantrick-Brooks—We are talking about listed companies here because that is where most impact occurs. The ASX has a reviewing period—it has five days in which to review documents—so you have to factor that into it as well.

CHAIR—Is that necessary or could that be eliminated in the 28 days—

Mr Cantrick-Brooks—No. The ASX requirement is an ASX listing rule requirement and you need to comply with that. Indeed, there are very good reasons you would want that to occur, because it provides a level of security and satisfaction to shareholders that the thing has been properly reviewed and there has been nothing—

CHAIR—So, effectively, if you have the 28 plus the three plus five, you are really up to 36 to 37 days.

Mr Cantrick-Brooks—Yes. That is not even counting the logistics of getting the printer to get the stuff printed, which a lot of people forget about. From a day-to-day, real life perspective, that is just so critical for us. We are finding ourselves working at the eleventh hour trying to get the stuff out.

Senator MURRAY—To clarify: your people support 21 plus three plus five, which makes 29 days.

Mr Cantrick-Brooks—Yes, although the five is not really our issue; it is an ASX issue.

Senator MURRAY—Yes, but that is effectively what they are supporting, if they want to go that route. The alternative is either 28, which is inclusive of the three plus five, or it is 28 plus three plus five.

CHAIR—You could not have a 28 inclusive of the three plus five because they are separate issues.

Senator MURRAY—You could design it so.

CHAIR—You are looking at a maximum rather than a minimum then.

Senator MURRAY—That is right.

CHAIR—You have still got to have a minimum.

Senator COONEY—Have you got any anecdotal evidence, either from here or overseas, about how a 28-day period would be a bad thing or a good thing? Or is just that you feel, from your well-educated instincts, that 28 days is a bit long?

Mr Cantrick-Brooks—Put it this way: under the 21-day rule, we did not get too many instances where people said either that they did not get enough notice or that there was not a sufficient period of time to consider the matters. So we believe that 21 days is sufficient. Indeed, I suppose there is an argument that the longer the period the more likely it is that people are going to forget what the issues are and come along perhaps less prepared.

CHAIR—As there are no further questions, thank you very much for your appearance before the committee and the evidence that you have given us.

[1.51 p.m.]

HARDIDGE, Mr David John, Senior Manager, Ernst and Young

PICKER, Mrs Ruth, Partner, Ernst and Young

CHAIR—I now welcome Mr Hardidge from Ernst and Young. As Mrs Picker is not here just yet, do you have any comments to make on the capacity in which you appear, Mr Hardidge?

Mr Hardidge—I work in the national accounting and auditing services area at Ernst and Young. I guess I should say I am here on a personal capacity, given that the partner I work with is not here, but the particular issue is one that we have worked through quite extensively throughout the firm.

CHAIR—We have before us your submission, which we have numbered 31. Are there any additions or alterations you wish to make to that submission?

Mr Hardidge—To clarify, I think 31 was our August submission. We have then updated that and resubmitted that under 38A. No. 38 was done by someone else, Bryce Hardman, and I would probably say that is a personal submission rather than a firm submission.

CHAIR—Ruth is now with us, and I will wait for her to come to the table. Mr Hardidge, would you like to make the opening statement, or would Mrs Picker like to?

Mrs Picker—I will make the opening statement. I am talking to the submission dated 18 January 1998, and I also sent to you recently a copy of our survey of executives' and directors' remuneration, entitled 'Corporate Governance Series: April 1999'. I understand you want to keep the opening statements brief, so I will do my best. I would like to start by saying that, overall, Ernst and Young welcomes the changes that have been made to the Corporations Law and, in particular, the Company Law Review Act 1998. For the most part, we supported the changes and we considered that they simplified financial reporting.

The two areas that we had concerns with in relation to the submission were redeemable preference shares and section 300A, which is what I want to talk to today. I guess the theme of my statement is that, where accounting issues are involved, they should be left to the accounting standards and not be dealt with in law, because the problems that have arisen here in the law have been to do with accounting issues, which we think could be better dealt with through the accounting standards. In fact, there were inconsistencies between the law and the accounting standards, which in the past we had with schedule 5. We were very pleased when schedule 5 was repealed, because there were inconsistencies between schedule 5 and the standards. So when that was repealed, it was a very welcome change, and we would support a continued trend to keep accounting issues out of the law.

In relation to preference shares, the issue with redeemable preference shares is that, although the stated intention in the explanatory memorandum was to make capital reductions easier for companies and to reduce the capital maintenance provisions, there appears to be an unintended consequence of section 254K(b) which effectively requires the full maintenance

of capital, whereas in the past, under the par value regime, when you redeemed redeemable preference shares, you only had to maintain the par value, which could have been a very small amount. Under the no par value regime, because there is not a par value anymore, you effectively have to maintain the full amount of the preference share capital. We consider that to be an unintended consequence. It has strengthened the capital maintenance provisions rather than reduced them. There are also a number of tax consequences relating to the tainting of share capital and so on. I am not a tax expert, so I am not going to go into all the tax consequences, but we do know that there are a number of unintended consequences.

Furthermore, we submit that because redeemable preference shares can now be bought back under the buyback provisions, there is no need for the redeemable preference share provisions to be in the law, because a company can buy them back. In fact, if they buy them back under the general buyback provisions, the capital maintenance provisions are much more lax than under the redeemable preference share provisions.

I would go one step further which is not in our submission. I would submit that the law need not deal with redeemable preference shares at all. The reason I say that is because companies are issuing all sorts of financial instruments at the moment—convertible notes, converting redeemable preference shares. There are all types of instruments out there. Those instruments are now being covered by the accounting standard on financial instruments—AASB 1033. That is an area in which I practise a lot at the moment. We are busy advising companies on how to account for these instruments under 1033, the accounting standard.

It seems to me that dealing with one particular type of financial instrument, being a redeemable preference share, in the law, and singling it out, has no purpose anymore. There does not seem to be any need for it, particularly now that par value has gone, particularly now that we have an accounting standard on how to account for these. In fact, in many cases, a redeemable preference share would be classified as debt under the accounting standards, not as equity; not as capital in the first place. So there would be no need to have any kind of capital maintenance provision for it under the law. Our submission in relation to redeemable preference shares is to remove section 254K(b), but, even further, to consider removing all provisions specifically relating to redeemable preference shares.

The second area we submitted on was section 300A, which is the directors' and executives' remuneration. This section has so many unintended consequences that I will not go into them. There is a list of them in the submission which has been put to you. In fact, our original listing was about 10 pages long, but we tried to shorten it for you. That is to do with definitional problems, differences in definition between emolument and remuneration, the use of the word 'and' instead of the word 'or'—those kinds of things which have caused problems in practice.

When we did our survey, what we wanted to do was to find out what was the level of compliance with section 300A amongst our top corporates and how they were interpreting it. We found that there was a lack of consistency, and we expected that, because we felt that 300A was ambiguous. We felt that ASIC practice note 68 in many cases was contestable, because it construed a certain interpretation to come out of section 300A, but the law does not actually prescribe that interpretation. So we felt that, although the practice note had been

issued, there was nothing to force companies to comply with that practice note. In fact, they could contest it.

The three areas that we focused on when we did the survey, the three areas in which we found a lot of variation, related to whether or not directors and executives should be treated as mutually exclusive. We found that some companies did and some did not. You would find that some companies would say, 'Our top five include our directors, so we'll just have five,' and others said, 'We'll disclose it for all of our directors plus our top five executives.'

Ms JULIE BISHOP—Is this because of the use of the word 'officer'?

Mrs Picker—Yes. We found that a great inconsistency. ASIC have said that they believe it should be all the directors plus the top five executives. But a company can easily contest that because they can say, 'Hang on, look at the definition of an "officer" in the law. That includes a director.'

The second area that we found concerned the elements of the package to be disclosed. Section 300A just talks about the components or the elements of the remuneration. Companies have interpreted that vastly differently. The breakdown of what is disclosed is different among almost all the companies that we surveyed. ASIC have said, 'These are the components we think you should disclose,' but there is no evidence that companies are following that.

