Government Response

to the report of the

Parliamentary Joint Committee on Corporations and Securities

on the

Draft Second Corporate Law Simplification Bill

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Introduction

1. In June 1996 the Government referred the draft Second Corporate Law Simplification Bill to the Parliamentary Joint Committee on Corporations and Securities. The Committee received 26 written submissions on the draft Bill and held hearings on 13 September and 2 October 1996 in Canberra and Sydney respectively. The Committee's report was tabled in the Senate on 18 November 1996. In its report the Committee expresses its approval of the general content of the Bill. The Committee made 11 specific recommendations. It also made several suggestions on matters of detail which the Government has reviewed and, where appropriate, amended the Bill.

2. The Government wishes to thank the members of the Committee for considering the submissions and preparing their report. The Government also acknowledges the valuable contribution made by those who made submissions to the Committee.

3. The Government proposes to accept or note a number of the Committee's recommendations, in particular, those which would facilitate the orderly calling and conduct of company meetings or which invite the government to consider or review certain matters. However, a number of recommendations would impose additional costs on companies. The Government considers that these recommendations would best be addressed through the ASX's Listing Rules or best practice in corporate governance.

4. Since the Committee's report was tabled the Treasurer has announced the adoption of the Corporate Law Economic Reform Program. This program will involve a fundamental review of key areas of the Corporations Law affecting business and market activity. It is designed to bring a greater

economic focus to corporate law reform, consistent with the Government's objective of facilitating investment, employment and wealth creation while providing investor protection. As part of this program the project of rewriting the Corporations Law will continue. The Second Simplification Bill will be advanced as part of the Corporate Law Economic Reform Program and has been renamed the Company Law Review Bill 1997.

Background to the Bill

5. The Company Law Review Bill will rewrite most of the core company law provisions of the Corporations Law. It will improve and simplify these provisions to make the Law more accessible and encourage efficient business practice by increasing choice and flexibility in the management of companies. For example, the Bill will provide a model framework of default rules for the management of a company's internal affairs (replaceable rules). These rules will be conveniently located within each subject area of the Law and will be able to be replaced or varied to suit the needs of particular companies. The Bill will also enable companies to make greater use of communication technology to hold meetings and exchange documents. The plain English approach taken in drafting the Bill will make the Law more readable and accessible. The Bill will also take up the Committee's suggestion that the person chairing a meeting be referred to as the chairman.

6. The seven subject areas covered by the Bill are registering companies, meetings, share capital, financial reporting, annual returns, deregistration of defunct companies and company names. The main reforms to be made in each of these areas are set out below.

7. The Bill will make it easier to register a company. It will be possible to register a standard company suitable for operating a typical small business by lodging a single form with the Australian Securities Commission (ASC), instead of the several that are currently required. Changing from one type of company to another (eg from a proprietary company to a public company) will be facilitated to enable company structures to best suit their commercial or other objectives. Doing business with a company will also become easier, especially for those who provide finance to companies, because the Bill will reduce the need for third parties to make inquiries about the company's internal affairs.

8. Proprietary companies will be able to pass a wider range of resolutions without incurring the expense of holding a formal meeting. Companies will be able to hold meetings more conveniently and involve a wider range of people. The proxy voting rules will be updated to give members greater certainty and flexibility in exercising their votes. Investors, particularly institutional and overseas investors, will have more time to prepare for general meetings. The Law will expressly recognise that, for public companies, the annual general meeting is an opportunity for shareholders to raise matters of concern with directors and the auditor.

9. Streamlined provisions will be introduced to deal with the issue of shares (including bonus shares), changing the rights attached to shares, partly-paid shares, dividends and the redemption of redeemable preference shares. The share buy-back provisions will be amended to require that a buy-back not materially prejudice a company's ability to pay its creditors.

10. The Bill will give companies greater flexibility in the management of their share capital. First, it will be easier for companies to return capital to shareholders. This will be particularly useful for companies that have underperforming assets or that wish to dispose of capital assets not required for their core business activities.

11. Second, the Bill will replace the outdated concept of par value for shares, so that shares will no longer have a par value. Accounting and financial arrangements by companies will be easier to understand and companies whose shares are traded at a price less than their par value will therefore be able to raise fresh capital without prior approval from the court and their shareholders.

12. The Bill will reinforce the existing prohibition against a company acquiring or controlling its own shares. The rules prohibiting a company from financially assisting a person to acquire its shares will be relaxed so that a company will no longer require shareholder approval for a range of ordinary commercial transactions.

