GOVERNMENT RESPONSE TO THE REPORT OF THE PARLIAMENTARY JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES

MATTERS ARISING FROM THE *COMPANY LAW REVIEW ACT 1998*

Introduction

In March 1997 the Government commenced the Corporate Law Economic Reform Program as a comprehensive initiative to improve Australia's corporate law as part of the Government's drive to promote business and economic development. The Program also included a commitment to ensuring that the Corporations Law is user friendly. The *Company Law Review Act 1998* began that work.

The *Company Law Review Act 1998* has also improved the efficiency of corporate regulation, and reduced the regulatory burdens on business and other users of the Corporations Law. The Government considers that the Act has brought substantial benefits for both small and large business. This has been confirmed by the strong support from the business community for the Act.

The Act rewrote and improved the core company law rules regarding registering companies, meetings, share capital, financial reporting, annual returns, deregistration of defunct companies and company names, with a view to facilitating business and investment.

The proposed reforms in the Company Law Review Bill 1997 were exposed for public comment in 1995. In June 1996 the Government referred the draft Bill to the Parliamentary Joint Statutory Committee on Corporations and Securities (PJSC). This provided an additional opportunity for input by users of the Corporations Law. The PJSC's Report was tabled in the Senate on 18 November 1996. The PJSC expressed its approval for the general content of the Bill, and made 11 specific recommendations that the Government addressed separately.

As a result of public consideration, a number of significant changes were made to the Bill by the Government following its consideration by the PJSC in 1996. However, a number of amendments to the Corporations Law were moved by the Senate during the passage of the Bill, without the benefit of public consultation and analysis by stakeholders. The Government wished to ensure that amendments passed in this fashion were subjected to public scrutiny and therefore referred the amendments to the PJSC.

Accordingly, the reference for the PJSC to examine certain matters arising from the passage of the *Company Law Review Act 1998* was given by the Treasurer, the Hon Peter Costello MP, in July 1998. The matters referred were as follows:

(a) The Government opposes the following amendments:

- The directors of a listed company should be elected by a proportional voting system;
- Companies should be required by the Corporations Law to report on compliance with environmental regulation (section 299(1)(f) of the Corporations Law);
- Listed companies should disclose information which is disclosed to, or required by, foreign exchanges (section 323DA of the Corporations Law).

(b) The following matters have been the subject of complaint and/or concern expressed to the Government by the business community:

- Companies should be obliged to report any proceedings instituted against the company for any material breach by the company of the Corporations Law, or trade practices law, and, if so, a summary of the alleged breach and the company's positions in relation to it;
- An application to register a proprietary company should include a copy of its constitution;

- Listed companies must give at least 28 days notice of a general meeting (section 249HA of the Corporations Law);

- Listed companies should be required to disclose more information relating to proxy votes (section 251AA of the Corporations Law).

(c) The Government requests that the Committee generally examine the following matters:

- Listed companies should be required by law to establish a corporate governance board;

- Listed companies should be required by law to establish an audit committee;

- Whether the directors and executive officers of a company should be obliged to report to the auditor any suspicion they might have about any fraud or improper conduct involving the company;

- Whether a director of a listed company should have the power to call a meeting of members (section 249CA of the Corporations Law);

- Whether listed companies must specify a place, fax number and electronic address for the purpose of receiving proxy appointments (section 250BA of the Corporations Law);

- Whether listed companies' annual reports should include:

  (a) discussion of broad policy for determining the nature and amount of emoluments of board members and senior executives of the company;

  (b) discussion of the relationship between such policy and the company's performance; and

  (c) details of the nature and amount of each element of the emolument of each director and each of the five named officers of the company receiving the highest emolument (section 300A of the Corporations Law).

The PJSC also considered new section 117(2)(ka) of the Corporations Law: "Applying for registration" –

(ka) for a company limited by shares or an unlimited company, a statement that the written agreement referred to in sub-paragraph (k)(i);

(i) includes a summary of the rights and conditions attaching to the shares agreed to be taken up;

(ii) *sets out the total number of persons who have consented to be members and the information referred to in sub-paragraph (k)(i) and (k)(ii);*

(iii) contains a statement that, if a constitution has not been adopted, the Replaceable Rules will apply and that they create a contract between the members the terms of which may alter if the Replaceable Rules change after the company is registered."

Following the Federal election in 1998, the PJSC recommenced its inquiry. On 2 August 1999, the Minister for Financial Services and Regulation, the Hon Joe Hockey MP, requested the PJSC to also examine the operation of sections 249D and 249Q of the Corporations Law and the then proposed regulation-making power in Schedule 6 of the Corporate Law Economic Reform Program

Bill 1998. The PJSC resolved to consider these matters in the context of its inquiry into matters arising from the Company Law Review Act.

The PJSC reported in October 1999.

Some of the issues considered by the PJSC have also been considered by the Companies and Securities Advisory Committee (CASAC) in the context of its Report entitled *Shareholder participation in the modern listed public company*, released in June 2000.

The Government thanks the members of the PJSC for their comprehensive consideration of the relevant issues.

Together with the PJSC, the Government acknowledges the valuable contribution made by those persons who appeared before the PJSC, and who provided written submissions to the inquiry.

Summary of recommendations

PJSC recommendations supported by Government

- that the Corporations Law makes no provision mandating the adoption of any form of proportional voting for directors or requiring a company to put any such proposal to its members.

- that s.299(1)(f) of the Corporations Law be deleted.

- that s.323DA of the Corporations Law be deleted.

- that the Corporations Law should not require companies to report any proceedings instituted against the company for any material breach of the Corporations Law or the trade practices law.

- that the 28 day period of notice for meetings of listed companies should be reduced to 21 days.

- that the Corporations Law should not provide that listed companies establish a corporate governance board.

- that the Corporations Law should not require listed companies to establish an audit committee.

- that the Corporations Law should not expressly require the reporting of suspicions of fraud and improper conduct involving the company to the auditor.

- that section 249CA of the Corporations Law be repealed.

- that the Corporations Law [in Chapter 13 of the PJSC's Report]:

  (iii) should include in section 249X(1) provision for a body corporate as well as a natural person to be appointed as a proxy.

PJSC recommendations supported by Government in part

- that the Corporations Law should be amended as follows [in Chapter 8 of the PJSC's Report]:

  (ii) section 250J(1A) should be repealed and replaced with a provision that requires the minuting of proxy votes "For" and "Against" the resolution when a resolution has been decided on a show of hands;

- that the Corporations Law:

  (i) *should retain section 250BA subject to the amendments described above* [in Chapter 13 of the PJSC's Report] to authenticate proxy appointments.

- that sections 300 and 300A of the Corporations Law should be amended.

PJSC recommendations not supported by Government

- that the ASX and ASIC broadly review company voting procedures with a view to encouraging best practice in relation to voting design and process. This review could take the form of advising on a number of options for voting procedures, with indications of the advantages and disadvantages of each.

- that the Corporations Law should provide for:

  i. a proprietary company to lodge a copy of its constitution on registration with the ASIC; and

  ii. proposed amendment of section 117(2)(ka), apart from item (iii).

- that the Corporations Law should be amended as follows [in Chapter 8 of the PJSC's Report]:

  (i) section 251AA(1)(a) should be repealed;

  (iv) section 250A(7) should be amended to correct what appears to be a drafting oversight;

  (v) the AWB Ltd should be granted exemption from the provisions of the Law relating to proxy appointments.

- that the Corporations Law [in Chapter 13 of the PJSC's Report]:

  (ii) should include a new definition of "sign" in Section 9 – Dictionary, to define sign for electronic purposes to be the input of a "PIN".

- that the Corporations Law be amended to provide that the sole test to requisition a special meeting of a company is 5% of the issued share capital to be met collectively by the requisitioning members.

Proportional voting for directors

During the committee stage of debate on the Company Law Review Bill 1997, Senator Murray of the Australian Democrats moved that a provision be added to the Corporations Law that would mandate a form of proportional voting for directors of listed companies and require other companies to put a proportional voting proposal to their members for resolution. The proposed amendment was unsuccessful, and the Government indicated its opposition to the proposal when referring the matter to the PJSC.

The Corporations Law does not currently mandate any particular form of voting for the election of directors. That is, companies are generally free to choose voting methods they consider appropriate, with the constitution making provision for the appointment of directors. Constitutions often provide for the power to appoint directors to be exercised by the general meeting, and boards may be able to make appointments to fill casual vacancies or to bring the numbers of the board up to the maximum allowed by the constitution. Some companies may rely on the replaceable rules in the Corporations Law, which allow a company to appoint a person as a director by resolution passed in general meeting (replaceable rule, section 201G) unless the company's constitution provides otherwise. In addition, directors may appoint other directors, subject to confirmation by resolution (replaceable rule, section 201H).