The final area—and probably the most controversial one—is whether or not the values of options granted to directors and executives should be included. ASIC have said that they think they should be included. The law is silent on that, and we think there is also a conflict between 300A and 300(1)(d) on options as to whose options need to be disclosed. That is a very controversial area and it is internationally an area that the accounting standard setters are paying attention to. At the moment it is really only the US—the SEC—that requires the value of options to be included in the amounts disclosed as executives' remuneration.

Our overall recommendation in relation to section 300A is to repeal the section and to leave it to the accounting standards board to write an accounting standard that deals with all of these issues and effectively mandates the requirements very specifically and very clearly and makes it law—through the standard—so that there will be consistency across all companies. However, we understand that the standard has not yet been written—it is in exposure draft form—and so we would recommend that this section stay until the standard is finally released. Once the standard is issued, 300A should then be repealed because we are so far gone now that companies have begun to comply; they complied from 1 July onwards. Repealing it before 30 June would probably be a bit unfair because you would have had the December balancers who have had to comply with it. There are June balancing companies already being prepared to give these disclosures. Most of our clients are getting ready to comply as best they can. So our recommendation would be to keep it there until the standard is issued and then repeal it.

Senator GIBSON—How long is that due to be?

Mrs Picker—The accounting standard?

Senator GIBSON—Yes. What is the expectation with that?

Mrs Picker—I would say about a year by the time it is issued unless there is some kind of directive to fast-track it, which you probably would be able to do.

CHAIR—Does that conclude your comments, Mrs Picker?

Mrs Picker—Yes.

CHAIR—Mr Hardidge, would you like to add your comments before we proceed to questions?

Mr Hardidge—No. I have done the research on the redeemable preference shares, so if you have any questions on that I would be happy to answer them. Ruth is the specialist on the remuneration side.

Senator CONROY—I made the comment earlier that this is a very comprehensive submission, in terms of the submissions we got, pointing out the unintended consequences. I do not know if you have had the opportunity or the desire to read the *Hansard* of the last few days in particular. We have been having a debate about this. Can I put to you that, under the intended consequences, it was certainly intended to capture everything including options and valuations of options? We have had some discussion earlier today about whether or not options could be counted as income revenue or on the capital side of the balance sheet instead. Can I put to you very strongly that the intent was certainly to capture them as a value to the executive officer?

Mrs Picker—To be disclosed separately or just to be included within the general situation?

Senator CONROY—To be disclosed so that shareholders, when they were voting on an options package, understood what the value was. It would be so that shareholders would be fully informed before they cast a vote. And in terms of—you mentioned three points and I am just trying to remember what the second one was—

Mrs Picker—The mutually exclusive one?

Senator CONROY—I think that one probably falls into the category of the unintended consequences in terms of whether it is directors or officers. As I think I indicated to your colleague a little earlier today, we would certainly welcome any amendments you would be interested in putting to the committee to try to clarify these issues. I can only speak on behalf of my party on this issue but, while I welcome the board producing its draft standard and the final standard, it would be disappointing if it had done all that work and it was inconsistent with the legislation. From our perspective, we will not be voting to repeal the legislation; I cannot speak on behalf of the Democrats.

Mrs Picker—Even if an accounting standard is issued that covers all that and more?

Senator CONROY—At this stage, I would say 'even if'. So it would be disappointing if the standard was inconsistent with the law—

CHAIR—Senator Conroy!

Senator CONROY—I am speaking on behalf of the Labor Party.

CHAIR—No. You are a member of this committee; you should not be pre-empting what this committee might find.

Senator CONROY—I wasn't. I said I am speaking for the Labor Party.

CHAIR—You are supposed to be on this committee as an open-minded member of the committee, not to be a member of a party.

Senator CONROY—I am sorry. If Mrs Picker misunderstood, I apologise to her. But we would take an awful lot of convincing to change our position on it. We traditionally have very strong views in this area. As I said, if there are amendments you feel could clarify what are the unintended consequences, we would certainly be keen for you to put them either to the committee or to us directly. We would be very keen to try to work through them with you. I understand that there are, potentially, questions of tax involved if there is a valuation. I do not think, even in the wildest of anticipations, that there was an intended consequence for a tax liability to arise out of the changes. If there are any issues at all like that on which you are able to assist, or are interested in assisting, the committee, we would certainly value your contribution.

Ms JULIE BISHOP—Mrs Picker, in relation to remuneration and your proposal that section 300A be removed from the law, that is based on the belief that accounting matters ought to be left to the accounting standards. It is not a question of it being inappropriate to have that level of disclosure, or that the law, if differently drafted, could not clarify those issues of unintended consequence that you raise; you are just saying that the proper place for it is in the standards.

Mrs Picker—Yes.

Ms JULIE BISHOP—In relation to this submission, the best practice document, you refer to the United States, where they have different disclosure requirements for directors and for executives. As you have suggested, the US focus is mainly on executive compensation. Do I take it that there is a far greater requirement for detail in the disclosures of executives than in those of directors?

Mrs Picker—Yes.

Ms JULIE BISHOP—Why is that so?

Mrs Picker—The focus is on the executive team—effectively, the CEO and the top five. They focus on those people for disclosure of their remuneration. They effectively consider directors to be non-executive or independent directors. So they would consider that they

would only get sitting fees and so on. That is really the difference in the focus. The extent of detail for executives is enormous.

Ms JULIE BISHOP—Is the extent of detail required of directors in the United States on a par with what we require for directors and officers, or is our requirement somewhere in between the US executive and the US director disclosure?

Mrs Picker—For directors?

Ms JULIE BISHOP—Ours does not differentiate between disclosure required for a director or an officer, does it?

Mrs Picker—No. Well, it does—ours talks about officers, but it talks about the most highly remunerated officers.

Ms JULIE BISHOP—I am trying to understand the level of disclosure that we require of our directors and officers. Is it at the US director level or is it at the US executive level, or are we somewhere in between?

Mrs Picker—We are now somewhere in between, after 300A. Before, we would have been at the director level, I guess.

Mr Hardidge—Some of the confusion is with executives who are also directors.

Ms JULIE BISHOP—It is a definition problem, isn't it?

Mrs Picker—Yes.

Mr Hardidge—Yes. So, director plus the top five executives picks up those executives who are directors, as I understand it, in the United States.

Ms JULIE BISHOP—Yes, but what we are discussing today is that it be directors and then, mutually exclusive, the executives.

Mrs Picker—Yes.

Senator MURRAY—Dealing with redeemable preference shares first, one of the reasons they were described as capital was that they had voting rights attached to them, which is not traditional with other forms of debt. How would your recommendation propose to deal with that aspect of a redeemable preference share.

Mrs Picker—In terms of removing all provisions?

Senator MURRAY—Essentially, your argument was, 'This is debt, not equity.' But the voting provision makes it equity.

Mrs Picker—I think, applying the debt versus equity rules from the standard, even though preference shareholders may have voting rights, they tend to relate only to their

specific rights as preference shareholders, so it is in relation to their dividends or to their position as preference shareholders. That would be only one of the factors we would look at in classifying it as either debt or equity. Just because an instrument has a voting right attached to it does not necessarily make it equity under the accounting principles. I understand that that might be a reason to keep it in the law, but I would still recommend removing any kind of provision that relates to how to account for them.

Senator MURRAY—In accounting terms it may not, but in legal terms it will because that is the prime definition of equity—the ability to exercise a vote. The second question related to that is the size of redeemable preference shares in the totality of either debt or equity. If it were a minor part of the instruments of either, your recommendations matter not at all. If it were a major part—in other words, if redeemable preference shares were 80 per cent of all equity or 80 per cent of all debt—it would make a very significant difference to how particular ratios are looked at, the reporting requirements, things about gearing, things about return on capital—all that sort of discussion. Therefore, I am concerned to ask you whether the size of the redeemable preference share within equity or capital affects at all your judgment that it should be withdrawn?