13. The Bill will improve the framework for financial reporting to members. It will establish within the Corporations Law the general conceptual framework for financial reporting, leaving matters of detail to be addressed in the accounting standards. Companies will have the option of sending concise

annual reports to members, saving printing and distribution costs, although full reports will be available on request.

14. Annual returns to the ASC will be much shorter. The Law will expressly recognise that annual returns and other documents can be lodged electronically, with the agreement of the ASC.

15. It will be cheaper and easier to deregister a company that has no liabilities. It will be possible to make a claim against the insurer of a deregistered company without having to incur expenses associated with re-registering the company.

Response to PJC recommendations

16. The remainder of the Government's response to the report addresses in turn each of the Committee's recommendations.

Recommendation 1

The Committee recommends that:

(a) the Bill should more extensively recognise electronic forms of communication between companies and their members, and regulatory authorities; and

(b) the Law should make clear that, where it is proposed to hold a meeting using the assistance of technology, the participants at the meeting should be aware of:

(i) the intended use of that technology;

(ii) the effect on the meeting of any failure of that technology; and

(iii) for directors' meetings, the effect on the meeting of any withdrawal of consent to its continued use.

17. The Government supports the use of technology for communication between companies and their members and regulatory authorities.

Communication technologies accelerate the flow of information in the market, leading to more timely decision-making. The Government notes that this is consistent with recommendations made by the Financial System Inquiry that the Law should facilitate electronic commerce.

18. Under the current Law companies can only use technology for their meetings if it is permitted by their constitution. The Bill will facilitate the use of technology without requiring a specific provision in the constitution.

19. The draft Bill considered by the Committee would allow companies to send notices and proxy documents by fax and to lodge documents electronically with the ASC and its agents. In light of the Committee's recommendations, the Bill will now enable companies to make greater use of communications technology. In particular, companies will be able to:

- send notices of meetings to an electronic address nominated by a member; and
- receive proxy documents from members electronically if the company has specified an electronic address in the notice of meeting.

20. The Government proposes that the use of communications technology in other areas of the Law, such as the provisions dealing with takeovers and fundraising, should be addressed when these areas are dealt with by the Corporate Law Economic Reform Program.

21. The Government agrees with the Committee that some specific provisions are necessary so that members are properly informed about the intended use of a technology. The Bill will therefore provide that if a members' meeting is proposed to be held at two or more places using technology the notice of meeting must indicate this and also the type of technology proposed to be used. This will enable members to decide whether to attend the meeting in person or via the technology.

22. More generally, the Government believes that provisions dealing with meetings should be consistent across all types of meetings. The use of technology in the conduct of a meeting is merely an extension of the normal meeting procedures and should be treated as far as possible as other meetings. For example, a breakdown in video-conference technology has similar effect as the failure of microphones at a normal meeting. If a meeting does not give members a reasonable opportunity to participate, the existing law enables a

court to declare the meeting invalid if a substantial injustice has resulted. The Government considers that this is also the appropriate outcome for members' meetings held at two or more places using technology.

23. In relation to directors' meetings, the Government accepts that directors must give reasonable notice before withdrawing consent to the use of technology at a meeting. However, the Law should allow directors and the company more generally to devise their own solutions concerning the consequences of a failure of technology.

Recommendation 2

The Committee recommends that the right of an individual director to call a meeting of members should be a mandatory rule for listed companies.

24. The Bill will allow individual directors of companies, operating under the replaceable rules to be inserted into the Law, to call members' meetings. A company will be able to adopt a constitution and displace the rule through its constitution. It is envisaged that widely-held companies would displace the rule. The rule is primarily designed for closely-held companies to allow a members' meeting to be called with a minimum of formality.

25. For listed companies, a single director may wish to call a meeting to pass a resolution (eg removing a director or amending the company's constitution) or to publicise a matter of concern. However, for listed companies, calling a members' meeting is a significant and potentially costly action.

26. The Government believes that listed companies should be able to decide for themselves whether individual directors are able to require the company to hold a members' meeting. The Bill provides other safeguards for minority shareholders, such as allowing 100 members or members with 5 per cent of the votes to be able to require the directors to convene a meeting. The right of a director to call a meeting unilaterally would therefore only be relevant in practice where a director is unable to obtain this level of support for a resolution. It is therefore not considered necessary or appropriate to accept this recommendation.

