SUPPLEMENTARY REPORT ON THE CORPORATE LAW ECONOMIC REFORM PROGRAM BILL 1998

BY SENATOR ANDREW MURRAY: AUSTRALIAN DEMOCRATS

1. Introduction

1.1 The Australian Democrats have supported the efforts of the government, both during this term and the previous term, to reform and modernise Australian company law.

1.2 We actively participated in that process during the passage of the *Company Law Review Act 1998*. The Senate successfully amended that Bill to incorporate a number of changes which were sought by the business community, shareholders and other groups, in particular concerning improved corporate governance and accountability.

1.3 As with that Act, it is expected that this Bill will improve the efficiency and understanding of company law and regulation.

1.4 There are a number of issues which relate to corporate governance on which we wrote at length in our minority report on the Company Law Review Bill 1997 (March 1998, page 20). We remind readers of those issues and we note that we intend to revisit some of the relevant issues arising from that report when the Corporate Law Economic Reform Program Bill is before the Senate. However, we will not restate those issues in this report.

1.5 There are also a number of issues, which have arisen out of amendments which we were successful in making to the Company Law Review Bill 1997, which may need to be reconsidered in light of subsequent media comment about them. An example is the disclosure of directors' remuneration.

2. Takeovers

2.1 The majority report of this Committee raises a number of issues in relation to takeovers. I agree with the Committee's deliberations in respect of those issues except in relation to the following issues.

Consideration offered during a bid

2.2 Section 621 of the Bill deals with consideration offered during the bid. Subsection 621(4) requires that where a bidder makes a cash-only bid, the amount of the offer must at least equal the maximum consideration paid by the bidder during the last 4 months. For various reasons set out in the majority report, the Companies and Securities Advisory Committee (CASAC) has recommended that the subsection 621(4) be extended to all bids including bids which were not cash-only bids.

2.3 I am concerned at the equivocation by the majority of this Committee in their report and the suggestion that either the Bill could proceed in its present form and an inquiry be conducted into this issue or that the government could act on the CASAC recommendation. This is an issue which should be resolved prior to the passage of the legislation.

2.4 I believe that the CASAC recommendation should be followed and that subsection 621(4) should be extended to all bids. This is consistent with the Australian Democrats general view that shareholders should be treated equally and benefit equally from takeover activity.

2.5 Recommendation – that section 621(4) be amended to apply to takeover bids which are not cash-only bids, so that regardless of the type of consideration being offered, the minimum consideration on offer is at least equal in value to the maximum paid during the 4 months before the date of the bid.

Collateral benefits

2.6 Section 623 of the Bill deals with collateral benefits. The provision of collateral benefits is prohibited (i.e. during the 4 months preceding the bid, giving target company shareholders any benefit not provided to all shareholders under the takeover bid).

2.7 A number of issues are outlined by the majority in their report. I will not restate those issues here. Those issues need to be addressed prior to the passage of this Bill.

2.8 I am again concerned at the equivocation by the majority of this Committee in their report and the suggestion that the government 'may therefore care to accept that recommendation , or proceed with the Bill as drafted and refer this matter to the Committee for further consideration.' Again, this is an issue which should be resolved prior to the passage of this legislation.

2.9 The adoption of the CASAC recommendation in relation to subsection 621(4) will allow the removal of subsections 623(2) and (3) while still retaining the requirement of equal treatment between target shareholders.

2.10 Recommendation – that sections 623(2) and (3) be removed from the Bill. This should only occur if the recommendation at 2.5 is accepted.

Bidder's statement formalities

2.11 Section 637(1)(a)(ii) provides that where a bid is made other than on a cash only basis, the bidder's statement lodged with the ASIC must be approved by a 'unanimous resolution passed by all the directors of the bidder'. The Australian Institute of Company Directors raised the issue of a problem arising when directors are on the board of both offerer and target.

2.12 This problem needs to be corrected. It is not sufficient that the ASIC has a power to exempt or modify the operation of the Part if necessary, and I will elaborate on that issue later in this report.

