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THE TREASURY

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20 April 2001

Mr D. Creed
Secretary
Parliamentary Joint Statutory Committee on Corporations and Securities
Parliament House
CANBERRA ACT 2600

Dear Mr Creed

INQUIRY INTO THE *CORPORATIONS (COMMONWEALTH POWERS) ACT 2001* (NSW), THE CORPORATIONS BILL 2001 AND THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION BILL 2001

On behalf of the Commonwealth Treasury and the Commonwealth Attorney-General's Department, I enclose the joint submission of those Departments, together with a background briefing, in relation to the above inquiry.

Officers of the Treasury and the Attorney-General's Department would be pleased to provide any further assistance that the Committee may require.

Any inquiries in relation to the submission or appearance may be addressed to James Faulkner, Assistant Secretary, Constitutional Policy Unit, Attorney-General's Department (02 6250 6422) or Andrew Sellars, Corporate Governance and Accounting Policy Division, The Treasury (02 6263 3979).

Yours sincerely

Veronique Ingram
General Manager

INQUIRY INTO THE *CORPORATIONS (COMMONWEALTH POWERS) ACT 2001* (NSW), THE CORPORATIONS BILL 2001 AND THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION BILL 2001

JOINT SUBMISSION OF THE COMMONWEALTH TREASURY AND ATTORNEY-GENERAL'S DEPARTMENT TO THE PARLIAMENTARY JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES

INTRODUCTION

This submission outlines the package of legislative and other measures that has been developed ('the new scheme') to place the Corporations Law scheme on a secure legal foundation following the decisions of the High Court in *Re Wakim*[1] and *Hughes*[2]. It also outlines the considerations that have shaped the new scheme.

Further detail is set out in the explanatory memoranda for the Corporations Bill 2001 ('the Corporations Bill') and the Australian Securities and Investments Commission Bill 2001 ('the ASIC Bill').

THE NEW SCHEME

The fundamental objective of the new scheme is to restore, for practical purposes, the regulatory environment that existed before *Re Wakim* and *Hughes*. The scheme will not make substantive policy changes to the law.

The various elements of the new scheme are the result of exhaustive negotiation between the Commonwealth and the States and are thus highly interdependent. They strike a fine balance in reinstating a secure and responsive scheme, capable of delivering legal and business certainty in the modern commercial environment, while accommodating a range of specific State concerns. State references will, for example, include an objects clause ruling out reliance on the references for the purpose of regulating industrial relations; the Corporations Agreement will restrict amendments having the effect of requiring the adoption of a corporate structure to agreed areas. States were also adamant that the new scheme should be reviewed within 5 years. Accordingly, State references are for a period of 5 years (which may be extended).

The new scheme will, in effect, re-enact the Corporations Law as a single federal law capable of operating nationally. (The current scheme is an aggregation of State and Territory laws.) To the extent that the Commonwealth Parliament does not have the power to enact the replacement scheme on its own, the scheme will find constitutional support in State references made in accordance with subsection 51(xxxvii) of the Constitution. The model reference enacted by the New South Wales Parliament commenced on 4 April 2001.

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1 (1999) 198 CLR 511.

2 (2000) 74 ALJR 802; 171 ALR 155.

Each State reference will be two-fold: the first (or text) reference will ensure, in effect, that the Commonwealth Parliament may enact the text of the Corporations Bill and the ASIC Bill; the second (or amendment) reference will ensure that the new Commonwealth Acts may be amended from time to time by the Commonwealth Parliament, so long as those amendments are laws with respect to the formation of corporations, corporate regulation, or the regulation of financial products or services.

This approach is based on an established model (see the *Mutual Recognition Act 1992* (Cth) and relevant State references such as the *Mutual Recognition (New South Wales) Act 1992* (NSW)). It has been developed in close consultation with Commonwealth and State Solicitors-General. The model reference was drafted by the Parliamentary Counsels Committee under the auspices of the Standing Committee of Attorneys-General and the Ministerial Council for Corporations.

The new scheme will be simpler than the current scheme. Commonwealth laws relating to the administration and enforcement of the Corporations Act, such as the *Administrative Appeals Tribunal Act 1975* and the *Crimes Act 1914*, will apply of their own force. It will no longer be necessary to apply such adjectival laws as State laws by means of complex application provisions in State Acts.