Recommendation 3

The Committee recommends that:

(a) where members call a general meeting under proposed section 249E, only those directors who fail to take reasonable steps to convene the meeting when requested under proposed section 249D should be liable to reimburse the company for the expense incurred in calling that meeting; and

(b) the Bill should make clear that the power of members to requisition or convene a general meeting should not be exercised frivolously, and should be exercised only where the purpose of the meeting is a valid purpose for such a meeting.

27. The Law currently provides that, if the directors have failed to call a meeting requested by members, the directors who are in default are liable to reimburse the company out of their fees for the cost of calling and holding the meeting. The draft Bill originally held all directors liable for failing to call a meeting. While this was intended to provide an incentive for compliance by directors, the Government accepts that some exemption should be offered to directors who act diligently. The Bill will therefore exempt from liability directors who can show they took all reasonable steps to cause a general meeting requested by the members to be held.

28. Under the common law a meeting that has not been called for a proper purpose can be declared invalid. It was suggested to the Committee that members may requisition meetings for improper purposes, without being aware that the meeting would be invalid, and that this would cause the company unnecessary costs and inconvenience. To address this concern the Bill will include a provision stating the general common law position that general meetings must be called for a proper purpose. This will help to make members aware of the limited nature of their power to request a meeting. The rule will apply to all members' meetings as there is no reason to distinguish between meetings called by members and those called by directors.

Recommendation 4

The Committee recommends that, as a general rule, for listed companies, the minimum notice period for a members' meeting should be 28 days.

29. Under the current Law the minimum notice period for a members' meeting is 14 days, with 21 days notice being required for a special resolution. The Bill will increase the minimum notice period to 21 days and remove the distinction between notice periods for different types of resolutions. This will encourage members and their representatives to participate in meetings as they will have longer to prepare and consider the content of notices.

30. Institutional investors, particularly those outside Australia, have argued that a 28 day notice period is required to give them sufficient time to receive, consider and respond to a notice of meeting (eg to appoint a proxy). The existing notice periods are said to discourage participation by institutional investors in members' meetings. However, the facilitation of communication technology proposed by the Bill, particularly in relation to the electronic service of notices of meetings and proxy documents, will greatly reduce the real time required to send notices.

31. Companies tend to prefer a short notice period to minimise costs and delay. A significantly longer notice period would make it more difficult for listed companies to capitalise on windows of opportunity to enter into a range of significant transactions requiring shareholder approval under the Corporations Law or the ASX's Listing Rules. Requiring a 28 day notice period would either cause the company to miss the opportunity or put pressure on the ASX to allow the transaction to proceed without shareholder approval.

32. The 21 days notice period therefore strikes an appropriate balance. It will be the minimum required by the Law: it will be open to companies to establish longer notice periods in their constitution, or in practice to offer a longer notice period.

Recommendation 5

The Committee recommends that:

(a) the Law should be amended to require the auditor of a listed company (or the auditor's representative) to be available to take questions at the AGM at which the auditor's report is tabled; and

(b) *the Bill or its Explanatory Memorandum should specifically refer to the applicability of qualified privilege to answers to questions put to auditors by members at an AGM.*

33. The Bill will increase the ability of shareholders to make inquires about the company, by recognising the right of members to ask questions of directors and auditors at an AGM. Whether a company's auditors attend its AGM is currently a matter for negotiation between the company and its auditors as part of the audit engagement.

34. The Government generally considers that matters such as this should be determined by the relevant parties, and not be required by the Corporations Law. Accordingly, before mandating attendance by auditors at AGMs, the Government would need to be satisfied that interference with companies' freedom of contract on this issue was warranted.

35. The question whether to compel auditors to attend an AGM has been considered by a Ministerial Council for Corporations Working Party on the requirements for the registration and regulation of auditors. The Working Party comprised representatives from the accounting profession, the States and Territories, the ASC and the Treasury and consulted widely with relevant interest groups. Given the specific inquiry being made by the Working Party, the Government proposes to defer its consideration of this issue until it the Ministerial Council for Corporations has considered the Working Party's report.

36. The Law currently confers qualified privilege on auditors for any statements they make in the course of their duties as an auditor. This is a general privilege that applies in a variety of situations, including answering questions at an AGM. The Government agrees with the Committee's recommendation and the Explanatory Memorandum to the Bill will confirm

that qualified privilege applies to answers given by an auditor to questions at an AGM.

Recommendation 6

The Committee recommends that further consideration be given to the issue of voting at meetings, with particular reference to:

(a) developing a standardised proxy form which will enable all shareholders to express the full range of their voting intentions; and

(b) requiring the chairman to call for a poll:

(i) if so instructed by a required number of proxies held by him or her; or

(ii) if the vote on a show of hands does not reflect the votes of the proxies held by him or her.