2.13 I believe that in circumstances where a person is a director of both the offerer and target companies, he or she should not vote on the approval of the bidder's statement and a unanimous resolution of all other directors should be sufficient for the operation of section 637.

2.14 Recommendation – In relation to approving bidder's statements; where a person is a director of the offerer and target companies, he or she should not vote on a resolution to approve the bidder's statement, regardless of the type of consideration being offered. The determination of whether the resolution is passed or not should be made as if the person was not a director.

Scope and powers of the Panel

2.15 Section 657G deals with applications for enforcement of orders where an order of the Panel is contravened. Applications for enforcement may only be made by the ASIC.

2.16 The Australian Institute of Company Directors expressed dissatisfaction with that limitation and took the view that any party who can apply to the Panel for an order should be able to apply for enforcement. The Australian Democrats agree with that argument. Whilst curbing the 'egregiously litigious nature of Australian takeover

activity' is undoubtedly one of the objectives of the legislation, I am of the view that allowing enforcement applications to be made by persons other than the ASIC will:

(a) not result in any substantial increase in litigation, given that there must first be an order on foot and a contravention of that order before an application can be made; and

(b) relieve the ASIC of the need to become involved in litigation which is essentially between private citizens.

2.17 Recommendation – that section 657 of the Bill be amended to allow any of the following persons to make an application for enforcement of an order:

(a) any person to whom the proposed order relates;

(b) each party to the proceedings; and

(c) the ASIC.

Compulsory Acquisitions

2.18 The introduction of proposed section 664A into the *Corporations Law* is, in the view of the Australian Democrats, entirely unsatisfactory at this stage.

2.19 I agree with the summary of evidence by a majority of the Committee in their report and with the view that consideration must be given to both minority and majority shareholders. However, I do not agree that the imposition of a 6 month time limit on the use of the new compulsory acquisition power is an adequate safeguard for minority shareholders.

2.20 The limited power of the Court to intervene, i.e. where the majority holder cannot establish that the consideration is 'a fair value' is also unsatisfactory. This is further compounded by the capital gains tax problem; specifically that this compulsory acquisition can burden a person with a CGT liability when that person may be vehemently opposed to selling their shares.

2.21 I agree with the majority of Committee that some form of rollover relief should be provided in relation to both compulsory acquisitions and scrip for scrip takeovers.

2.22 Recommendation - The Australian Democrats cannot support this power of compulsory acquisition until:

(a) the problems relating to CGT are resolved;

(b) the power of a Court to intervene are extended and are not limited only to the fairness of the consideration offered; and

(c) additional safeguards for minority shareholders are considered.

3. Appointments to Accounting Standards Bodies

3.1 My concern in relation to the new regime for the creation of accounting standards relates to the appointment of members of the Financial Reporting Council (FRC) and the appointment of the chairman of the Australian Accounting Standards Board (AASB).

3.2 The Democrats are concerned to ensure that wherever appointments are made to the governing organ of public authorities, whether they be institutions set up by legislation, "independent" statutory authorities or quasi-government agencies, that the process by which these appointments are made is, and is seen to be, transparent, accountable, open and honest.

3.3 The adage of "jobs for the boys" should be an anachronism in 1999. Notwithstanding this, there is a widespread public perception that very little of substance has changed. Many appear to believe that Government appointments result in patronage to handsomely remunerated positions. This perception can damage the reputation of these bodies, as in the public eye they are then seen as being controlled by persons who lack the appropriate independence and who may not be as meritorious as they might be.

3.4 The Democrats are of the opinion that whilst this is often not so, and many outstanding appointments have been made by both the previous and present Governments, nevertheless this is a matter which has to be addressed.

3.5 In truth, there is little empirical evidence that can be brought to bear to rebut this perception. It is still the case that appointments to statutory authorities are left largely to the discretion of the Minister with the relevant portfolio responsibility. In the absence of "umbrella" legislation to correct this situation in a systematic fashion, the Democrats will have to argue for each piece of legislation dealing with these bodies to include standard provisions setting out an accountable regime governing such appointments made by Ministers.