Mrs Picker—No, it does not. We did a survey when the financial instruments standard was first issued to have a look at all the redeemable and non-redeemable preference shares that were on issue by our top 200 companies. Their materiality, effectively, is what you are talking about—the size of them. We looked at their materiality relative to total equity and total debt and the impact it would have on gearing ratios when the new standard came in, which would require companies to reclassify preference shares from equity to debt. We found that in about 13 per cent of cases there would be a material impact on the gearing ratios. So it is not a very high percentage, but it is high enough that those companies would be affected adversely by having to reclassify from equity to debt. So preference shares were material to 13 per cent of companies.

Senator MURRAY—The reason I asked the question in that way is that a halfway house to your recommendation would in fact be to allow your recommendation only up to a certain percentage materiality, if you want to use that definition. But I do not know what the consequences of that would be.

Mrs Picker—I, personally, would not. The accounting standard, when it deals with classification between debt and equity, does not distinguish based on size. The substance of the instrument is what you look at. Whether it is a certain percentage of your equity or debt is not a factor.

Senator MURRAY—The third question I wanted to ask you in relation to this issue concerns the motivation behind redeemable preference shares. Quite often it is what is known as ‘mezzanine capital’—in other words, it is a form of venture capital used by merchant banks and other venture capital providers to allow them to steer the company until such time as the return and the risk are equated, and then they can exit with a substantial profit, whilst earning revenue along the way. How would your recommendation affect, either positively or negatively, the use of those instruments as venture capital mechanisms?

Mrs Picker—It could have a positive effect, because you are not being constrained by this strange accounting which we set out in our paper. I think it could have a positive effect. I certainly do not think it would have a negative effect. The issue with the accounting that we have raised here is that you could actually have preference shares classified as debt in the balance sheet but then when you redeem them, when you buy them back, you would be forced to maintain equity capital even though it never was equity in the first place. It was never equity for accounting but it was always equity for the law, and then you bought them back, repaid the debt, effectively, from an accounting point of view, but had to create this accounting entry to maintain capital which there never was.

Senator MURRAY—I hate to be creative in this field because it has bad connotations, but do you need a name change? As long as you call something a share, it implies capital. Does it need to be called a redeemable preference instrument in law if you are going to go your route?

Mrs Picker—If you called it an equity instrument you would be all right. The accounting standard would call it an equity instrument or a liability. The distinction is debt versus equity. The accounting standard definition is liability or equity instrument. If you called it a redeemable equity instrument you would be okay, because then you would be consistent with the accounting standard. The accounting standard would treat that instrument as equity.

Senator MURRAY—Through the chair, this is not an issue I have seen raised by other witnesses. I suggest that perhaps the secretariat could refer this issue back to accounting and other bodies with a transcript of *Hansard* and the submission so that we can get some more information on it. I would be reluctant to proceed just on your analysis.

CHAIR—There being no objection, it is so ordered.

Senator MURRAY—Thank you.

Mr Hardidge—The actual removal of 254K, which is causing both the operational problem and the tax tainting problem, is independent of how the redeemable preference shares are used and whether they are classified as liabilities or equity. I have seen companies that have as the only capital on issue redeemable preference shares and that is called equity. Other companies have got one particular type of redeemable preference shares called liability for accounting and other redeemable preference shares called equity for accounting. Both those instruments that Ruth refers to—equity instruments—have this operational and this tax tainting problem.

The main one we want to get rid of is this tax tainting problem, because that causes problems on the tax side for the shareholders. If companies do not know about this problem, the shareholders all of a sudden will receive a dividend return instead of a capital return, which obviously has taxation implications for those individuals. It could also have a tainting problem for the company and cause them to pay unnecessary untainting tax to fix up that tainting problem. That is independent of how those instruments are used. Ruth is suggesting further that there is no point in really referring to redeemable preference shares in the law at all because you have all these weird and wonderful things, but that is a separate issue from

immediately trying to get rid of this operational and tainting problem that is causing problems for our clients. When they want to issue mezzanine capital, they have got a problem in five years time when they redeem it, and that is what we are trying to avoid.

Senator MURRAY—In terms of reporting, there is a view that the ASX's continuous disclosure rules allow for sufficient reporting on all that is material and significant in terms of present and future financial risk and financial liability. However, there is another view, that it has always been interpreted narrowly and therefore when parliament wishes to broaden disclosure it needs to signal the area. The three areas that have been picked on in this particular inquiry are those of environment, trade practices law breaches and Corporations Law breaches and those of remuneration. All of those are designed either for accountability reasons or to signal that the community wants particular, significant and material financial risk to be reported in those areas. As we all know, the environmental issue is not about a scrubber in a factory stack; it is all about whether you going to be subject to hundreds of millions of dollars of damage for something or other somewhere. How do you feel about the generality of continuous disclosure? How do you feel about the way in which companies approach that at present and whether the Corporations Law should in fact signal where it wants reporting widened and improved in areas where companies have been deficient in the past?

Mrs Picker—I think certainty is what the market wants. If, for example, it was thought that the continuous disclosure requirement would require disclosure of directors' remuneration, that is not the way that companies interpreted it. Our view would be that if the law creates certainty in a market and creates an even playing field then the introduction of additional disclosure requirements is the better way to go. The overriding disclosure requirement to the stock exchange is generally regarded by companies as material transactions or events that they are about to undertake, and that is what they will disclose. But they have not interpreted it as being a general disclosure about environmental matters or compliance with the Trade Practices Act and so on. That is not the way they have interpreted it in the past.

Senator MURRAY—You hear the language I have used and the language you have used in response. I have used the language of particular, significant and material present and future financial risk, and I am attaching large amounts to it. I am not talking about general environmental reporting or general trade practices reporting. The implication, of course, is that I, and maybe the committee, would accept clarifying amendments, but the purpose behind parliament's acceptance of those provisions should be understood by the professional and business community. That is really what I want to elicit from you, as to whether you and they understand that and view it in the narrow but very material way in which parliament attempted to express itself.

Mrs Picker—I would say so. The issue with disclosure requirements is the corporate culture that you put that requirement into. If you make a very general requirement, it depends on the corporate culture as to how that general requirement is interpreted. Depending on the culture of the particular company involved, it could take a very narrow view and a very legalistic view or it could take a broader view and disclose more. That is really the environment that you are dealing with, and companies will interpret a broader statement differently depending on their culture. That goes back to the issue of corporate

governance and the view that the board of directors takes on the amount of disclosure that they want to give.

Senator MURRAY—But most of all they are guided by professionals like you and professional associations, aren't they?

Mrs Picker—Yes. But in cases where we cannot say definitively, 'This is what the law requires,' it would be a very brave auditor who qualified the audit report because of a particular interpretation of a general provision. It is very hard for an auditor to qualify, and probably they would find difficult grounds to qualify, because the directors would say, 'But that is not what the law says. Show me where it says that.'

Senator COONEY—From what Senator Murray said and perhaps going back to what Senator Conroy said, can I get some more clarification about what you would hope the Australian Accounting Standards Boards would come up with? I will tell you the problem I have. Suppose you get to the point where the Australian accounting standards board, instead of simply setting accounting standards, is starting to introduce policy which we ought to be making. I particularly think that the issue of whether or not there ought to be disclosure about officers' and directors' remuneration is one of those areas. I think this question has been asked of you a couple of times today but I would like you to keep on with it.

There are more and more shareholders, so we are told, and people entering into superannuation schemes which have big investments. It is just a matter of how we as a parliament balance off our responsibility in legislating in that climate as against what we can expect from the Australian Accounting Standards Board, which of course knows a lot more than we as individual parliamentarians would know and which would have an understanding of the corporate culture, as you said. On the other hand, we cannot responsibly allow the Australian Accounting Standards Board to legislate on policy. Have you any thoughts on that? And given those issues, if you agree with them, how would you expect the accounting board to go around both on the issue of the redeemable shares and on the issue of the remuneration?

