AUSTRALIAN LABOR PARTY MEMBERS' REPORT

The Labor Party members of the Parliamentary Joint Committee on Corporations and Securities thank all those who provided submissions and gave evidence at hearings for the Inquiry.

INTRODUCTION

Labor Committee members support the ongoing reform of Australia's corporate regulatory environment. The Labor Government began this process with the Corporations Law Simplification Program in 1993, and the Howard Government, to its credit, has continued it under the rebadged Corporations Law Economic Reform Program (CLERP).

However, the Government's CLERP Bill, incorporating CLERP discussion papers 1-4 on issues of takeovers, fundraising, accounting standards, directors' duties and corporate governance, reflects a sentiment that efficient corporate regulation can only be achieved by relaxing regulation. Such a sentiment ignores lessons from past and recent financial crises and does not take account of the potential dangers of a boom in Australian share-ownership of listed companies.

The Labor members of the Committee acknowledge that reform in these areas is appropriate to ensure that regulation allows Australian corporates to meet the changing demands of an increasingly competitive global marketplace and to take advantage of innovations in capital raising. But with flexibility must come a level of investor and shareholder protection that engenders international confidence in the integrity of Australia's capital markets.

The CLERP Bill has not got the balance right and requires changes.

TAKEOVERS

The takeover provisions in the Bill suggest that having more takeovers would essentially be good for Australia, and that in business bigger is better. These views, however, take little account of reality and the inherent risks - takeovers tend to go through a periodic cycle, do not always deliver the expected economic benefits, and that bigger is not necessarily better.

The predetermining factor in successfully competing in the global market is not necessarily the size of a company, but rather its domestic experience of competition. A competitive domestic environment can serve as a training ground to succeed in the international arena.

Many takeovers and mergers overseas have proven to be less than successful or at least have failed to meet initial expectations. They fail to realise the efficiencies or higher profits that they aspired to despite initial jumps in stock prices. Job losses and cuts in investments might also accompany them.[1]

Mergers have failed because managers from the combined companies were unable to settle clashes, overestimated the synergies or got together for all the wrong reasons.[2]

Notwithstanding these risks or potential disappointments, as well as Government claims of faults in the current regime, takeover in Australia is significantly high. An Ernst and Young report on mergers and acquisitions found that in 1998 Australia recorded its highest ever number of acquisitions, and that the extent of the rise in takeover activity will continue in 1999.[3]

Real world experiences, however, have not deterred the Government from proposing amendments to the current takeover rules to fuel the activity further.

[1] "How to make mergers work." The Economist. 9 January 1999. Page 13-14.
[2] "How to merge: After the deal." The Economist. 9 January 1999. Page 19-21.

One of its key proposal is to allow a person to acquire shares beyond the current 20% threshold without making a prior announcement of a full unconditional takeover bid.

This would effectively grant the bidder shareholder-control of a company before fully revealing its takeover intentions to the market, and close any window of opportunity for competing bidders and directors of the target-company to respond.

Competitive price bidding in takeovers, which helps in the discovery of fair prices, would be restricted under such a regime and company directors would find extreme difficulty in pursuing defensive proceedings should they consider the takeover detrimental to the company.

Moreover, the loss of competitive bidding would deprive shareholders and directors from obtaining the best possible price and other terms and conditions that would come from an open auction process.

Another disturbing takeover related proposal is the change on compulsory acquisition rules. The Government seeks to allow a person holding 90% of beneficial ownership of securities in a company to acquire, at any time, the remaining securities in that company.

This sort of acquisition can take place with only a *notice of acquisition*, accompanied by an expert's report justifying the value placed on the remaining securities. Doubts have been raised about the independence of such an expert's report because the majority shareholder would be selecting the expert and paying for its report.

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[3] Mergers and Acquisitions Index. Ernst & Young Corporate Finance Pty Limited. 1999.

The Government claims that the proposed changes to compulsory acquisition will help in the management of companies and discourage minority shareholders from demanding excessive prices – so-called *greenmailing*.

What these changes really mean, however, is that majority shareholders gain a mechanism to squeeze out minority shareholders at an unfair price. The interests of minority shareholders will be effectively scrapped. The Government members of the Committee have accepted, to a degree, the harshness of the proposal by recommending that compulsory acquisition be limited to 6 months after the initial takeover, rather than having the mechanism available "at any time".