The legislative package will include Commonwealth, State and Territory legislation to deal with a range of consequential issues. States will also enact legislation to ensure that actions of Commonwealth officers and authorities already taken under the current Corporations Law scheme, and at risk following *Hughes*, are valid.

NO POLICY CHANGES

The federal bills do not make substantive policy changes and preserve so far as possible the current section numbers. Changes to the text of the existing corporations legislation have been made solely for the purpose of:

- enabling current complementary State and Territory provisions to operate as a single federal law capable of national application;

- preserving, as nearly as practicable, the status quo in relation to the interaction of the federal law and other State and Territory laws (the federal law enables the continued operation of otherwise inconsistent State and Territory legislation); and

- correcting cross-referencing and other minor errors, and adopting current Commonwealth drafting protocols (eg, changing ‘shall’ to ‘must’).

TIMING

Re Wakim and *Hughes* have had extremely negative consequences for the administration of the current scheme, and general confidence in that scheme. The new scheme has been welcomed by business and legal groups as a timely solution to these problems. In order to avoid prolonging the current uncertainty, and further undermining business confidence, it will be important to meet the 1 July 2001 target for commencement of the new scheme.

20 April 2001

CORPORATIONS (COMMONWEALTH POWERS) ACT 2001 (NSW), CORPORATIONS BILL 2001 AND AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION BILL 2001

BACKGROUND BRIEFING FOR THE PARLIAMENTARY JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES PREPARED BY THE COMMONWEALTH TREASURY AND COMMONWEALTH ATTORNEY-GENERAL'S DEPARTMENT

PURPOSE

This briefing note contains background material on the package of Commonwealth and State legislation intended to replace the Corporations Law framework in the wake of the High Court in *Re Wakim*[1] and *Hughes*[2]. This material may be of assistance to the Parliamentary Joint Statutory Committee on Corporations and Securities in the conduct of its inquiry into the *Corporations (Commonwealth Powers) Act 2001* (NSW), the Corporations Bill 2001 and the Australian Securities and Investments Commission Bill 2001.

DEVELOPMENT OF THE CURRENT CORPORATIONS LAW SCHEME

The Commonwealth and States established a co-operative scheme for companies and securities regulation in 1981. This scheme involved the Commonwealth enacting legislation for the Australian Capital Territory which was applied by the States as State law[3] and the establishment by the Commonwealth of a national coordinating body, the National Companies and Securities Commission.[4]

In 1989 the Commonwealth enacted national corporations legislation, in the shape of the *Corporations Act 1989* and the *Australian Securities Commission Act 1989*. Key aspects of that legislation were challenged on constitutional grounds before it commenced. In *NSW v Commonwealth*[5], a majority of the High Court held that the provisions of the *Corporations Act 1989* enabling the incorporation of companies that were trading and financial corporations were invalid.[6]

Negotiations following that decision resulted in establishment of the current system of corporate regulation which came into operation on 1 January 1991. Like the co-operative scheme that it replaced, the system is based on complementary State and Territory laws.

In particular, the Commonwealth Parliament has enacted the Corporations Law as a law for the Australian Capital Territory. Laws of each State and the Northern Territory apply the Corporations Law of the ACT as a law of that jurisdiction. Commonwealth adjectival laws dealing generally with the administration and enforcement of legislation, such as the *Administrative Appeals Tribunal Act 1975* and the *Crimes Act 1914*, are similarly applied in relation to the Corporations Law of each jurisdiction.

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1 (1999) 198 CLR 511.
2 (2000) 74 ALJR 802; 171 ALR 155.
3 The Commonwealth enacted the *Companies Act 1981* and the *Companies (Acquisition of Shares) Act 1980*. Each State and the Northern Territory enacted application Acts applying the Commonwealth Acts.
4 *National Companies and Securities Commission Act 1979*.
5 (1990) 169 CLR 482.
6 (1990) 169 CLR 482 at 498.

The Corporations Agreement, to which the Commonwealth, all States and the Northern Territory are parties is a political agreement underpinning the present legislative arrangements which, among other things, imposes certain requirements on the Commonwealth in relation to amending the Corporations Law.

Unlike the former co-operative scheme, responsibility for the administration and enforcement of the Corporations Law rests solely with Commonwealth bodies – the Australian Securities and Investments Commission ('ASIC'), the Commonwealth Director of Public Prosecutions ('DPP') and the Australian Federal Police. These bodies are responsible to the Parliament of the Commonwealth through the Commonwealth Minister.