Mrs Picker—On the issue of the redeemable preference shares, I think that is covered by an existing standard. That is dealt with; they would not need to do any more. On the issue of directors' remuneration, we could expect a pretty good and thorough standard from them. They would have the resources to do the international study and research to make sure that the Australian standard draws on international best practice, and they can be quite prescriptive in what they require. In terms of policy and the amount that is required to be disclosed, they can set that and they can require that. They would be able to look to international best practice to say, 'This is what is required in the US; this is what is required in the UK,' and so on.

Senator COONEY—What concerns me is whether the standards board ought to be saying that or whether we as a parliament ought to be saying that. I suppose that is an issue for us, but can you get the point I am trying to make? There comes a point where we stop making the policy, or the government stops making the policy, and the standards board starts.

Mrs Picker—If it is on an accounting and disclosure related issue, I think they should be the ones making the policy. They would have regard for current practice and overseas practice. That is something that they would always do as a matter of course; they would review and research what happens internationally.

Senator CONROY—Like Senator Cooney, I may be a bit confused. Is this what you are saying: if there is to be disclosure, whether it is mandatory or voluntary, here is how it should be done and that is what the board would do?

Mrs Picker—Yes.

Senator CONROY—Probably where I suspect Senator Cooney and I are a little confused is that what we have done is say, 'There is going to be disclosure; it is now mandatory,' as opposed to you saying, 'No, it should not be mandatory—it is voluntary—and here is how you should do it.'

Mrs Picker—No, they would say it must be disclosed. They would be able to say, 'All listed companies, all listed trusts et cetera should comply with this accounting standard.' They can do that. It would be their policy decision to require the disclosure.

Senator CONROY—When you say 'they', you mean the standards board?

Mrs Picker—Yes, the Accounting Standards Board. In fact, each time they write an accounting standard on a particular issue, they effectively say, 'It is our policy that there should be a new rule on this issue. Here is the rule and here is how you apply it.'

Senator CONROY—I note Senator Gibson just mumbled that it has the force of law. In a variety of other corporate areas, particularly the cross-vesting rules which the High Court will rule on soon, there are arguments about whether or not you can pass off laws to other bodies. How does your body cope with the problem where the courts are ruling to stop parliament passing authority to what they are defining as quasi-judicial bodies. The Superannuation Complaints Tribunal is the most recent where they have made a ruling. Has the board ever had a problem like that? I am just interested in the way that Senator Gibson expressed the comment that it has the force of law.

Mrs Picker—Not that I am aware of. Once the accounting standards are issued as an AASB standard, they have the force of law, and auditors are obliged to qualify for a departure from that standard.

Senator CONROY—No-one has ever challenged that under the same sort of challenge?

Mrs Picker—Not that I am aware of.

Mr Hardidge—I think we are looking at different types of laws. The Accounting Standards Board issues instruments, so they are not deciding on cases like the superannuation tribunal that you mentioned. It is an actual instrument that the Corporations Law requires to be issued. There could be a problem in delegating the instrument making capacity to the standards board.

Parliament can disallow standards because they are disallowable instruments. So that is where there could be a problem. In the past if there was a gap or a deficiency parliament has issued a requirement to disclose. That used to be called schedule 9 in the old Companies Act, then it became schedule 7 and then schedule 5. The Accounting Standards Board finally came out with an accounting standard. When that was found to be suitable by parliament, as at least equivalent to what was there, schedule 5 was removed. What we are asking is that parliament review the final standard on remuneration disclosures by directors. I am sure we will find that it will actually be much more comprehensive than the current law and we are asking that the law be removed.

That also happened for the Company Law Review Act. There were areas on consolidations that were in the law and got taken out because an accounting standard was found suitable. So I do not believe the board is making policy; they are really implementing what was already there. We are just freeing up the requirements so that instead of having two sets of requirements we will just have one, which is an accounting standard. I am sure it will be more comprehensive than the current law. As for cross-vesting, the way I have read the papers is that that is making law and almost acting in a court capacity to decide on individual cases.

Senator CONROY—Are you familiar with the superannuation complaints tribunal?

Mr Hardidge—Yes. The way I heard it is that someone was trying to get some money out from the trustee and the trustee decided something and then went to court to appeal against it. But my interpretation is that the tribunal was effectively acting as a court where the problem is. The same with cross-vesting between the different states—acting as a court. The Accounting Standards Board are not acting as a court; they are working on delegated powers through disallowable instruments.

Senator CONROY—It is the question of delegated powers that is at the nub of the argument, though.

Senator GIBSON—Well, yes it is. But the company law is setting the policy direction. Hence the recommendation to leave the law as it is whilst the standard is being produced. But the general principle of allowing the Accounting Standards Board to set the detail and it is easier for that to be changed, amended, through time rather than the complication of having to change the law—

Senator CONROY—Perhaps there has been a confusion. You define it as detailed.

Senator GIBSON—But Mrs Picker is saying that we have got conflict now between the interpretation of the accounting standard and what is in the law, leave the policy direction of the law there for next year or so and then when the accounting standard comes out, we do not want any conflict and do not want to remove any source of conflict, so simplify the law and rely on the accounting standard.

Senator COONEY—How readily available to the public are the accounting standards of the board?

Mrs Picker—If you are a member of the accounting profession, you receive your standards in hard copy. You can access them through the AARF web site. So they are accessible. I think you have to pay for them off the web site.

Mr Hardidge—They publish a volume every year.

Mrs Picker—They are published.

Senator COONEY—Clearly they ought to be available to anybody who wants them. I think that is another point to the issue of delegating power. Are they readily available only to the profession?

Mrs Picker—To members of the accounting profession, but anybody can get a copy of them from the Accounting Standards Board.

Senator COONEY—You have to go to the board, do you?

Mrs Picker—You would go to the research foundation, to AARF. You would get it from there.

Mr Hardidge—Sort of like a copy of the Corporations Law. You have to go to CCH or Butterworths to get a new copy.

Senator COONEY—Can you get the standards at CCH or Butterworths?

Mr Hardidge—AARF, I understand, publishes an annual bound copy of all the standards. So it is equivalent to that.

Senator COONEY—But, say, with Butterworth CCH they are all in the various capital cities as I understand it and you can get to them. Can you get to the standards in the same way?

Mr Hardidge—I do not know.

Mrs Picker—I do not think so through CCH, no, but they are readily available.

Senator COONEY—When you say 'readily available', what do you mean? Can you give us an impression?

Mrs Picker—If you have heard about an accounting standard and you want one, you can ring up the Accounting Research Foundation and order a book or get one off the web site.

Senator COONEY—If you were a small investor—we keep talking about the mums and dads investor group—it would be difficult to get it, I take it.

Mrs Picker—No, not as long as they know where to go. You have to know where to go to get that.

Mr Hardidge—That is the same with a lot of legislation, any sort of instrument or prudential requirements.

Ms JULIE BISHOP—Corporations Law—you can go and buy it.

Senator COONEY—Because other laws are hard to get, I do not know whether that is a justification for saying that laws—

Ms JULIE BISHOP—But you are saying that every accountant, every auditor would have it?

Mr Hardidge—Yes.

Mrs Picker—Yes.

Senator COONEY—But the point I am making—

Ms JULIE BISHOP—I know the point you are making.

Mrs Picker—In this *Corporate Governance Series*, we produce a guide to accounting standards for the lay person, for non-accountants to understand because I am sure shareholders would not really want to read them in detail.

CHAIR—Thank you Mrs Picker and Mr Hardidge for appearing before the committee and for the evidence you have given us today.

[2.37 p.m.]

STODDART, Ms Ellen Kathrine, Lecturer, Swinburne University of Technology

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

Ms Stoddart—Yes. In this instance I will appear as a lecturer at Swinburne University. For students, there is usually available every year, published by Prentice Hall, two volumes—it is a big set—which have all the current accounting standards in them, updated to that point, and usually carrying various other auditing standards. Sometimes it has international accounting standards in it. In certain units, the students must buy these sets and they must be up to date. Therefore, I assume that they are available. You might have to go to a slightly more technical bookshop like a university bookshop, but anyone who is interested can get them. With regard to availability from the Australian Accounting Research Foundation, exposure drafts are available free of charge, if anybody rings. They have a fairly wide—

Senator COONEY—Rings who?