Mr Alfred Rofe, Chairman of the Australian Shareholders' Association Ltd, highlighted this concern of minority shareholders:

> "Compulsory acquisition involves the expropriation of the property of the shareholders whose shares are to be acquired. Minority shareholders in a partly-owned group of companies are in a particularly vulnerable position. It is therefore essential that any compulsory acquisition of their shares can be seen to be fair to both the majority and minority shareholders. As the courts have pointed out on a number of occasions, fairness in this context involves both fair dealing and a fair price. The proposed new compulsory acquisition power in its present form tips the scales too much in favour of the majority shareholder."[4]

As more and more Australians become shareholders, changes to compulsory acquisition need to be considered very carefully. A recent survey by the Australian Stock Exchange estimates that 4.4 million Australians now hold shares directly – about 31.9% of the population. The majority are likely to be

[4] Submission to the Inquiry by Mr AEF Rofe, Chairman of the Australian Shareholders' Association Limited. Submission number 20. 19 January 1999.

inexperienced, first time shareholders who may not be able to best represent their own interests.

The principle of revamping the Corporations and Securities Panel to allow takeover disputes to be addressed more effectively and to minimise the involvement of the courts is sound. The Bill would allow any party directly affected by a takeover dispute to lodge applications to the Panel, and that the Panel could declare circumstances as unacceptable whether or not they constitute a contravention of the *Corporations Law*.

However, the Bill restricts individuals from approaching the courts with a Panel order. Only the Australian Securities and Investment Commission (ASIC) can proceed to take such action after due consideration of the dispute by the Panel.

But as ASIC has limited resources, it is doubtful that it would be able to appropriately follow-up all the cases that have cleared the Panel. It would be far better for the Bill to allow relevant affected individuals in a takeover dispute to take action in the courts should the Panel support such action.

The Australian Institute of Company Directors expressed the view:

> "The AICD considers that a significant deficiency in the provisions is proposed subsection 657G(2) which only allows ASIC to make an application to the Court for enforcement of the orders of the panel…if only the ASIC is able to make application to the Court to enforce orders of the panel then the operation of the panel could be significantly undermined. The ASIC is motivated by different set of circumstances, including funding, which is likely to be different to the interests of an applicant in deciding whether or not to take particular Court action."[5]

[5] Submission to the Inquiry by Australian Institute of Company Directors. Submission number 22. 8 December 1998.

Deacons Graham & James raised a further and not entirely unrelated concern about the court's role in takeover disputes:

> "Proposed section 659C regulates Court proceedings after the end of the bid period. The heading of this section seems to imply that all Court action after the bid is regulated by the section, although subsection 659(91) has certain preconditions to its operation. Subsection 659C(2) then indicates that the only order a Court can make is one that requires "the person to pay money to another person". It is not clear whether subsection 659C(2) is intended to limit the Court's power after the bid in all circumstances. In our view, it is important for the Courts to have power to order divestiture of assets in the event a breach of the Corporations Law has occurred in a similar manner to that available in the case of a breach of section 50 of the Trade Practices Act. We do not believe this would detract, in any real sense, from the Panel's ability to deal effectively with the matters before it. It would only be in exceptional cases that the Court would consider making these type of orders."[6]

Notwithstanding the argument for the need to reduce the excessive amount of litigation on takeover issues, the role of the courts in settling disputes and enforcement is important and should be duly recognised.

In aggregate, the proposed takeover provisions reflect a Government that does not find merit in maintaining fairness in the market for corporate control and does not put sufficient value on equality of treatment between shareholders.

FUNDRAISING

The CLERP Bill also features amendments to fundraising provisions of the Corporations Law. These proposed changes are intended to reduce costs to

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[6] Submission to the Inquiry by Deacons Graham & James. Submission number 23. 11 December 1998.

capital raising, particularly for start-ups and small and medium sized enterprises (SMEs). This is an appropriate goal in order to assist entrepreneurs and smaller companies to realise their full potential and help create employment.

The amounts of capital usually sought by start-ups and SMEs are typically small, which makes prospectus preparation prohibitively expensive. It may, therefore, be appropriate for small capital raising to be excluded from prospectus requirements.

Capital raising would be excluded from prospectus requirements if it results in 20 issues in Australia (rather than the previous 20 offers) within a rolling 12 month period, as long as no more than $2 million is raised. This is consistent with other major markets world-wide and appropriate for Australia.

Currently exempted from prospectus requirements are issues to *sophisticated investors*, defined as an individual that subscribes to a minimum of $500,000 worth of securities. An expansion of this definition is proposed.

It is proposed that a sophisticated investor would be able to invest less than $500,000 if that investor has net assets of at least $2.5 million; or, has earned gross income of $250,000 for each of the last two years; or, has been assessed as competent and experienced by licensed securities dealers. The latter criterion has the potential to be abused – in that the prospectus process is circumvented - due to pressures to maintain commissions.

This proposal may be better examined once the licensing issues raised in CLERP 6 have been finalised.

The Bill also proposes to allow for the preparation of an Offer Information Statement instead of a prospectus when raising capital of not more than

$5 million. Above this figure, a prospectus will have to be prepared, but a Profile Statement (i.e. a short-form or summarised version of the prospectus) need be the only information document circulated publicly.