3.6 This Bill restructures the accounting standard setting process. Proposed new section 235A of the *Australian Securities and Investment Commission Act 1989* will provide the Minister with an unqualified discretion to appoint members of the FRC. Those persons will hold their positions on the terms and conditions determined by the Minister. The Minister will also be empowered to appoint the chairman of the AASB. A useful but insufficient requirement is that the appointee must have knowledge of business, accounting, law or government. By and large the Minister is given broad, unstructured discretion. These provisions are an example of the unjustified latitude given to executive government in making key personnel appointments.

3.7 The Nolan Committee, which reviewed the processes for making public appointments in the United Kingdom, set out the following principles to guide and inform the making of such appointments:

(i) A Minister should not be involved in an appointment where he or she has a financial or personal interest[1];

(ii) Ministers must act within the law, which includes its safeguards against discrimination on grounds of gender or race[2];

(iii) All public appointments should be governed by the overriding principle of appointment on merit[3];

(iv) Except in limited circumstances political affiliation should not be a criterion for appointment[4];

(v) Selection on merit should take account of the need to appoint boards which include a balance of skills and backgrounds[5];

(vi) The basis on which members are appointed and how they are expected to fulfil their roles should be explicit[6];

(vii) The range of skills and backgrounds which are sought should be clearly specified[7].

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[1] First Report of the Committee on Standards in Public Life (the Nolan Committee), (1995) Cm 2850-I, para. 30.

[2] *Ibid*, para. 32.

[3] *Ibid*, para. 36.

[4] *Ibid*, para. 41.

[5] *Ibid*, para. 46.

[6] *Ibid*, para. 46.

3.8 These guidelines provide only a basic framework for ensuring that proper practices are followed in the making of appointments. They do not necessarily represent "best practice", rather they set out what should really be taken for granted in a modern system of accountable government. Indeed, the UK Government accepted fully the Nolan Committee's recommendations on public appointments. The office of Commissioner for Public Appointments was subsequently created (with a similar level of independence from the Government as the Auditor General) to provide an effective avenue of external scrutiny. The Commissioner subsequently developed a Code of Practice for Public Appointments which came into force on 1 July 1996. The Code regulates, *inter alia*, appointments to non-departmental public bodies. It sets out seven principles upon which such appointments *must* be based: Ministerial Responsibility; Merit; Independent Scrutiny; Equal Opportunity; Probity; Openness and Transparency; and Proportionality. The Code provides mandatory guidelines for the application of these principles.

3.9 A comparison of these reforms with the current practice of government in the Federal sphere in Australia shows clearly that we lag well behind the UK in this respect. We lack not only the external scrutiny mechanism in the form of the Commissioner for Public Appointments, but more fundamentally we do not have even basic procedural safeguards. This should be redressed as a matter of public importance, with a far higher priority attached to it than has hitherto been the case.

3.10 The public must have trust and confidence that a Minister will not allow improper or irrelevant considerations or personal interests to influence public appointments. Indeed this relationship is in some respects analogous to those of a fiduciary nature, such as trustee and beneficiary, in that it is founded on a high degree of trust and confidence. Yet where a breach of duty occurs in a fiduciary relationship, the person to whom the duty is owed has access to a range of equitable remedies. This is not the case where a Minister acts for improper purposes in making an appointment.

3.11 There is no law to prohibit a Minister from doing this or, where the appointment has been made, to make the appointment voidable. This omission is addressed in the recommended amendments to the Bill which require that all appointments be made in accordance with a published code of practice.

3.12 The code of practice is intended not to act as a mere "guideline" to the Minister in making appointments, but to regulate by law the way in which the Minister exercises the power of appointment. The content of the code of practice is designed to accommodate those principles designated as fundamental by the Nolan Committee and the UK Commissioner for Public Appointments, as set out above.