Ms Stoddart—Rings the Australian Accounting Research Foundation. Indeed, my students have bugged them at times. You would have to know to ring them, but the initial spread and posting of an exposure draft is fairly wide. There is the wide consultative group that consults to the AASB and the PSASB and so those people would have it. But then again, when it is made a standard, apart from being free to members of the Institute of Chartered Accountants and the Australian Society of Accountants, other people have to pay because regrettably the Accounting Standards Board is required to offset its costs by selling its products in the same way that the Financial Accounting Standards Board in America charges and the International Accounting Standards Committee charges for copies of their standards. So we are in line with international practice in that respect.

CHAIR—Thank you very much.

[2.39 a.m.]

BOROS, Dr Elizabeth Jane, Law Institute of Victoria

BOSTOCK, Mr Thomas Edward, Member, Companies and Business Committee, Law Institute of Victoria

CHAIR—I take it that Mr Clifford is not appearing?

Dr Boros—I understand that he is not able to come.

Mr Bostock—He is unable to come for pressing reasons.

CHAIR—We have before us your submission, which we have—No. 55. Do you wish to make any alterations or additions to that submission?

Mr Bostock—The Law Institute put in two submissions. One was in August last year to the then committee on substantive matters. A little while ago, we put in a submission on anomalies in the Company Law Review Act.

CHAIR—Submission No. 55 is dated 18 August.

Mr Bostock—Right.

Secretary—Are you referring to the one that you forwarded the other day of 15 June?

Dr Boros—One should have come yesterday.

Mr Bostock—The 4 June submission is the anomalies one. The other one is dated August last year.

CHAIR—Yes, we have that one.

Senator CONROY—Mine is dated the 21st.

Mr Bostock—Yesterday the institute re-sent a submission that it sent to the Corporations Law Simplification Task Force, as it then was, on the reduction procedures. That is a subject on which Dr Boros will have something to say.

CHAIR—Has that been made available to the committee yet?

Dr Boros—It should have been re-sent yesterday with the other fax.

CHAIR—We have the one that is headed ‘Anomalies’. We have another one addressed to Mr Ian Govey.

Dr Boros—That is the one.

CHAIR—It is dated 25 October 1995. Is it the wish of the committee that they be received as submissions? There being no objection, it is so ordered.

Mr Bostock—Dr Boros will speak to that, when the time comes.

CHAIR—Other than drawing our attention to that, you do not wish to make any alterations to your earlier submission?

Mr Bostock—No.

CHAIR—Do you wish to make an opening statement, either or both of you?

Mr Bostock—Nothing very much. The August submission did not cover all of the areas raised by the committee's terms of reference, but it covered a number of them. Looking back through it, there is nothing one can usefully add to it. I would like to raise two areas that were not raised in the submission, which I think the institute did form a view on but, because of the then time scale of getting things in, they did not do it. In terms of the environmental aspect, I think the feeling on the requirement for reporting on compliance with environmental laws was: why single out environmental laws? This sort of selective approach seemed to be something that was inappropriate to Corporations Law.

The other area, if I may speak to it personally—I am not representing the institute; it is not something that to my knowledge has been discussed—is 300A, about which I imagine the committee has had a bit to say. I have come across a case, if I might mention it in a non-specific way, where it can have, in a sense, perverse results. A listed company was operating in a major country centre and the total remuneration payable to the five senior executives was less than three-quarters of a million dollars, which was not terribly significant in the context of things. But the consequences of having to disclose the remuneration of each of them would have created considerable difficulty between the staff and within the community, even extending to the suppliers to and the customers of the company.

Fortunately, the structure was such that, because of the way that the section was worded, the director was able to form a view. The section does not, in its terms, apply on a consolidated basis. The interests of the shareholders were served by treating the matter literally rather than, as the commission would have had in its release—as you would know about—on a consolidated basis.

Senator CONROY—You say they ignored the direction? They ignored or took a view that they did not agree with the interpretation from ASIC.

Mr Bostock—They took the view that the section should be applied as it was written and, of course, the aggregate figures would show that. What I am trying to point to here is that directors and employees stand in a different capacity. Directors are fiduciaries in relation to a company and ever since company law started can only get out of a company what the company's articles of constitution permit. That in the end is determined by the members and so the members need to be informed to be able to make a decision.

So, disclosure of remuneration is not something that would be seriously at issue. When you come to staff, whether they be senior executive employees or whatever, you have a different situation. They are not fiduciaries; their duty is to the company. It creates these difficulties within an organisation. The bigger the organisation, the less the difficulty, but with the small organisation in a small community it does create these practical difficulties that the committee should perhaps consider. It is not a complete answer to the whole issue, of course.

The other question is: what does one learn by naming people individually? You cannot relate a particular person's salary to the employment of the company as a whole. The aggregate amount of the payroll may be out of proportion to how the company is performing, or maybe the company is getting its services on the cheap, whichever way. But as for the information on individuals, I cannot think of anything other than it is a peering in, and that sort of thing. It does create difficulties for the administration of the company, particularly in small communities, and can work against the interests of the shareholders.

Senator CONROY—In what way? You keep say it is creating difficulties. I wonder if you could explain that?

Mr Bostock—The staff do not know what anyone else earns.

Ms JULIE BISHOP—It is confidential.

Mr Bostock—Yes. It is between the paymaster or paymistress and the particular member of staff. This requires across the board the remuneration payable to the top five—in its terms—to be published to the world at large. I am leaving aside the embarrassment that may cause to the people concerned—although I think that is something that one should consider—but what it does is create difficulties within the organisation. People will say, 'Why is so-and-so earning this amount?' and it spreads out to the suppliers, or perhaps even to the contractors of the company. The only point I am making is that I emphasise that this is not the institute, because the institute has not considered this and does not cover it. It is just something that one has come across in a sense by chance.

Ms JULIE BISHOP—It could involve issues of privacy. The institute may well be concerned with any violations of privacy laws and the like.

Mr Bostock—Undoubtedly there is an issue there. There is a distinction, as I said. Directors, by taking a position on board, forgo their right to privacy. What they get out must go to the shareholders. The shareholders must know what they are getting out, or want to get out, so as to vote on it. Staff are not in that position. The other issue is their own privacy and their entitlement to preserve that. The committee may have more questions to ask me about it. I do not claim to be an expert on remuneration philosophy, but it is just something that I felt the committee should have before it.

The other part of our submission is the so-called anomalies area. I do not think it is appropriate to talk about it here and now. The things that were raised by the institute are, by and large, of a technical nature. They do not relate, as far as I can see, to any political

difficulty, but they are difficulties which one has come across in trying to work with this new law.

Subject to any questions which members of the committee may ask, the one that comes to mind most immediately is the difficulty with charitable companies. It is not the most important problem—the others are commercially more important than this—but it affects quite a lot of what you could call voluntary work within the community. Again, it is not a question of fault; the law was redesigned, but it produced a somewhat odd result with respect to these companies that are allowed to have 'limited' out of their name.

There are two points made in the submission. The first is that the old law allowed a licence to be granted—either by the commission or, years before, by the Attorneys-General of the states—to companies engaged in charitable pursuits, scientific research, patriotic and other sorts of public purposes to dispense with the word 'limited' in their name.

The new law limits it to charitable organisations without exactly saying what 'charitable' is. Members of the committee would know that, at law, the definition is fairly limited—it is for the advancement of religion, the advancement of education, the relief of poverty and certain other objects. There is the risk that it could be more limited than was thought before. For example, with respect to a medical research institute, charitable status under the strict interpretation is doubtful. But there is no real reason why one should want to run the risk of this occurring; all that one has to do is state that 'charitable means scientific, educational, et cetera' and it would solve a possible problem.