There are other provisions in the Corporations Law and the Australian Stock Exchange (ASX) Listing Rules that affect the election of directors, but generally companies are free to choose the method of voting that suits them.

A common system adopted by companies in Australia allows each member to cast one vote per share for a candidate for each vacancy to be filled, so that a bare majority of shares is able to elect the board. In contrast, the system of proportional voting suggested by the Australian Democrats would allow the number of shares held by a member to be multiplied by the number of vacancies (sometimes known as cumulative voting). The members may then cast their votes among the candidates for directorships as they think fit. It is one method that could be used to ensure minority representation on the board.

The Government notes that should a listed company wish to adopt a system of proportional (or cumulative) voting, a waiver of the ASX Listing Rule of one vote per share would be required (ASX Listing Rule 6.9).

In its Report, the PJSC has indicated that:

- The current state of the Law is preferable, where companies themselves decide on the form of the election. The members of a company may decide if they wish to adopt any form of proportional representation, including cumulative voting, but there should be no compulsion in the Corporations Law for members to vote on a particular system;

- Proportional representation has the potential to affect the essential unity and cohesion of a board, with the possibility of factions and dissidents. Elections for directors are not comparable to those for Parliamentarians;

- Proportional voting may be impractical and counter productive. It strikes at the principle that directors should be generally representative of those with the greatest financial interest in the company, a position usually achieved by electing directors by an absolute majority of members voting;

- Proportional representation may affect consumer confidence and have adverse economic effects;

- Although proportional representation would increase minority representation on boards, its mandatory or irrevocable introduction would have disadvantages easily outweighing any benefits;

- Where there is a perception of unfairness when members vote one by one for directors in cases where there are more candidates than vacancies, the problem could be addressed by any suitable voting system, not necessarily proportional or cumulative;

- There is considerable merit in the ASX and the Australian and Securities and Investments Commission (ASIC) encouraging education and publicity campaigns with the object of making companies aware of the different voting procedures that are available and may be suitable for the individual circumstances of the company. This could be a matter for consideration when companies are revising their constitutions. Companies should be encouraged to adopt best practice in relation to the voting design and process in relation to their existing constitutions.

PJSC recommendations

The PJSC recommends that the Corporations Law make no provision mandating the adoption of any form of proportional voting for directors or requiring a company to put any such proposal to its members.

The PJSC recommends that the ASX and ASIC broadly review company voting procedures with a view to encouraging best practice in relation to voting design and process. This review could take the form of advising on a number of options for voting procedures, with indications of the advantages and disadvantages of each.

CASAC's views

CASAC has considered whether cumulative voting should be mandatory for elections of directors in Australian listed companies in its Final Report, *Shareholder participation in the modern listed public company* (paragraphs 4.197 to 4.207).

In its Report, CASAC indicates that the rationale for cumulative voting is to assist minority shareholders to secure some representation on the board of directors. The greater the number of vacancies, the higher the possibility of minority shareholders securing some representation by focusing their multiple votes on the same one or few candidates. By contrast, under non-cumulative voting, a majority shareholder, or a majority group of shareholders who vote, could determine all positions of the board. CASAC recommends that there should be no legislative provision for cumulative voting (Recommendation 30, page 95 of CASAC's Final Report).

Government response

The Government supports the recommendations of the PJSC and CASAC. Shareholders may choose any form of proportional voting, including cumulative voting (a waiver of the ASX Listing Rule may be required for listed companies) that meets their specific corporate governance requirements.

The Government does not consider it necessary for the ASX and ASIC to undertake the suggested reviews, as CASAC has already considered the issue of voting procedures.

Environmental reporting

During the passage of the *Company Law Review Act 1998*, paragraph 299(1)(f) was inserted into the Corporations Law following a motion by the Australian Democrats. Paragraph 299(1)(f) requires that the directors' report for a financial year must include disclosure of:

> "(f) if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory – details of the entity's performance in relation to environmental regulation."

The Government indicated that it opposed the provision during debate in the Senate and indicated its continued opposition when referring the matter to the PJSC for inquiry.

The PJSC has advised that:

- It is inappropriate for the Corporations Law to require inclusion in the annual directors' report of details of performance in relation to environmental regulation, noting the almost total unanimity on this point in submissions from the Australian financial and legal communities;
    - Environmental reporting is not a matter that relates to the Corporations Law – the proper place for such reporting is the environment law itself;
    - Why should environmental performance be singled out to the exclusion of other worthwhile performance indicators (for example, taxation regulation or occupational health and safety);
    - Mandatory reporting may lead to a standardised form of general words as the lowest common denominator – a voluntary system would better encourage companies to achieve best practice, while the market will deal adversely with those companies that lag;
    - The provision is vague and uncertain, and cannot be solved by asking ASIC to refine its Practice Note;
    - The provision lacks any of the usual safeguards, even those for other requirements imposed by section 299 – there is no protection for self-incrimination or in relation to civil proceedings or other liability claims;
    - There is an existing obligation on listed companies to disclose immediately all events that would have a material effect on the price or value of its securities. Any additional material required by paragraph 299(1)(f) would be non-material and up to a year out of date, limiting the practical effect of the provision;
    - There are significant legal or economic structures to which paragraph 299(1)(f) does not apply – for example to the overseas operations of entities formed under the Corporations Law. Also the provision requires entity rather than project reporting for mining and exploration joint ventures;
    - Companies are required to duplicate existing Commonwealth and State environmental reporting requirements, with resulting additional costs;

- The submissions from the environmental groups were not as persuasive as those from the business community.

PJSC recommendation

The Committee recommends that s.299(1)(f) of the Corporations Law be deleted.

Government response

The Government supports the PJSC's recommendation in principle.

However, the Government does see value in greater public environmental reporting as it can address environmental accountability and community right-to-know concerns, as well as generate significant benefits to the reporting organisation.

In this regard, the Government is actively encouraging greater public environmental reporting through a range of voluntary, as opposed to mandatory, measures. These include:

- the release by the Government of a guidance document on how to prepare public environmental reports, *A Framework for Public Environmental Reporting – An Australian Approach, March 2000*; and

- partnering with the Business Council of Australia, the Australian Chamber of Commerce and Industry and the Australian Industry Group, to employ Public Environmental Reporting Extension Officers to assist members of these industry associations in preparing reports.

The Government encourages public corporations to adopt appropriate governance structures and processes (for example environmental disclosure), on an on-going basis and in a non-prescriptive manner. It is considered preferable for Australian corporate governance practices to develop in response to competitive economic, commercial and international pressures, rather than in response to prescriptive rules mandated by Government. The Government will therefore not seek to impose additional mandatory legislative requirements unless there is a clear failure of these mechanisms to produce appropriate corporate governance practices.

In the context of environmental issues, the benefits of mandatory reporting may need to be further reviewed and acted upon, depending upon the voluntary uptake and quality of public environmental reporting in Australia over the next few years.

Disclosure of information filed overseas

During the passage of the *Company Law Review Act 1998*, section 323DA was inserted into the Corporations Law following a motion by the Opposition, requiring Australian listed companies that disclose information to, or as required by:

(a) the Securities and Exchange Commission of the United States of America; or

(b) the New York Stock Exchange; or

(c) a prescribed securities exchange in a foreign country,

to disclose that information to the Australian Stock Exchange.

The Government indicated that it opposed the provision during debate in the Senate and indicated its continued opposition when referring the matter to the PJSC for inquiry.

The PJSC has concluded that:

- The provision is superfluous and includes a number of potentially undesirable consequences:
  - The ASX Listing Rules already require the disclosure of any information that would have a material effect on the price or value of a company's securities. Any additional information disclosed to foreign exchanges would not be price sensitive and would not be material to the Australian market;
  - It is conceptually preferable for the ASX Listing Rules to provide for disclosure requirements of listed companies, with the Corporations Law providing for enforcement of these. It is not appropriate for the Corporations Law to provide this kind of detailed prescription for listed companies;
  - There are possible difficulties with the release of confidential information and the large amount of non-material information disclosed to, for instance, United States exchanges, which would need to be reconciled with Australian accounting principles to be meaningful, at some cost to the individual company;
  - The PJSC accepts that the strongest argument in favour of retaining the provision is that it would encourage globalisation and harmonisation of disclosure standards. Although the PJSC strongly supports these objectives, it considers that the best way to advance these desirable features is not through the Corporations Law, but rather the ASX and the various accountancy bodies should move to adopt world best practice for disclosure standards;
  - Shareholders will not be disadvantaged by removal of the provision, because the only additional information that the provision requires to be disclosed is non-material.

PJSC recommendation

The PJSC recommends that s.323DA of the Corporations Law be deleted.