Until recently, this combination of Commonwealth and State laws was thought to operate well and was seen to give Australia – for the first time – an efficient and national approach to corporate regulation.

THE UNRAVELLING OF THE CORPORATIONS LAW SCHEME

However, recent decisions of the High Court have revealed significant constitutional flaws in the Corporations Law scheme.

Re Wakim; ex parte McNally

The first constitutional blow to the scheme came with *Re Wakim*[7]. That decision invalidated significant aspects of the 'cross-vesting' provisions in the Corporations Law scheme, which, along with the general cross-vesting scheme, had been devised to remove uncertainties about the jurisdictional limits of the various federal, State, and Territory courts. Under the schemes, one court could determine all matters in dispute between the parties, effectively creating an integrated court system and ensuring the efficient, convenient, effective resolution of disputes.

The High Court in *Re Wakim* held that State jurisdiction (generally including jurisdiction in relation to matters arising under the Corporations Law of a State) cannot be conferred on federal courts.

As a result the Federal Court lost most of its jurisdiction in relation to Corporations Law matters.

The Queen v Hughes

The constitutional validity of the Corporations Law scheme was again before the High Court last year in *R v Hughes*.[8] That case involved a challenge to the conferral of State functions and powers on Commonwealth bodies and officials under the scheme. While the particular prosecution at issue in *Hughes* survived challenge, the Court's reasoning has very serious ramifications for the Corporations Law scheme as a whole.

The Court appeared to confirm the general principle that Commonwealth authorities may perform State functions and exercise State powers for the purposes of a co-operative Commonwealth/State scheme. However, the Court indicated that the exercise by a Commonwealth authority or officer of State functions or powers coupled with a duty – particularly where the rights of an individual could be adversely affected - must be capable of being supported by a head of Commonwealth legislative power.

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7 *Re Wakim; ex parte McNally* (1999) 198 CLR 511. .

8 (2000) 74 ALJR 802; 171 ALR 155.

This is problematic as the Corporations Law covers a number of areas in respect of which the Commonwealth may lack legislative power. These include not only the incorporation of companies, but also the regulation of bodies corporate other than trading and financial corporations (for example, non operating holding companies) and their officers, and the regulation of managed investment schemes operated by individuals in certain circumstances.

In the wake of *Hughes*, and other recent decisions, there is a 'pervasive uncertainty about the foundations of corporate regulation in Australia'.[9] The recent decisions are compromising the ability of ASIC and the DPP to administer and enforce and the Corporations Law by rendering day to day regulatory processes vulnerable to challenge.

A development with potentially more serious consequences is the case of *GPS First Mortgage v Lynch.* GPS is a Corporations Law company, incorporated by ASIC. In this case, Lynch argues that ASIC was under a duty to perform the function of incorporation, but as there is no head of Commonwealth power to support this function, the incorporation by ASIC of GPS was invalid and void. Thus, it is argued that the company does not exist, and accordingly cannot maintain bankruptcy proceedings. The Attorney-General has intervened to remove this case to the High Court.

A number of other similar cases have also been instituted and the High Court is likely to hear argument about this issue later this year.

If the High Court finds ASIC's function of incorporation under the Corporations Law scheme to be unconstitutional, in excess of 660,000 companies incorporated by ASIC under the State Corporations Law since 1991 would not legally exist. One consequence is the potential unravelling of all the legal relationships entered into by these companies, including transactions entered into by these companies.

The former Chairman of ASIC, Mr Alan Cameron AM, said last year that:

> 'the impact [of these decisions] in terms of delay, disruption, uncertainty and sterile debate about technicalities has been all too real and expensive. Together the decisions show serious deficiencies in the arrangements underlying our system of corporate regulation. While the uncertainty remains, business and investor confidence must suffer... The Corporations Law is so critical to the way our economy and financial system works and the way companies work that to have a situation where there is any uncertainty at all is damaging.[10]

Many other commentators, including business, professional, and shareholder representatives, echoed these concerns.[11]

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9 The Hon Daryl Williams AM QC MP, Attorney-General, 'Action needed to end legal uncertainty for business', *Australian Financial Review,* 5 May 2000, p. 31.

10 Mr Alan Cameron AM, *The law's condition is critical, warns regulator* Australian Financial Review, 7 April 2000, p.31.