The second aspect is of a more technical nature. Because of the way the legislation has been changed, it is now necessary to go back to the state Attorney-General to get approval to alter the constitution of one of these companies if it received its licence before 1 July 1982, because the licence said that no alteration could be made without the consent of the Attorney-General. When the law changed then, it provided for the consent of the NCSC, as it then was, to the change, and the ASC sufficed from that point of view. Now, of course, no consent is needed under the Corporations Law, so that provision was dropped consequentially, with the result of reviving the state Attorney-General's jurisdiction, which was thought to be dead 17 years ago. Unfortunately, he or she cannot get a fee for giving it nowadays, which is a double irony.

Anomalies are always thought to be rather boring technical things, but these are things which are causing a good deal of practical difficulty and unnecessary expense in the business world, speaking very generally in that regard—small business as well as larger business. As I said before, there is nothing controversial about rectifying them. So, subject to any questions that the committee may have, I will close my remarks. My colleague Dr Boros would like to say a few words on the difficulties arising from the reduction provisions. I take the liberty of commenting that, as the author of a recently published monograph and other works on compulsory acquisition, the committee may have some questions on that subject.

Dr Boros—I have two things to offer. I was proposing to use the overhead projector, but I do not see an obvious wall. What I was proposing to do instead was to hand around the text of what was going to be on the overheads. At least you will have something in front of you. The other thing that I was proposing to offer was a decision that I want to refer to. It is

only three pages. You do not have to read it now, obviously. Should you wish to know what I am talking about when I refer to a particular case, this is the one.

Senator CONROY—Can we give you a test after?

Dr Boros—If I am going to refer to things and you do not have access to them, it is a bit pointless, so I thought I would save a bit of time. There should be two things going around.

Ms JULIE BISHOP—We can only handle one at a time.

Senator CONROY—And in large writing.

Dr Boros—Forgive me, I am used to dealing with undergraduates.

Senator CONROY—You still are.

Dr Boros—What prompted me to ask for a little of the committee's time today was in fact one of the last lines of this decision by Justice Santow. I would take you to the third page of this decision in ETRADE. You do not need to read it, but if you want to know where I am coming from it is in the third last paragraph or the last big paragraph. The sentence reads:

Attention should be given by the legislature to this anomaly.

Basically, the case is about a problem which has occurred with the reduction of capital procedures and it has caused enough of a problem that judges are saying, 'There's a problem, deal with it.' I thought I would explain what the problem is.

The original drafting of the selective reduction of capital procedures, as I said in this first point, erroneously assumed that the people that you had to worry about, or the people who might be benefiting from reductions, would be the people who were receiving consideration—that is, the people who were going to have the money repaid to them. That might be the case in some reductions of capital, but the thing about reductions of capital is that, because they are approved by a resolution, you are going to have some people—not always but in many cases—who voted against it and who did not like the idea but who it is 73

going to happen to whether they wanted it or not. It is very hard to tell with a reduction whether the people that are benefiting are the people who are getting the consideration or, in fact, the people who are not getting the consideration. Sometimes with reductions it is one group, sometimes it is the other. It is very hard to say, without examining the particular reduction, who are the people who are doing well out of it. How do I know that it is done on the assumption that the people who are benefiting are the people who are receiving the consideration? We see it in the approval requirement that the resolution has to be passed unanimously or that nobody who is receiving the consideration is allowed to vote in favour. That is clearly indicating that the people we have to worry about—people who should not be

able to get this thing through—are the people who are getting the consideration. As I have said, that may be the case, it may not.

When that was pointed out to the simplification task force, they agreed, saying, 'Yes, maybe it is the people behind who are benefiting.' For example, if you are wanting to use a reduction of capital to take over a company, and say there are 100 shareholders, what you do is cancel the shares of all the other 99 and that leaves you as the 100 per cent shareholder. You might be the person who is staying behind but nevertheless be the one who is benefiting, even though it is those other people who are getting the consideration.

How did the simplification task force deal with that? They did this stopgap thing where they said, 'If you are cancelling the shares, then those people whose shares are being cancelled have to approve it as well.' That was one aspect of dealing with the problem. But by leaving the old requirement in there as well—the old requirement being that nobody who was receiving the consideration was allowed to vote in favour—it created some new problems.

What were the new problems? First of all, some perfectly legitimate, otherwise desirable transactions could not proceed. The facts of this case, ETRADE, give you a bit of an example of when that might occur. In very brief terms, it was about a reduction where all the ordinary shareholders were going to receive consideration. They were intending to give them all the same amount of consideration, but some of the shareholders were foreigners. The people who were Australian were going to get replacement shares, and the people who were foreigners—because of the complications of offering shares overseas and complying with foreign regimes about offering shares—were going to get a cash equivalent instead. They wanted to treat them all the same way but, because some were foreign, they could not.

Justice Santow talks in ETRADE about them treating the people slightly differently. One of the requirements for equal reduction is that all the ordinary shareholders have to be treated the same way. Justice Santow talks about the definition, on this basis, that these people were not being treated equally. I will read from his judgment. This is from the same paragraph that I was talking about before, the third last paragraph. Justice Santow says:

> The effect of that definition—

and he is referring there to the definition of selective reduction approval requirement—

> in the present circumstances would have been to give rise to the absurdity that in practical terms the necessary resolution could not have been passed unless there were total unanimity, inviting corporate blackmail. This is because no shareholder could vote under paragraph (a)—as all shareholders receive consideration as part of the reduction. That renders paragraph (b) applicable, requiring unanimity of all ordinary shareholders at the meeting. Even one dissenting shareholder could thus scuttle the proposal.

So that is what is happening in some cases. Where you are unavoidably categorised as selective, you have disproportionate power to one dissenting shareholder.

The other consequence which is following—and this is what happened in ETRADE itself—is that transactions are having to be restructured so that the reduction part of them is an equal reduction, and then whatever else happens, the differential treatment part happens as

part of a scheme of arrangement. It is a two-step process, and that is actually what Justice Santow found was happening in ETRADE. Everybody was getting cash, and then—for the Australians—they were having that cash immediately turned into shares. They never actually had the cash in their hands. The differential part happened as part of the scheme not as part of the reduction, so that you could have the easier approval requirement.

Why is that unfortunate? The cost savings which I presume the legislature intended to achieve from taking the courts out of a reduction of capital procedure are not happening, because you still have to go to the court for a scheme of arrangement. I am sure this committee is aware that I am the greatest advocate of minority shareholders that you could find, but an approval process that should have been a minority shareholder protection measure has instead become a means for minority dictation. The suggested solution would be that instead of having the slightly mismatched approval requirement, you have a class consent requirement—that is, you divide up the members into the people who are receiving the consideration and the people who are not, and you require a special resolution from each of them. That way, you do not have to worry about who has been benefited, because it does not really matter in each case, and you can get away without necessarily having the supervision of the court. The only other supplementary requirement would be that you would have to prohibit associates of either class from voting as part of the other class.

If we go back to my example where we had 100 shareholders and the one person was remaining, it may well be that, for example, that one shareholder's wholly-owned subsidiary was in the group that was having their shares cancelled. To put them in the class and allow them to vote along with people whose shares are being cancelled is not really a good test, because you need the people whose interests are the same voting. We would have to take the associates out of the mix. That is what used to happen in practice when the court used to supervise, because the ASC used to have a policy statement that said that we should record the votes of those people separately and, generally speaking, if they were associates of the instigator, their votes were disregarded as part of the process. If we divide it up into classes and have associates excluded from voting with the other class, maybe the provisions would work a bit better. That is my submission on reductions.

Senator GIBSON—Congratulations on a clear exposition of how to fix the problem. That is good.

CHAIR—Your students obviously get very well taught.

Dr Boros—I will have to mention to them that you said that. They might need some convincing!

Ms JULIE BISHOP—I am obviously one of those students that will need to have a remedial class. When you talk about dividing it into the two classes for the purposes of voting, does that apply to the overseas situation?