Government response

The Government supports the PJSC's recommendation.

Reporting of proceedings

During the debate on the Company Law Review Bill 1997, a provision was unsuccessfully sought to be inserted by the Australian Democrats that companies should be obliged to report any proceedings instituted against the company for any material breach by the company of the Corporations Law, or trade practices law, and, if so, a summary of the alleged breach and of the company's position in relation to it.

The Government referred the issue to the PJSC as a matter that has been the subject of complaint and/or concern expressed to the Government by the business community.

The PJSC has advised that:

- The evidence before the PJSC was not supportive of the proposal;
- In the continuous disclosure regime, it is difficult to assess the benefits arising from the recommended disclosures, particularly if the company's defence is a denial of the statement of claims or that the alleged breach has not been proven;
- The institution of proceedings is not by itself proof that a breach has occurred or that an offence has been committed. If the proceedings have only been initiated, then it is premature for a company to declare its position in relation to the alleged breaches;
    - The nature of proceedings under the Trade Practices Act is such that the reporting of allegations or claims of breaches under section 52 can be misleading;
- Legal proceedings should not be the subject of company reporting beyond the usual continuous disclosure requirements for reporting entities;
    - When proceedings have commenced, any written statements or admissions could be used against the company in litigation to the detriment of the company and its shareholders;
        - There is difficulty in determining whether qualified privilege should attach to the company's summary of the statement of claim, especially where these contain defamatory imputations;
- The high cost of compliance is a concern, estimated at over $750,000 annually for a large listed company;
- Although the requirement is misplaced and should not be legislated, companies should, as a matter of corporate governance, disclose the instituting of proceedings or make a fuller report when these have been concluded.

PJSC recommendation

The PJSC recommends that the Corporations Law should not require companies to report any proceedings instituted against the company for any material breach of the Corporations Law or the trade practices law.

Government response

The Government supports the PJSC's recommendation and notes the important role of the continuous disclosure provisions of the Corporations Law. The Government also notes that companies are currently required to disclose information about legal proceedings in the notes to their accounts where the proceedings constitute a material contingent liability.

Proprietary company registration

Following the *Company Law Review Act 1998*, public companies are required (as previously) to lodge a copy of their constitution on registration and any modifications of their constitution with ASIC. The Act removed that requirement for proprietary companies, although the Corporations Law grants:

- the power to ASIC to direct a company to lodge a consolidated copy of its constitution (section 138 of the Corporations Law); and

- a member the right to request the company to send them a copy of the company's constitution (section 139 of the Corporations Law).

The Government referred the issue of the lodgment of company constitutions by proprietary companies to the PJSC as a matter that has been the subject of complaint and/or concern expressed to the Government.

The PJSC concluded that:

- Information about a company as fundamental as its internal rules, powers and shareholding should be available to parties dealing with the company in the commercial environment – uncertainty about documents executed by a company can affect the efficient conduct of its business;

- Although the *Company Law Review Act 1998* simplified company registration and conduct of affairs, the statistic that 50% of all new companies have purportedly issued shares of a particular class or classes without having adopted a constitution, is an unsatisfactory risk for the company and its members;

- A proprietary company should file a copy of its constitution on registration with ASIC;

  - A proprietary company on filing its constitution may elect to adopt the replaceable rules in place of a constitution;

  - Any subsequent modifications to a constitution should also be filed with ASIC;

  - Proprietary companies should re-lodge their constitutions and ASIC should maintain a database for this purpose;

  - ASIC should also retain its emergency power under section 138 to direct a company to lodge a consolidated copy of its constitution with ASIC.

PJSC recommendation

The PJSC recommends that the Corporations Law should provide for:
i. a proprietary company to lodge a copy of its constitution on registration with the ASIC.

Government response

The Government notes that an early draft of the Company Law Review Bill would have required proprietary companies to lodge their constitution with ASIC. The draft provision was withdrawn following consultations with small business interests, which expressed concern at the unnecessary nature and extent of the compliance costs for lodging constitutions.

A Corporations Law company has the legal capacity and power of an individual. The exercise of a power by a company is therefore not invalid merely because it is contrary to an express restriction or prohibition in a company's constitution, or because it is contrary to, or beyond, any objects in the company's constitution.

The Government supports the point put to the PJSC that the public has full protection under sections 128-130 of the Corporations Law and therefore does not need to know the contents of a constitution to secure their interests when transacting with a company (paragraph 6.14 of the PJSC's Report). A person may assume that a company's constitution (if any), and any provisions of the Corporations Law that apply as replaceable rules, have been complied with. A person is not taken to have information about a company merely because the information is available to the public from ASIC. A third party's dealings with a company will generally only be affected by a restriction in the company's constitution if the third party knew of, or suspected, a limitation.

The rights and liabilities of persons doing business with companies are generally not affected by the company's constitution, and those whose rights may be affected (mainly a company's members) are able to obtain the constitution at short notice.

In light of the above, and the concerns expressed by small business, the Government does not support the PJSC's recommendation.

Proposal to require additional information in applications for company registration

During the debate on the Company Law Review Bill 1997, a provision was unsuccessfully sought to be inserted by the Australian Democrats to amend section 117 of the Corporations Law to require further information to be stated in an application for registration as a company.

The contents of an application to register as a company must currently include the following information:

- The number and class of shares each member agrees in writing to take up (Corporations Law paragraph 117(2)(k)(i));
- The amount (if any) each member agrees in writing to pay for each share (Corporations Law paragraph 117(2)(k)(ii)); and
- If that amount is not to be paid in full on registration – the amount (if any) each member agrees in writing to be unpaid on each share (Corporations Law paragraph 117(2)(k)(iii)).

The proposed amendment (paragraph 117(2)(ka)) would have required additional information to be stated in the application to register a company in relation to such shares:

- A summary of the rights and conditions attaching to the shares agreed to be taken up;
- The total number of persons who have consented to be members and the information referred to in subparagraphs 117(2)(k)(i) and (k)(ii);
- A statement that, if a constitution has not been adopted, the replaceable rules will apply and that they create a contract between the company and the members the terms of which may alter if the replaceable rules change after the company is registered.

PJSC recommendation

The PJSC recommends that the Corporations Law should require the following additional information be provided in an application to register as a company: • A summary of the rights and conditions attaching to the shares agreed to be taken up, and

- The total number of persons who have consented to be members and the information referred to in subparagraphs (k)(i) and (k)(ii).

However, the PJSC considered that an additional statement in section 117 as to the contractual effect of the replaceable rules would result in duplication. The Government notes that section 140 of the Corporations Law already sets out the contractual effect of a company's constitution and the replaceable rules.

Government response

The Government does not support the inclusion of the additional requirements in section 117 recommended by the PJSC, namely a summary of the rights and conditions attaching to the shares agreed to be taken up, and the total number of persons who have consented to be members and the information referred to in subparagraphs 117(2)(k)(i) and (ii).

The *Company Law Review Act 1998* sought to simplify the processes for forming a company. It was decided that notice of the issue of shares would not have to be lodged with ASIC, but details would need to be recorded in the company's register of members. Section 169 of the Corporations Law requires detailed information to be kept as to the members of a company, and the shares and classes of shares that they hold.

Furthermore, section 246F requires that, where a company divides its shares into classes or converts shares of one class into shares in another class, then the company must lodge a notice with ASIC setting out details of the division or conversion. Public companies must lodge with ASIC a copy of each document (including an agreement or consent) or resolution that attaches, varies or cancels rights attaching to shares, or binds a class of members.

Section 117 itself already requires details of numbers and classes of shares, and the amount agreed to be paid for each share (paragraphs 117(2)(k)(i) and (ii)). Where shares are to be issued by public companies for non-cash consideration, prescribed particulars are required about the issue of the shares, unless the shares are to be issued under a written contract and a copy of the contract is lodged with the application (paragraph 117(2)(l)).

The Government considers that detailed information is already provided as to members, share holdings and classes of shares, for both proprietary and public companies, whether in the company register or lodged with ASIC. A requirement to provide the total number of persons in the application, when this information can easily be ascertained from other sources, and would in many cases shortly become inaccurate, could be both duplicatory and misleading.

The Government is concerned at the unknown legal effect of the suggested summary of class rights. Class rights often vary over time, and even where a company's constitution does not mention different classes, a court may still find that they exist and have differential rights that the court will protect. Where class rights are set out in the company's constitution or a separate agreement, it is those documents that would need to be interpreted (probably by a court if there is a dispute). A summary submitted only at the time of application to register a company could quickly become out of date, and be misleading, as to the actual legal position regarding those rights.