37. The formalities for appointing a proxy are currently determined by the company's constitution and the common law. Tables A and B also provides a basic proxy form, and sets out the basic requirements for appointing a proxy. The Bill will introduce greater choice to this area of the Law by providing that a proxy will be valid if it contains certain minimum information. A company's articles can therefore prescribe the use of one of the standard proxy forms available in the market place, set out the company's own specific proxy form or remain silent and allow informal proxies containing the minimum information required by the Law.

38. Companies have an incentive to provide a proxy form which meets their members' needs. This will vary depending on the structure of the company's membership. Introducing a standardised proxy form into the Law could reduce the flexibility and choice currently offered by the Bill to companies wishing to design their own proxy forms. The Governmment therefore considers that the development of a standard proxy form is a matter that is best considered by the relevant peak organisations outside of the legislative framework.

39. As at present, the Bill will allow resolutions to be passed either on a show of hands or on a poll. The current position under the Corporations Law

is that resolutions may be carried on a show of hands but a poll may be demanded by the chairman or 5 members (including a proxy) or members holding 10 per cent of the votes. The Bill will reduce this to 5 per cent for consistency with other provisions conferring rights on shareholders in relation to meetings. Voting on a show of hands allows the company to progress meetings in a timely and efficient manner while the ability to call a poll provides a safeguard for matters which are closely contested.

40. If every member who appointed the chairman as their proxy could be counted towards the 5 members who may demand a poll most resolutions would be decided on a poll. This could cause companies considerable expense and delay and interfere in the orderly conduct of meetings. The Government considers that allowing proxy voters to count towards the call for a poll would be likely in practice to render voting on a show of hands redundant, as most resolutions would be decided on a poll, putting companies to additional expense and inconvenience and changing the character of the meeting. Given that the Bill will allow proxies to be lodged electronically, the Committee's recommendation would have a similar effect to the introduction of electronic voting. However, the Committee, in its consideration of whether the Law should facilitate electronic voting, noted that to do this 'might ultimately change the character of the AGM, and the Committee has not been persuaded that the character of an AGM should change.' (Report para 2.17)

Recommendation 7

The Committee recommends that the adequacy of the transitional period for, and the possible taxation consequences of, those provisions in the Bill which abolish the par value of shares and the share premium account, and make other consequential amendments, should be carefully considered by the Government. The Committee also would welcome an opportunity to further examine this issue when the Bill is ultimately introduced into Parliament.

41. The Government acknowledges the need to ensure an adequate transitional period to give the business and professional communities sufficient time to adjust to the introduction of no par value and the abolition of court confirmation for capital reductions.

42. The Government is making a separate announcement about the taxation measures it will be introducing as a consequence of the abolition of par value for shares and court confirmation for capital reductions.

Recommendation 8

With regard to the annual directors' report, the Committee recommends that:

(a) proposed section 299 stand unamended, but be reviewed 3 years after its implementation; and

(b) proposed section 300 be amended to additionally require listed companies to disclose the following matters:

(i) the policies of the Board for determining the remuneration (including incentives) of the Board and senior executives, and the relationship of these policies to the performance of the company/group;

(ii) the quantum and components of the remuneration of each director of the company and each of its 5 highest paid executives, including the existence and length of any service contract for the CEO;

(iii) the age and all other listed company directorships of each director;

(iv) whether, during the reporting period, any proceedings were 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 of the company's position in relation to it; and

(v) whether, during the reporting period, any such proceedings were concluded or settled and (if so) the terms on which they had been.

43. The Government notes that the age and other listed company directorships of a director are already publicly available, for example, through the ASC database. Also, companies are currently required to disclose information about legal proceedings in the notes to their accounts where the proceedings constitute a material contingent liability. The Government considers that as this information is already available it would not be appropriate to be more prescriptive.

44. The Government notes that the Bill will enhance the disclosure of options granted to directors and senior executives. The Bill will require companies to disclose in their directors' report details of options that are granted over unissued shares or unissued interests during or since the end of the financial year to any of the directors or any of the five most highly remunerated officers in the company.

45. The Government believes that accurate and informative reporting to company members about a company's activities and performance is essential to maintaining investor confidence. Investors need to be informed about the factors underlying their company's performance, particularly when considering their ongoing investment in a particular enterprise. The Corporations Law currently provides an extensive framework for reporting members which ensures that members are well informed about the state of the company's business.