Dr Boros—That is a good question. You have caught me out. I gave e-trade as an example. I think that e-trade where you have the overseas people would probably still need to take place as part of a scheme of arrangement. So my example was not a perfect one. But I used that case more to exemplify how people will deal with the problem of having an

unworkable provision. They will divide things up into two parts, even if they do not need to, whereas here they probably would need to. My proposed new regime would apply wherever you have a selective reduction, which can take place purely within the reduction of capital procedures. Where you are getting scrip as part of your consideration generally it has to happen as part of a scheme anyway. That will remain unchanged.

Ms JULIE BISHOP—I understand.

CHAIR—Under your proposal, a majority of both classes would have to vote for the reduction for it to proceed.

Dr Boros—They would—a special majority of each class.

Senator CONROY—How is the nomination for which class you end up in managed? Is it self-nominated?

Dr Boros—I would say that it would have to be on the basis of legal rights—that is, how the scheme affects people's rights. That way it is more clear. You can tell quite simply, from the face of the scheme, if you are receiving consideration or not. By taking a legal rights approach, we do get to where you are perhaps leading. You get associates who really do not have the same interests being in that class. I do not see a way around that, other than going back to what we had before where the reduction procedure was supervised.

Senator CONROY—I may be in one and it may be in my interest to convince my associates to volunteer to be the other side for the vote.

Dr Boros—That is why I would disqualify associates of the instigator from voting altogether. That is perhaps not the most subtle solution, but you can certainly define associates. There are definitions already in the takeover context. It is the only way I can think of for dealing with it, apart from returning the matter to the court, which is what we had before, or perhaps imposing another supervisory body like ASIC.

Senator COONEY—Are you going to end up taking it to court? Answering questions, you have said you will put the associates in one category, and there is going to be dispute as to whether they go into this category or otherwise. Would it be best to go back to courts in any event? Aren't you going to get problems that are likely to end up in court with this scheme?

Dr Boros—You might. The only other example that I can think of is the related party transaction procedures in chapter 2E of the Corporations Law where there is a financial benefit being given to a related party of a public company. The only way that it can be approved is where it goes back to the shareholders and only the disinterested shareholders are allowed to vote—that is, those who do not have an interest. I think that is section 243ZF of the Corporations Law. We do have a precedent which, as far as I am aware, has not resolved it in a lot of litigation to date. If you were wanting to challenge it, there would be opportunities there, but I do not know that it necessarily opens the floodgates to litigation.

Senator COONEY—How often has 243ZF come into use? Can you give us some idea of just how it is working?

Dr Boros—I might defer to Tom on this. My days of practice are now four years ago. When I used to be a corporate lawyer, we used to quite often have to advise people in relation to the application of the related party procedures.

Mr Bostock—Absolutely. It is a marvellous scheme waiting to trip us all up, actually. You have to be very attentive to it.

Dr Boros—I think it is 243ZF.

Mr Bostock—You are quite right.

Senator COONEY—I want to ask Mr Bostock about the issue of whether or not you should tell people even in country towns about the remuneration that the directors and the executives are getting. I can understand your point about privacy, which is a big issue, and the difficulties in a small town and the tensions you get there.

On the other hand—and this is part of a general rule—take a union. You would expect union members to know what the secretary was getting—even in a local tennis club. I know they are not comparable but, nevertheless, what I am trying to point out is that the members have an interest, and also perhaps the community has an interest, in knowing what people get at that level, given the issue of remuneration generally and how the economy works and those sorts of issues. I wonder if you could develop your thoughts in that situation a bit more. Take the Law Institute: you would want to know what your chief executive officer was getting.

Mr Bostock—I had not really come along with the object of producing the killer argument. But it is a factor that is apt to be overlooked; because it occurs in a micro area, it does create problems. I have no brief from the institute on this and I have no personal axe to grind about it. But it has come to my attention where a measure that is designed to be beneficial to shareholders can have side-effects that are, in fact, detrimental to shareholders in that sort of way. I certainly cannot claim myself to be a remuneration specialist.

Senator COONEY—But you are pointing out the issues that arise.

Mr Bostock—There is an issue; but this is not to disagree. With a public company—I speak as a shareholder, not a terribly great shareholder, nor a very successful one—looking at annual reports, you see what people earn. What does it matter? It is interesting to see aggregate amounts because, if the aggregate amounts are going up, and the company is going down, you might ask, 'Have the directors got a remuneration committee that is looking into these things?' When you get to an individual, you can ask, 'Why is he worth so much?' If he is a director, of course, for the reasons said earlier, it is has to be disclosed. I think there should be no argument about it: directors stand in different capacities as fiduciaries. If it is an employee, how can one judge? The individual shareholder has no real means of judging whether he is worth it or not. But if they see the overall amounts going to the executive

staff—and I think that is the way the band thing works, for example the way it goes up while the company is diving—well, maybe they have a point to raise at the AGM.

Ms JULIE BISHOP—It is all relative, though, isn't it? It is the relativities that are important.

Mr Bostock—Yes.

Senator COONEY—But, in practice, haven't you got to give an assessment of what the case is going to cost and all this sort of thing? There seems to be a growth of this idea that people ought to state beforehand or make public what the charges are going to be and what remuneration is being paid.

Mr Bostock—In the United Kingdom, looking at the Hampel reports, they seem to have adopted the view that it is the prior disclosure of directors' remuneration, using the word in the widest sense as everything that the directors get out of a company. They do not seem to have moved in the direction of the non-board staff. I think in the US it is otherwise.

Ms JULIE BISHOP—We have heard evidence that it is the reverse. In fact, it is the executives whose remuneration is required to be more detailed than the directors.

Mr Bostock—That seems to be the case but then, of course, the board structures that one tends to have in the US are executive boards rather than non-executive boards. In the way we seem to be moving in our country—as in the UK—we look towards non-executive directors on the grounds that they are independent. It is a slightly different culture. As I said, I do not wish to be understood as trying to say the last word on this subject—by any means it is complex—but I wish to draw to the committee's attention that it has this peculiar effect that can give trouble in a context.

Senator COONEY—I am just trying to tease that out in my own mind. The other thought I had about it—and I have not even thought about this, and you may not have, so don't bother answering if you have not—is that public companies generally tend to make public comments, as they are entitled to do and should do. They say, 'Wages should go up by so much or should drop by so much. We should be doing this and we should be doing that.' I suppose that tends to invite an examination of their remuneration if they are making comments on others.

Mr Bostock—I can understand why people might think that particular way. They are employees the whole way through. I suppose the only difference one would make is that those who make the comments—and I suppose it is really only terribly applicable if they say wages should go down rather than wages should go up—are speaking in very general terms and not picking on any particular individuals to say that this person is earning too much or too little.

Senator COONEY—That is true.

Mr Bostock—As I said, it is a matter of controversy, and I certainly do not wish to be understood as—

Senator COONEY—No, thank you very much for those.

Ms JULIE BISHOP—I just had one question in relation to section 150 about companies and 'charitable'. You have said that this anomaly is of serious concern and should be remedied urgently. Your concern is that currently a company is eligible to be registered as a limited company without the word 'limited' if, among other things, the constitution requires it to pursue charitable purposes. You want a definition of 'charitable' for the purposes of section 150.

Mr Bostock—Let me put it this way. I think that, without a definition of 'charitable', it would perhaps bring in the previous law's idea of scientific, educational things. There is a risk that a lot of these very highly respected bodies would find themselves at risk for their licence. The commission has got power to take it away if they stray outside that thing. It is not a controversial thing. If it is left undefined, there is a risk that a court will apply the traditional legal meaning which is enunciated by Lord Macnaghten in Pemsel's case. It is relief of advancement of religion, the relief of poverty—

Ms JULIE BISHOP—The four principles.

Mr Bostock—Yes.

Ms JULIE BISHOP—I understand.

CHAIR—Are there further questions?