Notice of meetings

During the course of debate on the Company Law Review Bill 1997, section 249HA was inserted following a motion put forward by the Australian Democrats and the Opposition. Section 249HA extends the notice period that must be given for meetings of listed companies from the 21 days,

proposed by the Government, to 28 days. The Corporations Law previously obliged companies to give 14 days notice for an ordinary resolution, and 21 days notice for a special resolution.

The Government did not support the amendment when it was moved during debate and indicated to the PJSC that this is a matter about which the business community has expressed concern.

In its March 1998 Report on the Company Law Review Bill 1997, the PJSC advised that it did not support calls for extending the period of notice from 21 days to 28 days. Although the PJSC had considerable sympathy for those concerned that the 14 days was too short, it was not convinced that the doubling to 28 days was either justified, necessary or in the interests of the company. It recommended that the clause in the Bill requiring a minimum 21 days notice of meetings should proceed.

The PJSC has advised in its October 1999 Report that:

- The 28 days notice has placed greater demands on directors and company management and has increased costs without any measurable corresponding benefit to shareholders;
    - The evidence that companies have been forced to the major expense and disruption of two mailings for the purpose of an AGM gives rise to concern;
        : The PJSC was told that a consequence of the extended notice period is that some companies would have to mail their notices of meeting separately from their annual reports, thereby incurring additional costs;
- The doubling of the period of notice from 14 to 28 days has added considerably to costs and inefficiency in company meeting cycles;
    - Increased use of electronic communication provides a more appropriate solution than extending the notice period for meetings;
- The 28 days is a minimum nominal period that can be extended by other time periods such as the three-day rule and obtaining consent from the ASX.
    - Delays to general meetings can cause inefficiencies in capital raising particularly for small listed companies and in approvals for share issues and schemes of arrangements;
    - The 28 days notice period creates a competitive disadvantage for companies requiring shareholder approval of a commercial transaction;
        : In addition, considerable changes would need to be made to the ASX Listing Rules and timeframes;
- No strong argument has been made to the PJSC as to the differentiation the Corporations Law makes between listed and unlisted companies;
    - Retention of the 28 day notice period would mean that members of listed companies may be disadvantaged by out of date information or positions that were overtaken by the lapse of over a month or longer;
        : In circumstances where members are required to vote on matters that are subject to changes in market conditions, information and directors' recommendations

could be out of date, inaccurate or misleading as a result of changed circumstances;

- The issue of timeliness and quality of information supplied to members is critical to a company's ability to conduct its affairs. Any action that can delay the holding of a meeting is not in the best interests of the company or its shareholders.

PJSC recommendation

The PJSC recommends that the 28 day period of notice for meetings of listed companies should be reduced to 21 days.

Government response

The Government supports the PJSC's recommendation.

Disclosure of proxy voting

Chapter 8 in the PJSC's Report focuses on two recent additions to the Corporations Law, section 251AA and subsection 250J(1A). These provisions were inserted during the passage of the *Company Law Review Act 1998*, following a motion put forward by the Australian Democrats and the Opposition.

The Government expressed its opposition to these provisions during the passage of the Act, and referred section 251AA to the PJSC as a matter about which the business community had expressed concern, following the passage of that Act. The PJSC also addressed section 250J(1A) in response to concerns raised in several submissions.

Subsection 251AA(1) requires listed companies to minute, in respect of each resolution at a meeting, the total number of proxy votes exercisable and;

(a) if the resolution is decided by a show of hands, the total number of proxy votes where the proxy appointment specified that the proxy:

(i) vote for the resolution;
(ii) vote against the resolution
(iii) abstain; and
(iv) vote at the proxy's discretion; and

(b) if the resolution is decided on a poll, the information in (a) and the total number of votes cast on the poll:

(i) in favour of the resolution;
(ii) against the resolution; and
(iii) abstaining on the resolution.

The company must also pass this information to the ASX (subsection 251AA(2)).

Section 250J(1A) applies to a company that is subject to the replaceable rules under section 135 of the Corporations Law and does not provide to the contrary in its constitution. It provides that:

250J(1A) Before a vote is taken the chair must inform the meeting whether any proxy votes have been received and how the proxy votes are to be cast.

The PJSC has recommended that these disclosures should be reduced. The PJSC considered that:

- The promotion of shareholding voting was not achieved by mandatory disclosures of this kind;
- There is no evidence to suggest there is a step change in the way shareholders or institutions use their voting rights as a result of the requirement for additional information;
- Witnesses had advised the PJSC that section 251AA and subsection 250J(1A) were inconsistent and might lead to confusion and unnecessary administrative difficulties;
- The reporting of proxy voting intentions might also be misleading as the Corporations Law does not reflect accurately the nature of a voting direction to an agent either with or without voting instructions;
- CASAC examined the operation of section 251AA in its September 1999 Discussion Paper *Shareholder Participation in the modern listed public company*, and concluded that its disclosure requirements were unworkable;
- There was no reason for the minuting of proxy intentions where these had not been exercised when a resolution was disposed of on a show of hands or when a vote was taken by poll;
- Subsection 250A(7) does not relate to the exercise of a dual proxy or whether two appointments are mutually exclusive, but rather which appointment should take precedence if more than one appointment can be exercised at the meeting. There is a presumption that a later appointment reflects a person's current thinking and subsection 250A(7) should be drafted to reflect this;
- The structure of AWB Ltd may be in conflict with the provisions of the *Company Law Review Act 1998*. The Senate Rural and Regional Affairs Legislation Committee had examined the structure of AWB Ltd and recommended that it should be exempted from any of the unintended consequences of the Company Law Review Act that may impact on the system of proxy voting.

PJSC recommendation

The PJSC recommends that the Corporations Law should be amended as follows:

(i) section 251AA(1)(a) should be repealed;

(ii) section 250J(1A) should be repealed and replaced with a provision that requires the minuting of proxy votes "For" and "Against" the resolution when a resolution has been decided on a show of hands;

(iii) section 251AA(1)(b)(iii) should be repealed;

(iv) section 250A(7) should be amended to correct what appears to be a drafting oversight;

(v) the AWB Ltd should be granted exemption from the provisions of the Law relating to proxy appointments.

CASAC's views

CASAC has considered the operation of section 251AA in its Final Report, *Shareholder participation in the modern listed public company*. CASAC notes the shortcomings in the existing requirements regarding the disclosure of proxy voting details (some argue that the information required may be irrelevant, repetitious, or misleading), and the argument that, if the minutes are to be strictly accurate, they should record only the outcome of the show of hands (paragraph 4.84 of CASAC's Final Report).

Show of hands

Notwithstanding the limitations, CASAC recognises the benefits in making publicly available proxy voting information for resolutions decided by show of hands. CASAC considers there is no public interest in refusing shareholders access to the information, particularly as disclosure of the shareholder decision making process is a fundamental corporate governance principle. The finding by the University of Melbourne Centre for Corporate Law and Securities Regulation Research Report *Proxy Voting in Australia's Largest Companies*, that the level of inaccuracy of the information provided under section 251AA(1)(a), is very low, was also relied upon by CASAC.

CASAC recommends that section 251AA(1)(a) should be retained, and extended to include direct absentee votes, if its recommendation that the Corporations Law should permit the directors of a listed public company to provide for direct absentee voting (Recommendation20), is accepted by the Government.

Poll

On the other hand, CASAC does not consider that requiring companies to include in the minutes for resolutions decided by poll all the proxy voting information required by paragraph 251AA(1)(a), serves any transparency purpose.

CASAC advised that the goal of ensuring transparent shareholder decision making is already covered by the recording of votes for and against, and abstentions, given that these details include proxy votes in any case.

Abstentions

CASAC also recommends that the total number of votes abstaining on the resolution (paragraph 251AA(1)(b)(iii)) should continue to be disclosed in the minutes, as it gives more complete information on shareholder voting patterns.

Disclosure of proxy voting information prior to voting

The Government notes that CASAC has also considered the issue of the disclosure of proxy figures at a meeting, in advance of the debate (paragraphs 4.44 to 4.69 of the CASAC Final Report). The Corporations Law makes no reference to whether proxy voting details can or should be disclosed prior to commencement of the debate at a meeting. Subsection 250J(1A) only requires disclosure before the vote is taken. CASAC has done an analysis of the arguments for and against disclosure prior to the debate but has not indicated a view on section 250J(1A) in its Final Report. However, in its Discussion Paper (*Shareholder participation in the modern listed public company*, September 1999), CASAC indicated that the information required to be disclosed under section 250J(1A) is, in any case, inherently unreliable (paragraph 4.36 of the Discussion Paper).

