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23 April 2004

Senator Grant Chapman
Chair
Parliamentary Joint Committee on Corporations & Financial Services
Parliament House
SG.64
Canberra ACT 2600
Fax: 6277 5719

Dear Senator Chapman

Parliamentary Joint Committee on Corporations and Financial Services
Inquiry into CLERP 9 (Audit Reform & Corporate Disclosure) Bill
Response to questions on notice at public hearing 18 March 2004

We refer to our attendance at the public hearing in Melbourne on 18 March 2004. We are pleased to respond to the questions on notice raised by Committee members with AICD representatives at the hearing.

Should the non-binding shareholder vote apply to executive remuneration packages above $1m?

Although AICD is supportive of the underlying principles in relation to disclosure in a remuneration report, as we have previously stated, we do not support the concept of a non-binding vote. However, given that the CLERP 9 Bill will most likely have such a requirement, AICD considers that the most effective disclosure is where the remuneration of a defined number of company officers is disclosed for a number of reasons. Firstly, a monetary threshold means differential reporting between companies - some companies will have officers who meet the threshold, while others (potentially the bulk of companies) will not. There may be difficulties identifying the true value of the packages to be voted on given that they often contain short and long term incentives. Moreover, the value of some incentives is not crystallised until after performance outcomes have occurred.

There may be certain unintended consequences that flow from setting a monetary threshold. Some companies could ensure that their executives' packages remain just under the threshold amount so that they do not have to be voted on by shareholders. Setting a threshold amount may also well include employees who are not officers of the company (such as employees on commission) but who nevertheless earn such amounts. Uncertainty could be created, because

there is always the potential for the threshold to be revised up or down. It is also likely that remuneration will be ratcheted up as comparisons are made within and between companies, which is probably not the intent behind the push for greater disclosure.

Should shareholders either approve political donations or approve the director's policy that attaches to them?

It is becoming less common for companies to make political donations. This is partly because such donations are required to be disclosed under other legislation. There is also scope for shareholders to ask questions about donations or the policy under which they are made at the company's general meeting. For these reasons, AICD does not support the concept that shareholders should approve political donations or the director's policy under which they are made.

Question from Senator Murray - Do we need tougher laws to catch delinquent directors?

Senator Murray raised an important question for our consideration. It is also one that should be considered by all interested in company law in this country.

From time to time we see company collapses in this country where those in control of the companies, or otherwise involved in apparent breaches of the law, appear to have 'got away' without the regulator being able to take appropriate action against those directors. There have been some cases where, regrettably, the results have been less than satisfactory from the point of view of a public perspective. But, from time to time, that will happen in all areas of our law (not just company law).

We start with the presumption that people are innocent unless proven guilty. This important principle of our law must remain the basis upon which we go forward in all areas of our law unless there are very strong reasons for moving away from the principle. Perhaps in the areas of national security, or during times of war, we may adopt a slightly different approach. We do not regard the collapse of companies, whether through inept behaviour by management, negligence or even fraud, as warranting a switch in the onus of proof.

Unfortunately, with due respect to ASIC, it has not always been as aggressive and as willing to pursue company collapses as the facts of the situation may warrant. For it to argue, as it has in relation to the infringement notice regime, that it is too difficult to establish a breach of that regime and therefore it needs the infringement notice regime to be introduced by CLERP 9, is an unsupportable argument.

Professor Bob Baxt is the Chair of our Law Committee and appeared before the Committee. He recently wrote an editorial for the Company and Securities Law Journal in which he highlighted the fact that a number of very important judgments have recently been handed down by the courts in which they have held directors liable in a range of scenarios. A copy of that editorial is attached. This is clearly the best evidence that can be offered to parliament that the system works well and that in appropriate circumstances, directors will be appropriately punished. The fact that there are some cases where directors escape liability or where ASIC does not achieve success is simply a reflection of human nature.

It would be unfortunate if we in effect destroyed the concept of limited liability or made it so meaningless that the entrepreneurial framework which led to the creation of the limited

liability company and our society as we now know it should be changed because several large company crashes occur each year, and it is felt that some people got away with more than they should have. We do not consider that changing the laws will lead to any better results or any stronger signals from the courts to the community that breaking the law will be punished if appropriate litigation is brought. We need to allow our laws time to work and we need effective regulators to police them. If appropriate, we may need to change the rules of our courts to deal with special problems as they arise.

Company Accounts - Accounting Standards and 'True and Fair'

We also want to take this opportunity to comment on an issue that was raised during the Committee's hearing with the Group of 100 on 18 March 2004. The issue relates to the dual requirement to prepare accounts so that they comply primarily with accounting standards and also present a 'true and fair' view of the company.

The preparation of set of accounts that comply with accounting standards may not also reflect the economic reality of an entity's financial situation and, hence, a 'true and fair' view. For this reason we consider that the law should firstly provide for accounts to be prepared to present a 'true and fair' view. If in presenting such a view, directors need to divert from the application of an accounting standard, that fact, its financial effect and the reason why directors believe they should override the accounting standard, should be disclosed in the accounts.

The practical result of the dual requirements is that when directors comply with accounting standards, without the primacy of the 'true and fair' obligation, the resulting financial statements could be held to be misleading under section 12DA of the Australian Securities & Investments Commission Act 2001 for which there is currently no defence.

For reasons of consistency, logic and more effective disclosure, AICD encourages the Committee to recommend that the 'true and fair' obligation be given primacy over compliance with accounting standards. Alternatively, AICD encourages the Committee to propose a due diligence defence for directors, so that they are not inadvertently made liable for alleged 'misrepresentation' in the accounts.

Thank you for the opportunity to respond on these matters of concern. Please contact me if you have any questions on (02) 8248 6601 or Rob Elliott, Manager Policy and Advocacy, on (02) 8248 6630.