While designed to cut costs in prospectus preparation, an Offer Information Statement and a Profile Statement would offer only limited gains. Cost savings are likely to be marginal as the major costs and inputs involved with prospectus preparation, such as, accounting, auditing and legal services, will remain.

These costs, as Mr John Jarrett, National Policy Manager of the Securities Institute of Australia stated, “are part of the due diligence undertaking and are an expensive part of the whole capital raising process”.[7]

Although a significant cost burden, these activities are crucial elements in company disclosure; shortcuts would simply hamper efforts to engender investor confidence in smaller companies. It would be remiss of the Government to think that less than rigorous rules in company disclosure would help capital raising. On the contrary, greater transparency, investor protection and market integrity are essential to improving access to capital.

DIRECTORS’ DUTIES AND CORPORATE GOVERNANCE

On the issue of directors’ duties and corporate governance, the Bill provides safe harbour rules to protect directors from liability. Protection is based on the premise that directors’ decisions and actions are made with due care and diligence.

Certain company directors have made the claim that current rules governing their responsibilities are unclear and the thought of litigation have inappropriately constrained them from performing their duties. The arguments

[7] Evidence provided by Mr John Dallas Jarrett, National Policy Manager of the Securities Institute of Australia, in a hearing in Sydney on Friday 22 January 1999.

or evidence offered to the Joint Committee on this matter remain unconvincing. It presumes that directors would have conducted their task differently with a certain positive outcome, if safe harbour rules existed.

Rather, it is more likely that the safe harbour proposal would encourage directors to act adventurously without fear of external review, and without certainty that the result would be beneficial for the company. With the lessons of the Asian financial crisis still fresh in our minds, the Government is sending the wrong signal with such a proposal.

This is exacerbated by other related provisions in the Bill, such as the proposed change in the definition of the duty of care of directors. Dr Geof Stapledon, a senior lecturer at the University of Melbourne, puts the point not too finely:

> "..the vast majority of Australian company directors – those who are competent and hard working – do not need such a reform. Those who stand to gain are directors who, essentially, hold positions for which they are ill-equipped."[8]

Existing court decisions[9] already clearly define directors' duties and responsibilities. In addition, the Government's own Explanatory Memorandum to the Bill states that under existing common law, the courts rarely review bona fide business decisions. Given this, there seems little merit in the proposed changes.

The statutory derivative action proposal is welcomed, as it would give shareholders greater responsibility for corporate governance. There is a widely held view, however, that the proposal is not sufficiently detailed to clearly instruct shareholders in bringing about proceedings on behalf of the company.

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[8] Submission to the Inquiry by Dr GP Stapledon, Senior Lecturer, Law School, University of Melbourne. Submission number 1. 5 May 1998.
[9] For example, AWA Ltd v Daniels t/a Deloitte Haskins ans Sells (1992) 10 ACLC 933.

Also, it may be prudent to permit the Australian Securities and Investment Commission to bring court proceedings under the statutory derivative action provision where it sees fit.

ACCOUNTING STANDARDS

Finally, the Bill flags the importance of making Australian accounting standards consistent with that used in the international arena.

It would also be important to note that while international harmonisation of accounting standards is an appropriate objective, most Australian companies only consider it if they have to go overseas to raise capital. Thus, when raising capital overseas, it would be important that the accounting standard adapted by Australia must be the standard used in the world's key financial centres.

Mr Jarrett of the Securities Institute of Australia confirmed this view:

> "..acceptance of international standards in our jurisdiction must occur only if those standards are accepted for domestic reporting purposes in major capital markets, particularly the United States, given that it accounts for half the world's capital."[10]

Furthermore, the Labor members of the Committee are somewhat concerned about the Financial Reporting Council's oversight of the standard setter the Australian Accounting Standards Board (AASB), particularly in setting the AASB's priorities, its business plan, budget and staffing arrangements.

CONCLUSION

The Bill is a step in the right direction in the ongoing reform of Australia's corporate regulations. However, as it stands, the Bill reflects a Government that has little concern for minority shareholders, investor confidence and market integrity. The Howard Government would relax regulation to increase the number of takeover activities and to encourage careless behaviour by company directors, without much care for the resulting quality of the industry and market, and with little concern for those that may be potentially disadvantaged.

The Howard Government would also establish a regime in which large investors get favourable treatment over small investors. Given the Howard Government's continuous promotion of individuals owning shares, it is surprising that many of the CLERP proposals have the potential to undermine the rights of small or so-called *mum and dad* shareholders. This Bill can be improved and should not be passed without amendment.

Senator Stephen Conroy	Mr Bob Sercombe MP
Mr Kevin Rudd MP	Senator Barney Cooney

[10] Evidence provided by Mr John Dallas Jarrett, National Policy Manager of the Securities Institute of Australia, in a hearing in Sydney on Friday 22 January 1999.