Section 250J(1A) provides (as a replaceable rule) that a chair must disclose, before any vote is taken, whether any proxy votes have been received and how they are to be cast. CASAC's view in its Discussion Paper is that the provision is based upon the assumption that proxies are required to vote the shares according to the terms of the proxy. Proxies (other than the chair) are not required to vote and directions on voting in a proxy form may quite legally not be followed by the proxy. A shareholder who has appointed a proxy may attend the meeting and vote, negating the proxy. The chair cannot accurately inform the meeting how proxy votes are to be cast.

Government response

The Government supports CASAC's recommendation that the current requirement in section 251AA(1)(a) for disclosure of proxy voting information where resolutions have been decided by a show of hands, should be retained. The Government does not support the PJSC's recommendation with regard to section 251AA(1)(a).

The Government will consider whether section 251AA(1)(a) should include information as to direct absentee votes, when it reviews Recommendation 20 of the CASAC Final Report in due course.

The Government supports CASAC's recommendation that section 251AA(1)(b) should be amended to exclude the information required by section 251AA(1)(a). The PJSC recommendation that paragraph 251AA(1)(b)(iii) should be repealed is not accepted by the Government. The Government supports CASAC's analysis that information regarding abstentions gives a more complete picture of shareholder voting patterns.

The Government supports the PJSC recommendation that section 250J(1A) should be repealed (and agrees with CASAC's analysis of the provision's difficulties in its September 1999 Discussion Paper).

The Government does not support the PJSC recommendation that section 250J(1A) be replaced with a provision that requires the minuting of proxy votes "For" and "Against" a resolution, when a resolution has been decided upon a show of hands, in view of the Government's acceptance of CASAC's recommendation that the current requirements in section 251AA(1)(a) be retained.

Section 250A(7) Appointments of second proxies

The Government does not consider that section 250A(7) is a drafting oversight. This amendment was inserted into the Corporations Law by the *Company Law Review Act 1998* to clarify that members can appoint a second proxy at any time after the first appointment, so long as the second appointment does not effectively replace the first one.

The PJSC indicates that one submission considered that the wording of section 250A(7) makes little sense, unless the word "could" is substituted for the words "could not". In the Government's view, the substitution of the word "could" does not assist the interpretation of the provision, as an earlier and a later appointment can, in certain circumstances, both be validly exercised. Where a later and an earlier appointment cannot both be validly exercised, section 250A(7) ensures the validity of the later appointment is assumed by the Corporations Law to reflect the appointer's current thinking.

An example of a situation where both an earlier and a later appointment can be validly exercised is where a shareholder appoints one proxy and then later appoints a second joint proxy. The appointing shareholder wants the second proxy to be able to exercise half his votes (or any proportion that the shareholder indicates) at the same time as the first proxy is exercising the remainder of the votes. Where the second appointment does not specify the proportional number of

votes that the proxy may exercise, each proxy is able to exercise half the votes (subsection 249X(3), which is a replaceable rule for proprietary companies only). The insertion of the word "could", instead of "could not", would mean that the later appointment would revoke the earlier appointment, when in these circumstances both appointments should be valid.

AWB Ltd

The Government disagrees in principle with the recommendation that AWB Ltd should be granted an exemption from the proxy provisions in the Corporations Law. The Corporations Law does not confer a discretion on ASIC to exempt AWB Ltd from these provisions, nor does the Corporations Law allow regulations to be made having this effect. If AWB Ltd is to be exempted from the proxy voting provisions, it would be necessary to either amend the Corporations Law or for the Commonwealth to enact legislation prevailing over the Law to the extent required to provide such an exemption.

The PJSC indicates that AWB Ltd has moved from the status of a statutory authority, with its own enabling legislation and regime, to become a company incorporated under the Corporations Law, subject to the general policies and requirements imposed upon all bodies incorporated pursuant to the Law.

The Government considers that it is generally undesirable for individual companies to be exempted from the policies applied by the Corporations Law to all companies registered under the Law, as these policies are set in place for the protection of shareholders, creditors, and in the best interests of companies themselves.

The evidence given by the Grains Council (paragraph 8.35 of the PJSC Report) would appear to be that it would be to the advantage of shareholders for certain changes to be made to the constitution of AWB Ltd, concerning the holding of open or closed proxies by directors and the issue of election of directors. The constitution of AWB Ltd could be amended by special resolution to achieve desired outcomes for shareholders, to the extent consistent with the Corporations Law, without exempting AWB Ltd from the general proxy voting provisions of the Law. This may be a matter on which AWB Ltd and its shareholders would wish to seek legal advice.

Corporate governance board

Amendments were moved by the Australian Democrats during the debate in the Senate on the Company Law Review Bill 1997, but not passed, to require all companies that become listed after the commencement of the section to have a corporate governance board. All other listed companies would have been required to propose a resolution that the company have a corporate governance board and, if passed, such a resolution would have been unable to be changed.

The Government requested the PJSC to generally examine the matter.

The functions of the corporate governance board (to the exclusion of the main board) would be as follows:

- To determine the remuneration of company directors;
- To appoint auditors and determine the remuneration of auditors;
- To review the appointment, remuneration and functioning of independent agents, such as valuers, who provide material information to shareholders;

- To appoint persons to fill casual vacancies of directors;
- To determine whether amendments should be made to the company's constitution, whether on the request of the company's directors or on the board's own initiative;
- To decide issues of conflict of interest on the part of the company's directors and determine how those conflicts will be managed;
- To control the conduct of general meetings and determine voting procedures.

ASX Listing Rule 4.10.3 requires each listed company to disclose its main corporate governance practices that have been in place during the reporting period. An indicative list of corporate governance matters is set out as a guide for listed companies in preparing the required statement. The matters listed include:

- The main procedures for establishing and reviewing the remuneration arrangements for directors and senior executives; and
- The main procedures for the nomination of external auditors and for reviewing the adequacy of existing external audit arrangements.

In its March 1998 Report on the Company Law Review Bill 1997, the PJSC indicated that it did not favour a prescriptive approach to corporate governance and opposed detailed arrangements of the kind recommended by shareholder groups.

The PJSC has advised in its October 1999 Report that:

- Research in the United States suggesting a correlation between good corporate governance practices and increasing shareholder value, and seeking to extend that correlation to establishing corporate governance boards cannot necessarily be extended to Australian markets, without undertaking Australian research;
- There are several concerns regarding a two tier governance model and the specific amendments that codify the method of election of members of the corporate governance board:
    - The proposed amendments would lead in practice to the bifurcation of board responsibilities and the devolution of the board's additional role with respect to shareholder protection;
    - The delegation of shareholders' powers to a supervisory board would reduce the rights and entitlements of individual shareholders, the most potent being the power to dismiss a director at the general meeting;
        - : The amendments would stipulate that the establishment of a corporate governance board is irreversible notwithstanding a resolution by members to the contrary;
        - : The amendments deny property rights to individual shareholders because the system of voting for election to the corporate governance board is on the basis of one vote per shareholder and not on the basis of economic interests;

- A strong case has not been made to support the amendments and the evidence before the PJSC does not justify imposing on companies another layer of expense and the possibly divisive structure of a two tier model;

    - The framework of company management in Australia is constructed on the basis of a unitary board. The introduction of a two tier governance model would shift the emphasis of current corporate governance developments from an "outsider" model to an "insider" model, with significantly reduced voting and property rights for individual shareholders.

- The responsibility for corporate governance must rest with the main board. Responsibility to shareholders should not be diminished to any degree by the establishment of a separately constituted corporate governance board;

- There are important issues where independent judgments need to be exercised on remuneration practices, selection of board members and company accounts, for example;

    - The effectiveness of the board may be enhanced by sub-committee structures that will vary from board to board depending upon the size of the company;

        : Initiatives by the Investment and Financial Services Association, the Australian Institute of Company Directors and the ASX, in promoting more disclosure of corporate governance practices are fully supported in this regard;

- The proposed amendments do not help to underpin future progress towards higher standards of corporate governance.

PJSC recommendation

The PJSC recommends that the Corporations Law should not provide that listed companies must establish a corporate governance board.

Government response

The Government supports the PJSC's recommendation. The Government considers that the shareholders of a company are generally best placed to determine the corporate governance arrangements that are most appropriate for their company.

While it will seek to encourage public corporations to adopt appropriate governance structures, the Government will avoid unnecessary prescription that could lead to inflexibility and inhibit innovation. It is preferable for Australian corporate governance practices to develop in response to competitive economic, commercial and international pressures, rather than in response to prescriptive rules mandated by Government. The Government will not impose additional mandatory legislative requirements unless there is a clear failure of those mechanisms to produce appropriate corporate governance practices.

The Government fully supports the disclosure regime in ASX Listing Rule 4.10.3 – disclosure enables the market to decide on the presence or otherwise of good corporate governance practices.

Audit committee

Amendments were moved by the Australian Democrats during the Senate debate on the Company Law Review Bill 1997, but not passed, to require listed companies to establish an audit committee. The Government requested the PJSC to generally examine the matter.