3.13 A further provision requires that even where the code of practice has been adhered to in determining an appointment, the Minister will be further obliged to consider the impact of the appointee on the overall complexion of the Authority. This provision is aimed at ensuring "capture" of the Authority by any particular interest group cannot occur. It is essential that Boards are genuinely representative of the inevitably divergent views of those groups affected by their actions. Without this requirement the potential remains for appointments to be made to Boards of persons that are well qualified, but who all hold similar views on key areas of policy. This must be avoided not simply because it is good public policy practice to do so, but to maintain the credibility of the Authority in its area of operation.

3.14 Recommendations - The Australian Democrats recommend that the Bill be amended in the following manner:

(a) In Schedule 2, page 345, proposed new subsection 235A(1)

[7] *Ibid*, para. 46.

After "writing" insert: "in accordance with a code of practice determined under Section 235D".

(b) In Schedule 2, page 346, after proposed new section 235C, insert

235D Procedures for appointment of members

(1) The Minister must by writing determine a code of practice for appointments to the Council and for appointing the chairman of the AASB that:

(a) sets out general principles on which appointments are to be made, including, but not limited to:

(i) merit; and

(ii) independent scrutiny of appointments; and

(iii) probity; and

(iv) openness and transparency; and

(b) sets out how these principles are to be applied to the selection of members.

(2) The code of practice must include principles relating to the appointment of any selection committee constituted under this Act.

(3) The code of practice must include a requirement for any person appointed to make a declaration if he or she is a member of a political party.

(4) After determining a code of practice under subsection (1), the Minister must publish the code in the *Gazette*.

(5) Not later than every third anniversary after a code of practice has been determined, the Minister must review the code.

(6) In reviewing a code of practice, the Minister must invite the public to comment on the code.

(7) A code of practice determined under subsection (1) is a disallowable instrument for the purposes of section 46A of the *Acts Interpretation Act 1901*.

235E Independence of the Council

In appointing members of the Council, the Minister must ensure that the balance of interests on the Council is such that no one interest may dominate the Council or derogate from its independence.

(c) Schedule 2, page 347, proposed new subsection 236B(1),

After 'AASB' insert: 'in accordance with a code of practice determined under Section 235D'.

4. Other Issues

4.1 I would like to raise the issue of abdication of the power of the Parliament to ASIC. The majority of the Committee refer, in four separate parts of their report, to the power of the ASIC to make orders modifying or exempting persons from compliance with the *Corporations Law*, as providing a mechanism to alleviate possible problems that may be caused by the new provisions. Specifically, and extracting from the report of the majority of this Committee, the power of the ASIC will mean it will be able to:

(a) 'relieve a person from the obligation to proceed with a mandatory bid…' (in relation to the mandatory bid rule)

(b) 'modify the law in this respect if necessary' (in relation to bidder's statement formalities)

(c) 'provide a second avenue through which any problems which arose could be addressed' (in relation to placements)

(d) 'grant an exemption or modification of the law should it be necessary' (in relation to new listings and investor protection).

4.2 This power seems to be viewed as some sort of a 'fix all', so that the problems raised before the Committee somehow are alleviated because the ASIC can always modify the law if a problem arises. At one point the majority's report actually states:

> In light of these factors [which includes the ASIC power of modification and exemption] the Committee does not believe that the possible problem identified by the ASX is sufficient to justify watering down this protection.

4.3 The ability of the ASIC to modify the law should not be taken into consideration by the Committee as a factor in determining whether the Parliament should address an issue or correct a problem.

4.4 We somewhat cautiously accept that the power which the ASIC will continue to have to modify the law or exempt certain persons from the operation of the law is possibly justified, and we are not therefore necessarily opposed at this time to the continuation of the existence of that power. However, it is the role of the Parliament to deal with issues when they are identified rather than to simply rely on the fact of the grant of these powers to the Executive or to autonomous bodies.

4.5 Recommendation – that the powers delegated to ASIC be the subject of a review and a report to the Parliament in five years.

5. Conclusion

5.1 The Australian Democrats are conscious that a number of matters in submissions have not been satisfied or addressed by the majority report. We have not had the opportunity to write a review of the relevant issues raised. We would expect there may be further issues which we will need to take up in the course of debate on the Bill.

Senator Andrew Murray