Senator MURRAY—You have the recommendation that a director of listed companies should have only the part call of a meeting of members as an optional.

Mr Bostock—Yes.

Senator MURRAY—The resistance to this protection, particularly from minorities, strikes me as having been fairly generalised. I have not heard expressed to me—maybe it has been expressed elsewhere—particular instances in which individual directors have actually acted maliciously, frivolously or vexatiously. My question to you really is: is it the problem that those who want the right taken away believe? Secondly, if it is a potential problem, does there need to be a two-step approach—namely, the director must first go to ASIC for advice within a certain period and then, only on consideration of that advice, call a meeting? Thirdly, should directors who call meetings be specifically under an injunction but, if they call them frivolously, vexatiously or maliciously, be subject to prosecution or penalty of some kind? I would like your response to those three views, please.

Mr Bostock—I think the latter first. My response to this question is a non-institute one because it is a question that we had not really covered. One would be disinclined to visit civil criminal penalties on people who seek to do what they see as their duty. Going back to the convening of meetings, the power to convene meetings that is usually vested in the board is one that is like all other powers: it has to be exercised in good faith and in the interests of the company. It is unclear to me where the thought that a single director should be allowed

by law to convene a meeting came from, because it is something I have not seen happen in my experience.

With a major public company, it does present a bit of a difficulty. If you take a company like, let us say, the National Australia Bank with a quarter of a million members, convening a meeting is something. It costs a heap of money to do it. A director doing that has to act also in accordance with the duties that the remaining directors are under. I suppose one's concern about the provision, when one comes to think about it, is that it might suggest that an individual director has got an untrammelled right to convene a general meeting of the company—untrammelled by the overarching obligations to act in good faith in the interests of the company as a whole. I am not necessarily saying this is the case, but the most obvious case where it is going to happen is where you have a split or partisan interest to be produced and where it is exercised for a partisan interest as opposed to being in the interests of the whole.

The converse of that is that, if you have a director who is saying, 'We must convene a meeting to consider this,' it seems that the rest of the board have to give that some pretty serious thought before they say no. If they say no they should, consistent with their duties, have a pretty good reason for saying no. The only reason they might have a pretty good reason for saying no is if the director proposing the meeting had no good reason for the suggestion that was made.

These hypotheses are possible through a range of things. I do not know whether that answers the three questions. Please probe me further if I have not.

Senator MURRAY—Earlier Ms Bishop mentioned that there were 200 listed companies. I think that was the figure you popped up with.

Ms JULIE BISHOP—Not me. I think it was a witness.

Senator MURRAY—Let us assume there were. That would make over 3,000 directors. That has been in law now since June 1998. My question is: has anyone abused that law yet out of, notionally, 3,000 directors? I understand no-one has, and I think it is a very important safeguard and brake upon the majority in the board behaving in a manner which an individual director may feel is unwise. We have had a lot of recommendations from witnesses who just make the general assumption that it is bad to have. I want to know: have there been any instances in which it has been bad to have? Secondly, do we need a protective process to go through so that, if a director wants to go this route, he or she has to go to ASIC for advice and only on consideration of that advice call a meeting? That is really what I am driving at.

Mr Bostock—Let me try to answer that, because it is a good question. First, though, I am not aware of any instance where it has been abused since 1 July last year because I am not aware of any instance where it has been used.

Senator MURRAY—Me neither.

Mr Bostock—That is a significant fact. The institute's submission on this was that it should be a matter of choice rather than a matter of compulsion. The points that Senator Murray has made about this as a safeguard are points that would be persuasive to a lot of people. I think it was the case before 1 July last year that under the Corporations Law, table A, a director had that power, but it was what we now call a replaceable rule and was seldom adopted. The institute's point is that it comes to a matter of choice.

The other point is: should a director go to ASIC over a matter like this? Again, I cannot answer for the institute. My personal view is that it does not seem to be a very good thing that the director, in exercising a power or a duty and in carrying out a duty, should go first to the regulator to find out what the regulator thinks. Instinctively, I feel that these duties are there and they have got to be—

Senator MURRAY—Sorry to interrupt you but, as I understood it, that is what the institute has said—that currently directors with concern about corporate governance matters can raise them with ASIC. If the institute finds that that is appropriate in that instance and they want a further safeguard, all I am suggesting to you is that there is one possibility.

Mr Bostock—I think it would be a bit of a misunderstanding. I think it is one thing to say that that process does exist. In a number of ways one does approach the regulator about certain things, and that is a good thing—I am not saying that one should not. We do this in practice very often—ask how they would view a particular thing, as one must, particularly in the takeover area, the fundraising areas, and things like that. But to enshrine in marble that notion in the context of a single director calling a meeting—I would be pretty worried about that. It has not proved a worry for practical reasons. No-one has, as I said, called a meeting. The concern is not so much that someone will do it because of a well-founded genuine belief that it is in the interests of the company, but that someone will do it because it is not. I think that is probably the risk. Again, I do not wish to give an expressly clear-cut disagreement with the principle of that section, but it has got these problematic areas, to which I believe others have drawn the committee's attention. There are pros and cons about it. As Senator Murray said, it is a safeguard for the sole director against a board of rogues, for example, which can happen.

Senator MURRAY—If I can summarise so far, what we are presented with is the majoritarian view that we should jump at ghosts because there is a notional danger we should take that safeguard out, and yet there has been no instance yet, to my knowledge—and I appreciate a year is not a long time—where it has proven a problem. And that is all I caution with this sort of generalised recommendation. If it has no substance, why should we take notice of it?

Mr Bostock—Indeed, as the institute says, it should be a matter of contract rather than compulsion. If companies wish to put that in their constitution they should be free to do so or not, as the case may be. Under the overarching agreement, the directors, collectively and individually, subject to convenient meetings, must act in accordance with fiduciary duties that are placed upon them. The problem—although it was not raised in the submission, I think; I stand to be corrected—is that the danger of putting it in the legislation the way it is is that people might see that it is not subject to these general duties because it seems to be expressed as an absolute right whereas it really is not. I do not think a court would ever hold

it were, but the trouble is no-one wants to go through the expense and any consequent litigation to get to that point. If it is done as a matter of contract, then of course that question is assumed.

Senator MURRAY—If I may interrupt to summarise it, you are saying if it is to be a right, it should be an appropriately qualified right relative to the normal fiduciary duties of directors?

Mr Bostock—It should be understood to be. I suspect that probably a corporate holder is subject to that, like every other power of a director.

Senator MURRAY—If you were afraid it would not be, you might need to actually put in that qualifying clause.

Mr Bostock—Yes.

Senator CONROY—Do you have a view on this clause, Dr Boros?

Dr Boros—I was just listening to the conversation about going to ASIC. I am just interpreting it my own way. When you think there is a cause for concern in the company and you are saying to them, 'Maybe you should investigate this,' that is one thing, but going to ASIC and saying, 'I am not sure whether I should exercise my power. What do you think?' is another. I think ASIC would be very reluctant to buy into that, particularly as it could have legal consequences for the director and even ASIC.

Senator MURRAY—I think you are right.

Dr Boros—But I am not here representing them.

CHAIR—Are there any further questions? Did you want to make some comment on the takeovers provisions? It is not directly relevant to this inquiry.

Mr Bostock—On compulsory acquisition, Dr Boros has forgotten more than I ever knew. There is one other anomaly I would like to mention just for the purposes of noting it, rather than for discussion. Section 1425 of the Corporations Law is one of the transitionals from the Company Law Review Act and states that the nominal value of a share immediately after commencement is the nominal value it had immediately before commencement. It is a simple one sentence.

If you go across to 254C it states that the shares become of no par value. The two are inconsistent; par value and nominal value being the same. I suspect that 1425 was a transitional thing relating to previous arrangements existing before 30 June and that for the purpose of those arrangements this is the case, but it is not set in that context.

CHAIR—There being no further questions, I thank you for your appearance before the committee and the answers you have given to questions. I declare this hearing closed.

Committee adjourned at 3.33 p.m.