The amendment would have required:

- The directors of listed companies to establish and maintain an audit committee with functions that include:
    - Assisting the directors of a company to ensure that financial reports comply with the requirements of the Corporations Law;
    - Assisting the directors of a company to ensure that the company at all times has a proper system of management and financial controls;
    - Providing a forum of communication between the directors, senior managers and auditors of the company;
- The majority of members to be persons who are not executive officers of the company;
- An audit committee to be established and maintained on such a basis that a meeting could not be held unless there are at least two members who are not executive officers of the company;
- The chair of an audit committee to be a member who is not the chair of the board of directors of the company.

The PJSC considered that:

- For most small to medium sized companies, the requirement for an audit committee would be costly, impracticable and redundant – with only three or four directors acting as the board, smaller listed companies would not be able to meet the requirement for an audit committee to have at least two non-executive directors and an independent chair;
- In the absence of an audit committee, a board would need to have other mechanisms in place to reassure shareholders and potential investors of the quality of the audit and the adequacy of the company's financial statements;
- The requirement for listed companies to establish an audit committee is addressed in the ASX Listing Rules:
    - ASX Listing Rules 4.10.2 and 4.10.3 and the Guidance Note deal adequately with the functions and composition of an audit committee and, in terms of best practice, provide the same level of monitoring and accountability as sought under the proposed amendments;
        - : The ASX Guidance Note in fact requires more, requesting companies to state their policy regarding the composition of the audit committee.
- The diversity, size and circumstances of listed companies makes it impractical for the Corporations Law to regulate the disclosure of information on audit committees in annual reports;

- Any low level of disclosure in annual reports is a matter that should be addressed in the first instance by the ASX and its contracting parties.

PJSC recommendation

The PJSC recommends that the Corporations Law should not require listed companies to establish an audit committee.

Government response

The Government supports the PJSC's recommendation.

The Government notes that the *OECD Principles of Corporate Governance* (May 1999), while identifying common elements that underlie good corporate governance, are clear that there is no single model of good corporate governance.

The Principles do not, for example, advocate any particular board structure. The Principles specify that the elements of good corporate governance are the same whether a "unitary" or "two tier" board model has been adopted, whether there are independent directors on the board, or whether specific committees have been established to deal with matters where there is potential for conflict of interest.

Whatever its structure, a board's fundamental responsibilities remain the same, whichever structures or processes are chosen by the company to enable the board to meet those responsibilities. Companies may choose to have some form of corporate governance board, audit (or other) committees, or some number of independent directors. The Government considers that a company must be free to choose the structures and processes that best enable its own particular board to fulfil its responsibilities to that company.

The Government will not impose mandatory legislative requirements unless there is a clear failure of current mechanisms.

Obligation to report suspicion of fraud

Amendments were moved by the Australian Democrats in the Senate during debate on the Company Law Review Bill 1997, but not passed, to require directors and executive officers of a company to inform the auditor if they suspect that fraud or other improper conduct has occurred.

The Government requested the PJSC to generally examine the matter.

The PJSC considered that:

- Directors have primary responsibility for the accounts and financial reports of a company, as well as for implementing internal control structures for the prevention and detection of irregularities – if directors or officers suspect fraud or misconduct they already have a duty to take action;

  - A director's duty to act in the best interests of the company imposes the duty of disclosure to the board, which may or may not involve the auditor;

  - A legislative requirement that imposes a duty of disclosure to the auditor will reduce a director's responsibilities under the Law. It will also place the auditor and not the board in the position of deciding how best to deal with suspicions of fraud or misconduct.

PJSC recommendation

Recognising that directors and executive officers already have a duty to report suspicions of fraud and improper conduct involving the company, the PJSC recommends that the Corporations Law should not expressly require the reporting of such suspicions to the auditor.

Government response

The Government supports the PJSC's recommendation.

Director's power to call a meeting

Section 249C of the Corporations Law was inserted by the *Company Law Review Act 1998*, providing as a replaceable rule that a single director may call a members' meeting. Following a motion by the Australian Democrats, section 249CA was also inserted into the Company Law Review Bill 1997. Section 249CA provides that a director of a listed company may call a meeting of members despite anything in the company's constitution. The Government expressed its opposition to the provision during the passage of the Bill and requested the PJSC to generally examine the matter.

The PJSC considered that:

- A director's power to call a meeting can be exercised despite anything in the company's constitution. By overriding a company's constitution, the Law permits a director to do so without regard to bona fides and without any sanction;
    - The Corporations Law should not override the wishes of shareholders who will have to bear the costs of a general meeting called by a director;
    - If the director's view does not prevail at the board it is unlikely it will prevail at a general meeting called by the director;
- It is undesirable for the Corporations Law to be used as leverage in board discussions and may have the effect of dissuading directors from exercising their commercial judgment in decisions affecting the company;
- A director's power to call a meeting should be optional under a listed company's constitution.

PJSC recommendation

The PJSC recommends that section 249CA of the Corporations Law be repealed.

Government response

The Government supports the PJSC's recommendation, noting that section 249C provides that a director may call a meeting of the company's members as a replaceable rule. This allows companies to adopt this rule if it is appropriate for their circumstances.

Receipt of proxy appointments

Section 250BA of the Corporations Law provides that, in a notice for a meeting of members, a listed company must specify a place and a fax number and may specify an electronic address for the purpose of receiving proxy appointments. This provision was inserted into the Company Law

Review Bill 1997, following a motion by the Opposition during the course of debate. The Government requested the PJSC to generally examine the matter.

Section 249X(1) of the Corporations Law provides that a member of a company may appoint a "person" as the member's proxy. In response to a submission made by the Australian Shareholders' Association, the PJSC considered whether an amendment is desirable to enable a body corporate, as well as natural person, to be appointed as a proxy.

The PJSC considered that:

- It is a matter of prudence and good corporate governance for companies to facilitate the receipt of proxy appointments;
  - Most listed companies already retain the services of a professional share registry to receive proxies by facsimile. The requirement for a facsimile address is not a large imposition on a listed company, and the benefit for companies is not in question;
  - There are however certain practical issues to consider including the authentication of proxies and security of electronic communications;
- The requirement allowing electronic forms of communication should remain optional for listed companies;
  - However, there are still two major concerns, that is, security of communications and the impediment of the Law;
  - Companies should be able to transmit electronically any document that the Corporations Law requires they send to members provided that the individual shareholder or institution has agreed.
    : To facilitate the receipt of proxy appointments a new definition of "sign" should be inserted in the Section 9 - Dictionary, which defines signing for electronic purposes to be the input of a "PIN".
- To formalise the practice of some listed companies in accepting proxies appointing the Australian Shareholders' Association, the words "including a body corporate" should be inserted after the word "person" in section 249X(1).

PJSC recommendation

The PJSC recommends that the Corporations Law:

(i) should retain section 250BA subject to the amendments described above to authenticate proxy appointments;

(ii) should include a new definition of "sign" in Section 9 – Dictionary, to define sign for electronic purposes to be the input of a "PIN";

(iii) should include in section 249X(1) provision for a body corporate as well as a natural person to be appointed as a proxy.

The PJSC recommended the following amendments to authenticate proxy appointments:

- For a facsimile transmission of a proxy to be executed, the proxy should be a complete reproduction of the entire original writing or transmission;

- For proxy appointments executed by corporate or institutional investors, proxy appointments must be witnessed or executed by an officer of the court. In the case of foreign investors it must be executed by an attorney;

- The notice of meeting must specify only one place and facsimile address.

Government response

The Government agrees that section 250BA should be retained, but does not consider that prescriptive requirements concerning the receipt and validation of proxy appointments should be imposed upon companies by the Corporations Law. Companies should be able to decide for themselves what arrangements are most appropriate for the authentication of proxy appointments. The amendments suggested by the PJSC concerning complete reproductions, witnessing of proxy appointments, notification of facsimile address, and appropriate methods of authenticating proxies lodged electronically, are matters that companies can include in their constitutions if they consider it desirable.

A non-prescriptive approach to the authentication of electronic signatures is consistent with section 10 of the recently commenced *Electronic Transactions Act 1999*. Section 10 provides that where a law of the Commonwealth requires a person's signature, that requirement is taken to have been met if (so far as relevant):

- A method is used to identify the person and to indicate the person's approval of the information communicated;

- Having regard to all the relevant circumstances at the time the method was used, the method was as reliable as was appropriate for the purposes for which the information was communicated; and

- If the person to whom the signature is required to be given consents to that requirement being met by use of the method mentioned above.

Subsection 250A(1) provides that a proxy appointment is only valid if it is signed by the member of the company making the appointment. Section 10 of the Electronic Transactions Act allows any reliable method agreed between parties to be used to authenticate electronic signatures.