46. The Committee has endorsed changes proposed to be made to the Law in the Bill in the area of directors' reports to members by the introduction of a requirement to include a management discussion and analysis of the matters members needs to be informed about if they are to understand the overall financial position and performance of the company. The Committee also recommended that additional components be added to the disclosure of directors' remuneration and to specific disclosures about the company. In a number of respects, these recommendations go beyond the current law and the Bill, as considered by the Committee.

47. While the Government believes that proper reporting to members is an important responsibility for companies it considers that the approach proposed by the Committee is not appropriate at the present time. In particular, it considers that the provision of a management discussion and analysis to members should be a matter for companies to decide.

Recommendation 9

The Committee recommends that the Corporations Law should require that information disclosed by Australian listed companies in overseas jurisdictions should be promptly and prominently announced via the Australian Stock Exchange to Australian investors.

48. The Government does not propose to amend the Bill in light of this recommendation as the disclosure requirements for listed companies are appropriately dealt with in the ASX Listing Rules.

49. A general requirement for the routine lodgment with the ASX of all documents lodged overseas by Australian listed companies runs the risk of imposing an unnecessary paperwork burden and therefore increased transaction costs on these companies.

50. The ASX Listing Rules currently require listed companies to disclose to the ASX information that is material to the price or value of their securities. These continuous disclosure requirements, which are backed by statutory obligations, ensure that the market is fully informed about non-confidential information that affects the value of quoted securities. However, the general content of the disclosure obligation is appropriately a matter for the ASX. The Listing Rules provide examples of material information required to be disclosed. One of the examples given is that a document containing market sensitive information that the entity lodges with an overseas stock exchange or other regulator is required to be made available to the public.

51. The ASX has indicated that there does not seem to be justification for requiring the disclosure of documents lodged in overseas jurisdictions if the information is not material to Australian investors, particularly as some jurisdictions require detailed filings. Furthermore, the ASX considers — and the Government agrees — that this matter is more appropriately dealt with in the Listing Rules.

Recommendation 10

The Committee recommends that consideration be given to the desirability of including in the Bill a provision giving the members of a class of shareholders the right to request and convene a meeting of that class to consider matters able to be dealt with at such a meeting.

52. This recommendation seeks to provide additional legislative safeguards for the interests of members of a class of shareholders in relation to their class rights. However, in order for a company to successfully compete for capital it must offer shares on terms which are attractive to the market. Market forces should therefore be allowed to determine the terms on which shares are issued. The rights attached to preference shares are negotiated as part of the terms of issue of the shares and could include the right of a class of shareholders to request or convene a meeting.

53. In addition the Law will continue to provide extensive safeguards protecting the interest of minority shareholders. In particular the rights of preference shareholders can only be varied by complying with the class rights provisions. Under the new class rights provisions, unless the company's constitution provides otherwise, any variation of the rights of preference shareholders has to be approved by a special resolution of the company and special resolution of the class of preference shareholders.

54. The Government therefore considers that a general rule to call a meeting of preference shareholders would interfere with the company's ability to negotiate the terms on which preference shares are issued and is not necessary to protect the rights of holders of preference shares.

Recommendation 11

The Committee recommends that the ASC reconsider the criteria to be included in its Draft Class Order covering audit relief for large proprietary companies to remove any unnecessary audit burden from franchise motor dealers or businesses in similar circumstances.

55. The Committee recommended in its August 1995 report on the First Corporate Law Simplification Bill that the Law contain criteria to govern the exercise of the ASC's discretion to grant relief from the requirement to prepare audited accounts. This recommendation was adopted by the former Government and enacted in the First Corporate Law Simplification Act 1995. The Committee also recommended in the same report that the 3 tests for determining whether a proprietary company was large or small (and therefore exempt from the reporting requirements), the criteria for exercising the ASC's discretion to exempt large proprietary companies from the requirements, and the effectiveness and cost of the process, should be reviewed by it and the Government after the new audit obligation has been in operation for 2 years. The Government is committed to undertaking this review. In May 1996, the Senate also resolved that the ASC should prepare a report by June 1998 on the operation of the small/large test. The Government considers it would be desirable to ensure coordination of these reviews to avoid duplication between them.

56. The Government notes that Recommendation 11 was not within the Committee's terms of reference, and that the Committee intends discussing the issue with the ASC. This recommendation is appropriately a matter for the Committee to raise with the ASC.

57. The Government notes that the ASC's Class Order exempting some large proprietary companies from the audit obligation has been changed from an earlier draft to meet a number of concerns raised, including by those representing motor dealers.