11 See, for example, Professor Ian Ramsay, quoted in 'ASIC jurisdiction in jeopardy' *Australian Financial Review*, 4 May 2000, p.11; Professor George Williams '*Hughes* decision heightens uncertainty' *Australian Financial Review*, 5 May 2000, p.33; 'No fix on the horizon for corporate law', *The Age*, 4 May 2000. p.C1; Professor Bob Baxt quoted in 'Questions unanswered', *Australian Financial Review*, 4 May 2000, p.10; Mr Alan Cameron AM, 'The law's condition is critical, warns regulator' *Australian Financial Review*, 7 April 2000, p.31; 'High Court may drive nail into Corporations Law coffin', *The Age*, 20 March 2000; Mr Ian Dunlop, then CEO, Australian Institute of Company Directors, 'Legal mess must be cleaned up as soon as possible', *Australian*

THE RESPONSE: A REFERRAL OF LEGISLATIVE POWERS TO THE COMMONWEALTH

In light of the very serious threats to the Corporations Law framework, last year negotiations between Commonwealth, State and Territory governments began in earnest with a view to finding a way to quickly place the regulatory framework on a sound constitutional foundation as a matter of urgency.

In August last year at a joint meeting of the Standing Committee of Attorneys-General and the Ministerial Council for Corporations, the States agreed, in principle, to refer to the Commonwealth sufficient legislative power to enact the existing Corporations Law and the Australian Securities and Investments Commission Act. The meeting also agreed that the States would refer an amendment power that will allow amendments relating to the formation of corporations, corporate regulation and the regulation of financial products or services to be dealt with as necessary.

The giving of the references would be subject to safeguards to protect the interests of the States. These were to be detailed in the Corporations Agreement. The most significant of them related to the use of the amendment power, including the approval process for making amendments.

The States also considered it important to ensure that the referral is reviewed after a period of time. Accordingly, the Commonwealth and the States agreed to insert a sunset clause to cause the termination of the referral after five years. In the meantime, the Commonwealth will consider the option of a constitutional amendment by way of a referendum. However, the referral can be extended by State proclamation.

Work proceeded on putting the agreement into legislative form. However, in November 2000, significant differences between the States and the Commonwealth emerged about the details of the agreement. In particular, the States expressed concerns about the possibility of the Commonwealth using the powers they would refer for purposes other than those expressly contemplated (such as the regulation of industrial relations). The States insisted on a range of measures to deal with that issue, but these were not acceptable to the Commonwealth. The matters included detailed express exclusions from the matters referred and a right of States to unilaterally terminate the amendment power. The Commonwealth considered that the measures proposed by the States would have created legal uncertainty and hampered policy flexibility to an unacceptable extent.[12]

In December 2000, at a meeting between Ministers representing the Commonwealth and New South Wales and Victoria, a compromise agreement was reached that was designed to address the States' concerns without unacceptably affecting the corporate regulatory framework.

Details of agreement

The key features of the final agreement (including the elements agreed in December 2000) are as follows:

Financial Review, 5 May 2000, p.57; 'Corporate Law fiasco must end', editorial, *Australian Financial Review*, 22 March 2000.

12 In particular, the express exclusions would have created doubts about the constitutional efficacy of legitimate amendments of the legislation. This would have amounted to replacing the existing uncertainty with another equally unacceptable form of uncertainty. Further, allowing individual States to unilaterally terminate the amendment power would effectively give each State a veto over every amendment. This could result in 'lowest common denominator' decision making, undermining a significant advantage of the present system whereby the Commonwealth has a clear leadership role.

- State references permit only the enactment of the Corporations and ASIC Acts, and amendments to those Acts relating to the formation of corporations, corporate regulation and the regulation of financial services and products;

- State references are for a period of five years (which a State may extend by proclamation); and a State may terminate both its text and amendment references, or just its amendment reference, with six months' notice;

- the State reference legislation includes an objects clause indicating that the referred powers are not to be used for the purpose of regulating industrial relations;

- the new scheme preserves the operation of inconsistent State laws (this is achieved by a comprehensive set of provisions in the Commonwealth bills); and

- the Corporations Agreement ('the Agreement') will remain a crucial component supporting the legislative framework. The major changes proposed to the Agreement under the new arrangements are:

    - it expressly rules out reliance on the State references for the purpose of regulating industrial relations, the environment or any other agreed matter;

    - it restricts amendments having the effect of requiring adoption of the corporate structure to agreed areas;

    - States' voting power (including the Northern Territory) under the Agreement will increase from two to three jurisdictions for approval of amendments in areas where approval of the Ministerial Council is already required;

    - States will have rights under the Agreement to prevent amendments where four referring States consider they are for an improper purpose (that is, beyond corporate regulation or regulation of financial services and products);

    - the Agreement will require the Commonwealth to use best endeavours to ensure consultation and, where relevant, voting in relation to parliamentary amendments; and

    - the Commonwealth will also be required to oppose amendments, and to refrain from moving amendments, outside the scope of the reference.