The Government considers that companies should be able to decide on their own methods for the authentication of proxy documents. Companies may wish to adopt the suggestion of an electronic PIN number, and the Government thanks the PJSC for their suggestion on this.

CASAC has considered the issue of whether a shareholder should have the option of appointing a body corporate as its proxy in its Final Report, *Shareholder participation in the modern listed public company* (paragraphs 4.31 to 4.36). The PJSC indicates that section 249X should be amended to specifically recognise "bodies corporate" as persons in this context.

CASAC supports shareholders having the option of appointing a body corporate as their proxy, noting the arguments in support that it may encourage shareholder voting, and remove technicalities in shareholder voting. The body corporate could advise the company of who will represent it at the

meeting, being either a nominated individual or whatever natural person holds a nominated position within the body corporate.

The Government supports the PJSC's recommendation that a body corporate as well as a natural person should be able to be appointed as a proxy.

Directors' Remuneration

Section 300A was introduced into the Company Law Review Bill 1997 during the course of debate in the Senate. The Government requested the PJSC to generally examine the provision to ensure ample opportunity for public consideration and consultation about the amendment.

Section 300A(1) of the Corporations Law requires the following disclosures about director and executive officer remuneration in the annual directors' report of listed companies:

(a) Discussion of broad policy for determining the nature and amount of emoluments of board members and senior executives of the company;

(b) Discussion of the relationship between such policy and the company's performance; and

(c) Details of the nature and amount of each element of the emolument of each director and each of the five named officers of the company receiving the highest emolument.

Section 300(1)(d) of the Corporations Law also requires the directors' annual report to disclose details of options that are:

(i) Granted over unissued shares or unissued interests during or since the end of the year; and

(ii) Granted to any of the directors or any of the five most highly remunerated officers of the company; and

(iii) Granted to them as part of their remuneration.

The PJSC considered the operation of section 300(1)(d) in the context of its examination of section 300A.

The PJSC considered that:

- The overriding principles in respect of directors' and executives' remuneration are those of accountability and openness;
    - Full disclosure of directors' and executives' remuneration is a means of ensuring accountability to shareholders and public confidence in the capital markets;
    - The disclosure objective behind paragraphs 300A(1)(a) and (b) is inherently reasonable, but the current requirement may only produce a discussion that states the board's justification for its policies;
        : More meaningful statements will result if boards indicate the manner in which directors' present and future benefits are structured to encourage higher performance;

: The statement of board policy should at a minimum discuss how the remuneration package reflects the responsibilities and risks assumed by the director and the various performance orientated factors linking rewards to corporate and individual performance;

- The provisions relating to the disclosure of directors' and executives' remuneration should apply to all listed companies;

- It is not unusual for companies to have highly paid technical staff who are not in positions of management, and disclosure of their remuneration would be misleading. A definition of the term "executive" should be inserted into section 9 as being "a person who is involved in the management of the company or entity";

- There is some evidence of a lack of apparent compliance with section 300A, particularly with the disclosure of the value of options, which is due to lack of clarity in the drafting of section 300A;

  - Section 300A is inconsistent with section 300(1)(d). Section 300(1)(d) does not specify whose options should be disclosed, and section 300A, which requires "details of the nature and amount of each element of the emolument" does not specify whether the details of the emoluments are to be aggregated for the purpose of disclosure;

  - To resolve the inconsistencies:

    : Section 300(1)(d)(ii) should be replaced by "granted to the directors and to the 5 most highly remunerated executives of the company"; and

    : Section 300A should include a provision that requires disclosure of the value of options granted, exercised and lapsed unexercised during the year and their aggregation in the total remuneration.

- Although ASIC's Practice Note 68 indicates the method of valuation to be used, this methodology has been criticised, and there is no certainty that the methodology will be used in the future as financial reporting moves towards market value accounting;

  - One body should be responsible for developing the method of valuation, and that body should be the Australian Accounting Standards Board (AASB);

    : This is consistent with the AASB's policy to develop a new accounting standard on directors' and executives' remuneration.

- There is no reason for applying the disclosure requirements to companies and not to listed schemes – section 300A should apply to listed managed investment schemes to ensure that the same levels of accountability and transparency apply to these entities.

PJSC recommendation

The PJSC recommends that sections 300 and 300A of the Corporations Law should be amended as described above.

[These recommendations were that:

- Section 300A should be amended as follows:

- The word "broad" should be amended to "board";
- The words "senior executive" should be amended to "executive";
- The reference to "company" should be retained and that it is intended that this will include executives within an "economic entity", as referred to in AASB 1034 and in ASIC Practice Note 68, paragraph 55(iv);
- The words "emolument" and "emoluments" should be amended to "remuneration", which has a more general and agreed use than the word emolument and is defined for the purpose the Law intended in Accounting Standards, AASB 1017 and AASB 1034;
- The words "details of the nature and amount of each element of the emolument of each director and each of the five named officers of the company receiving the highest emolument" should be replaced with "details of the nature and amount of each element of the remuneration received by the five named most highly remunerated executives of the company";
- To include a provision which requires disclosure of the value of options granted, exercised and lapsed unexercised during the year and their aggregation in the total remuneration;

- Section 300(1)(d)(ii) should be replaced by "granted to the directors and to the five most highly remunerated executives of the company";
- The new accounting standard on directors' and executives' remuneration should require a statement by the board which discusses its remuneration policy and the relationship between that policy and the company's performance and how individual performance is measured, in addition to the responsibilities of directors to encourage higher corporate performance, the risks assumed by the directors and how rewards are related to that policy;
- A definition of the term "executive" should be inserted in Section 9 – Dictionary as being "a person who is involved in the management of the company or entity";
- The Australian Accounting Standards Board should be the only body responsible for developing methods of valuation;
- Section 300A should apply to listed managed investment schemes to ensure that the same levels of accountability and transparency apply to these entities.]

Government response

The Government is committed to the principle of enhanced transparency in the corporate sector, particularly in the area of executive remuneration, which in recent times has become the focus of intense public interest. While it is appropriate for executive remuneration to be set through the operation of the market mechanism, transparent and relevant information on remuneration and its relationship to the performance and policy of the board is an essential tool for accountability to shareholders.

The Government supports the PJSC's view that sections 300A and 300(1)(d) should be retained. To a large degree, financial and accounting information should be set by an independent body, the AASB. However, transparency of executive remuneration is of such importance that it should

continue to be imposed by the Corporations Law, and be retained in the annual director's report (rather than the financial or concise financial statements), to ensure the widest possible dissemination to shareholders.

The Government's response to the various amendments proposed by the PJSC is:

- Paragraph 300A(1)(a) should be amended to replace the word "broad" with "board";

- The words "senior executives" in paragraph 300A(1)(a) should be substituted with "executive officers". The term "executive officer' is defined in Section 9 of the Corporations Law as a person who is concerned in, or takes part in, the management of the body (regardless of the person's designation and whether or not the person is a director of the body);

- The word "company" should be retained in section 300A;

- The words "emolument" and "emoluments" should be substituted with "remuneration" wherever occurring in section 300A;

    - Subsection 300A(1) should be amended to make it clear that disclosure of the value of options granted to directors and the five most highly remunerated executive officers, together with the valuation of options they exercised and the value of options lapsed unexercised, and their aggregation in the total remuneration, is required.

- While the Government supports the disclosure of information about remuneration policy and the relationship between that policy and the company's performance as already required by subsection 300A(1), the Government considers it would be inappropriate to use accounting standards as the vehicle for requiring the disclosure of this information and the additional information recommended by the Committee;

    - Accounting standards can only be used to specify the methodology to be used for accounting for different types of transaction and the disclosures that should be made in the financial report in respect of those transactions. In the case of information about remuneration, any disclosures required by an accounting standard would have to be included in a note to the financial statements;

    - The Government believes information about remuneration policies and the relationship between those policies and the company's performance is of considerable importance to shareholders and that the Corporations Law should continue to contain the requirement for the information to be disclosed in the annual directors' report;

    - However, the Government considers it unnecessary to make this general requirement any more specific and detailed as suggested by the Committee. In this regard, the general requirements in new section 300A are considered to be wide enough to encompass the matters outlined by the Committee. It is important that the requirements are flexible enough to enable companies to report those matters that most significantly impact on, and influence, remuneration and performance. An unnecessarily prescriptive approach in this area could risk stifling market developments and competition with regard to best practice;

- The Government is concerned that the disclosure currently required by paragraph 300A(1)(c) may be effectively limited, because one or more of the five named officers may also be directors;

- The Corporations Law should be amended so that the details of the remuneration of each director is listed, and the details of the remuneration of each of the five most highly remunerated executive officers, other than directors, is also disclosed;

- There does not need to be a new definition of the term "executive" inserted in Section 9 – Dictionary, as there is already a definition of "executive officer";

- It is preferable for methods of valuation to be developed by the AASB, especially as accounting standards have the force of law. However, ASIC can provide guidance as to how a legal requirement may be met, and the Government recognises the assistance that ASIC renders the business community in this regard;

- The Government does not support the application of section 300A to directors and senior executives of responsible entities of listed managed investment schemes. This position would also apply to unlisted managed investment schemes;

  - Section 300A requires listed companies to disclose the remuneration of directors and senior executives to shareholders who, as the owners of the company, have an equitable interest in the affairs of the company, including payments received by company officers and management;

  - The position of unit holders (or members) in a managed investment scheme is fundamentally different from that of shareholders in a company. Members of a managed investment scheme do not, as members, have any ownership interest in the responsible entity that manages the scheme's assets. As a consequence, it is not appropriate for managed investment schemes to provide members with information about remuneration of the directors and other company officers of the scheme's responsible entity;

  - Members do, however, receive information about fees and charges imposed by the responsible entity through the Corporations Law prospectus requirements. This provides unit holders with sufficient information to make decisions on the relative merits and costs of the different schemes in which they could invest.