The safeguards in the State reference legislation, the Agreement and the Commonwealth bills have been designed to ensure the new scheme remains within the spirit of the State references, without creating uncertainty about the integrity of the matters actually referred.

As noted above, the reference legislation allows for a State to terminate its references within the five-year period. However, if a State terminates its amendment reference it will cease to be part of the national corporate regulation scheme unless it does so simultaneously with other States (and with 6 month's notice). The Agreement will cover this situation in providing that, if four States vote to terminate the amendment reference, *all* referring States will terminate that reference.

The Agreement, which will underpin the uniform operation of the federal law throughout the referring States and Territories, will thus provide the States as a group with protection against misuse of their references, while ensuring effective operation of the new scheme.

The Commonwealth considers that these arrangements will meet its objective of overcoming the constitutional uncertainty in relation to the Corporations Law, delivering a scheme that is:

- certain in operation;
- national and uniform;
- easy and cost effective to administer;
- responsive to domestic and international policy pressures; and
- capable of seamless enforcement and interpretation on a national basis.

OUTLINE OF THE NEW LEGISLATIVE PACKAGE

The new legislative package will comprise the following elements:

- *State references*: uniform State legislation that refers sufficient legislative power to the Commonwealth to enact and amend the new Corporations Act and ASIC Act (an example of which is the *Corporations (Commonwealth Powers) Act 2001* (NSW);
- *Central elements—New Commonwealth core legislation*: in reliance on those references, the Commonwealth will enact the Corporations Bill 2001 and the Australian Securities and Investments Commission Bill 2001;
- *Fees Bills:* since the Constitution requires all taxing legislation to be in separate Bills dealing only with one subject of taxation, the provisions imposing fees and taxes have been excised from the Corporations Bill 2001 and the Australian Securities and Investments Commission Bill 2001, and will be presented in a separate package of Bills to be introduced in the Winter sittings;
- *Consequential Bills:* The commencement of the new core framework will require consequential changes to a large number of statutes and the Commonwealth, State and Territory level. Some ancillary provisions to complement the transitional provisions in the Corporations and ASIC Bills will also be needed. This legislation is currently being finalised; and
- *State validation legislation:* States will also enact legislation to ensure that past actions of Commonwealth officers and authorities already taken under the current Corporations Law scheme, and at risk following *Hughes*, are validated.

The Corporations Bill and the ASIC Bill are designed as the central elements of a replacement legislative scheme that will, in effect, reinstate the Corporations Law as a single federal law capable of operating nationally.

The fact that the new scheme will be established under federal law means it will be simpler than the current Corporations Law scheme. Laws related to the administration and enforcement of the new Corporations Act, such as the Freedom of Information and Crimes Act, will apply of their own force. It will no longer be necessary to apply such adjectival laws as State laws by means of complex application provisions in State Acts.

The legislation has been prepared in close consultation with Commonwealth and State Solicitors-General. The reference of two 'matters' – in effect, a specific text and a power to amend that text – is similar to the approach adopted for the mutual recognition scheme established in 1992 (see the *Mutual Recognition Act 1992* (Cth) and relevant State references such as the *Mutual Recognition (New South Wales) Act 1992*).

The Corporations Bill 2001 and the ASIC Bill 2001 are designed essentially to restore the regulatory environment which existed prior to the decisions of the High Court mentioned above. However, the federalisation of the law has necessitated some marginal changes to the text of this laws, such as the change to jurisdiction of incorporation of companies (required because there will no longer be a Corporations Law in each State). In addition, some minor technical amendments have been made to correct cross-referencing errors and implement the most recent Commonwealth drafting protocols (such as replacing 'shall' with 'must'). Full details of these consequential changes may be found in the Explanatory Memoranda accompanying each of the Bills.

20 April 2001