Requisitioning a general meeting

Section 249D of the Corporations Law requires the directors of a company to call and arrange a general meeting at the request of:

- Members with at least 5% of the votes that may be cast at a general meeting (section 249D(1)(a)); or

- At least 100 members who are entitled to vote at the general meeting (section 249D(1)(b)).

Section 249Q of the Corporations Law provides that a meeting of a company's members must be held for a proper purpose. Both sections 249D and 249Q were inserted into the Corporations Law by the *Company Law Review Act 1998*.

Schedule 6 of the *Corporate Law Economic Reform Program Act 1999* (the CLERP Act) contains an amendment to the Corporations Law (section 249D(1A)) that permits by regulation an alteration of the 100 members rule under section 249D, in the case of a specific company or class of companies.

Following the passage of the *Company Law Review Act 1998*, the Government requested the PJSC to examine the operation of sections 249D and 249Q of the Corporations Law and the regulation-making power in Schedule 6 of the CLERP Act.

CASAC has also considered section 249D in the context of its Final Report, *Shareholder participation in the modern listed public company*, released in June 2000. CASAC has recommended that the 100 member test should be abolished for listed public companies, stating that only shareholders whom collectively have at least 5% of the votes that may be cast at a general meeting should have the power to requisition a general meeting of a listed public company (CASAC Recommendation 2, page 15 of the Final Report).

The PJSC has concluded that:

- The present provision for 100 members to requisition a meeting of the company is inappropriate and open to abuse;
    - Currently 100 members who together may hold only a tiny economic interest in a company and be only a miniscule proportion of the company's numbers, may require the company to hold a special meeting, with the costs to be met by the company itself. The company is also disadvantaged by its directors and managers being diverted from their core functions;
    - Section 249Q is not a safeguard against abuse of the requisition power. It appears that a proper purpose is any matter that is within the competence of the general meeting, and it would be easy to draft a requisition in those terms;
- On making the present numerical test a replaceable rule, the PJSC endorses CASAC's preliminary view that requisitioning a meeting is a significant matter of corporate governance, for which a uniform rule is appropriate;
- The sole test for requisition of a special meeting should be an issued share capital threshold, which must be met collectively by the requisitioning members;
    - The numerical shareholder test or any variation of that is unsatisfactory because such tests do not overcome the basic difficulty that a group of members with an insignificant economic stake in the company may put the company and the other shareholders to the expense and inconvenience of a meeting;
- The test of a minimum proportion of issued share capital to be met by requisitioning members is preferable not only as a matter of principle but also for administration reasons – it is simpler to administer and more transparent. If requisitioning members cannot cross a 5% shareholding threshold, there must be serious doubts their resolution would succeed;
- A 5% issued share capital test would be reasonable, given CASAC research that this is compatible with overseas practice;
- Large mutual companies such as the NRMA are in a special position and may need different provisions.

PJSC recommendation

The PJSC recommends that the Corporations Law be amended to provide that the sole test to requisition a special meeting of a company is 5% of the issued share capital to be met collectively by the requisitioning members.

Government response

The Government is a strong supporter of share ownership and shareholder democracy. However, there must be a balance: companies should not be unnecessarily distracted from the business of wealth creation.

Without limiting individual shareholder rights the Government is concerned that companies are free to get on with the business of maximising wealth. The Government believes that companies should not be unreasonably subjected to the substantial cost of conducting a general meeting. In most cases the current 100 member test is too low, especially for the most traded listed companies (for example, in two recent cases members representing 121 and 166 (or 0.045% and 0.005% of shareholders funds) members sought to requisition a general meeting of members.

To address the concerns with the 100 member threshold, the Government has developed an alternative proposal to determine the number of members required to requisition a members' meeting under section 249D of the Corporations Law. However, the Government does not propose to alter the existing rules regarding shareholders' resolutions and statements through the shareholder proposal process.

The Government proposes to replace the existing 100 member test (section 249D(1)(b)) with a new 'square-root' rule. Under the proposal, the number of members required to call a company meeting would be the square root of the total number of members of the company who are entitled to vote at a meeting. The proposal involves retaining the proper purpose test currently in the Corporations Law (section 249Q) as well as the 5% of votes that may be cast at the annual general meeting rule (the "5% rule" (section 249D(1)(a)).

In contrast to the existing 100 member rule which is fixed arbitrarily, under the square root proposal, the number of members will be proportionate to the size of the company's member base. It is a fair, objective and simple formulation that links the required number of shareholders with the size of the company's shareholder base, but without sacrificing shareholder democracy. For instance, in the case of a company with a shareholder base exceeding 1 million members, the square root rule would require 1000 members (at least) to call a company meeting. For smaller companies, the number of shareholders required would decline proportionately.

The retention of the proper purpose test will continue to provide a safeguard against meetings being called for vexatious, frivolous or irrelevant purposes, while the retention of the 5% rule will continue to allow holders of substantial parcels of shares to call meetings.

At this time, the Government does not propose to include a specific mechanism to exclude persons who have become members solely for the purpose of joining in the requisitioning of a meeting (for example, by acquiring a small number of shares). However, if evidence of abuse becomes apparent then the Government would need to consider measures to disqualify certain shareholders from the ability to join in the requisitioning of a meeting.

Alternatives

There have been numerous alternatives considered including the removal of the existing 100 member threshold and retaining as the sole test members holding 5% of the voting shares as recommended by CASAC. This test would be in line with the position in the major capital markets overseas. However, the Government considers that this test proposes a threshold that is too high in a market that increasingly contains a material proportion of retail investors.

Another suggestion has been the retention of the current 100 member test modified with the additional requirement that each requisitioning shareholder has a minimum shareholding that has a minimum average market value. CASAC considers that requisitioning shareholders should have a minimum economic interest in the company, but considered it would be more directly and uniformly achieved through the issued share capital test (para 2.21, page 14 of CASAC's Final Report).

The Government recognises the merit of a minimum economic requirement policy, but considers that there are also some serious limitations. A minimum economic requirement would require a requisitioning shareholder to hold shares with an average market value of a certain amount at the time of requisition. If shareholders were, for example, seeking to requisition a meeting because of a falling share price, potential requisitionists may be required to increase their shareholding in order to qualify. Requisitionists may be reluctant to "throw good money after bad".

A further difficulty with a minimum economic requirement test is that it could not easily apply to companies with non-standard capital and voting shares (for example, such a test could not apply to mutual organisations, where the members have a single nominal value share). Such a test would require modification to cater for non-standard companies. There are a very large number of companies that do not have all of their shares quoted, so a test based on market value would necessarily be complex and could involve a difficult and potentially expensive valuation exercise.

In conclusion, the Government believes that the square root test strikes the appropriate balance between shareholders rights to call a company meeting in extraordinary circumstances, while lessening the potential for abuse of such a right.

Government Proposal

The Government proposes the following model to replace the current 100 member test contained in section 249D(1)(b):

- The Corporations Law would continue to require that a meeting be held for a proper purpose. The directors of a company would be required to call and arrange a general meeting on the request of:
    - Members with at least 5% of the votes that may be cast at a general meeting; or
    - Members greater than or equal to the square root of the total number of members.

Other matters

In the course of the inquiry by the PJSC some suggestions were made to the PJSC that other additional matters arising from the *Company Law Review Act 1998* ought to be dealt with in subsequent legislation.

rning redeemable preference shares and selective capital

quiry into the additional matters raised, and does not make any

'or bringing these matters to its attention, and will consider them