Yours sincerely

Ralph Evans
Chief Executive Officer

Editorial

Company and Securities Law Journal

May 2004 (forthcoming)

Professor Bob Baxt AO

Recent court decisions on directors' duties

In that context, may I make some observations about the courts in very recent times. The recent history suggests that our courts are very well equipped to deal with a range of issues.

Any suggestion that our courts were 'opting out' in dealing with the challenges thrown up by the recent series of company crashes and issues surrounding directors' duties have been clearly dispelled by a number of important court decisions in the last 18-24 months. As the Parliamentary Joint Committee on Corporations and Financial Services continues its 'hearings' on the CLERP9 legislation (CLERP (Audit Reform and Corporate Disclosure) Bill 2003), there promises to be some very interesting issues raised in the anticipated dissenting report of the Labor/Democrat Senators. They (and it seems the Government) seem to suggest (in part) by introducing these new laws, that our judicial system is not flexible enough and active enough to deal with serious questions arising out of corporate failures. In fact, our courts continue to produce judgments which give us one very clear message: if there are appropriate factual situations that can be taken to the courts and proved in the relevant case, the courts will deal with those issues in an appropriate and effective manner.

From time to time, there will be disappointment in the interpretation of relevant legislation. Whilst some might have hoped that the High Court of Australia would have seen that there were some issues of interpretation arising out of the *Whitlam* case (*Whitlam v ASIC* (2003) 46 ACSR 1), in view of the fact that the New South Wales Court of Appeal held that the regulator had failed to substantiate there was a breach of the *Corporations Act*, the relevant issues arising out of the increase of the powers and the specific duties of a chairman of a company in relation to the exercise of proxy votes must remain a matter for a future case. This is clearly an important issue as we go forward into a new era of greater shareholder democracy. Battles for corporate control will remain very high on the agenda and the proposed forthcoming meeting of shareholders of the National Australia Bank Limited dealing with issues concerning corporate governance will again test the way in which our proxy voting system operates. The last interesting examination of this area of the law occurred in the context of the Coles Myer annual general meeting about a year or so ago.

Austin J, having in the eyes of some, made some groundbreaking observations in *ASIC v Rich & Ors* (the *Greaves* case - (2003) 21 ACLC 450) has again handed down an interesting and thought provoking judgment in *ASIC v Vines (No 2)* (2004) 22 ACLC 37. In this case he examined the standard that one might expect of a non-executive director (the chief financial officer) in the context of the operations of a company. The most interesting observations offered by Austin J were again by way of dicta; but he makes it clear that in his view an objective standard of care will be applied by courts (unless the High Court tells us otherwise) in evaluating the skills and duties and responsibilities of particular officers and non-executive directors of companies. Indeed Austin J

seems to suggest that the chief financial officer of a company, especially a public company, would be expected to have not just ordinary skills but special skills in order to achieve an appropriate standard to undertake that position. The matter will no doubt be taken further through the court system.

In the meantime, many Australian directors will be concerned about the impact of what appears to be quite an extraordinary decision of the South Australian Full Supreme Court in *Hanel v O'Neill* (2004) 22 ACLC 274. This case concerned the interpretation of section 197 of the *Corporations Act* which deals with the liability of corporate trustees and directors of corporate trustees. The Full Court, although it excused the director of personal liability in a case where a corporate trust had no funds to meet payment due to a landlord, interpreted section 197 in a way that makes it clear that where a director responsible for administering a corporate trust estate allowed all the assets of the estate to be distributed, thus leaving the trust estate without funds to discharge the liability to the relevant creditor, that director could be deprived of the ability to seek indemnity and in an appropriate case the director is likely to be held personally liable. Mullighan J and Gray JJA both agreed with this interpretation, although Debelle J felt that this was a misinterpretation of the intention of parliament in re-enacting the relevant section in 1998. Once again, the High Court of Australia may be asked to deal with this matter.

In the Federal Court Gyles J in dealing with an application by ASIC to obtain certain information from a director of a company which had been involved in a large insurance claim, rejected the director's claim based on legal professional privilege in order to prevent the regulator from obtaining the relevant documents. In *Kennedy v Wallace* [2004] FCA 332, Gyles J held that although Kennedy had sought certain advice in relation to the relevant documents from a Swiss attorney, this advice, in his view, was being sought in a different manner to that which would normally attract legal professional privilege. In strong dicta, he also commented on the interaction of the important principle of legal professional privilege and the public interest to ensure that justice was seen to be done. In his view it was

> not conducive to the public interest in the administration of justice in Australia that the enforcement of Australian law, including laws with respect to taxation, should be hindered or obstructed by the use of devices constructed by reference to rules of foreign jurisdictions with the advice and assistance of overseas lawyers who may be acting properly and in accordance with the laws of the country in which they practice. It may not be unlawful for an Australian to seek advice for such a purpose or to act upon it, but there is no reason in principle why communications made for that purpose should receive the benefit of the cloak of legal professional privilege so as to prevent their disclosure to Australian authorities. [2004] FCA 332 at para 80.

He concluded that if Australians took advantage of foreign secrecy laws to evade 'scrutiny of assets and transactions by Australian authorities, including taxation authorities' this would have 'no conceivable connection with the administration of justice or the proper functioning of the legal system in Australia which is the sole rationale for legal professional privilege' ([2004] FCA 332 at para 81). For obvious reasons, this case will no doubt be appealed and we shall see whether the extra remarks of Gyles J will stand.

Finally, in quite an extraordinary period for decisions involving company directors, the Victorian Court of Appeal has upheld the decision of Mandie J in the *Waterwheel* case (*Elliott & Anor v ASIC* [2004] VSCA 54). In a judgment handed down on 6 April 2004, the Court of Appeal unanimously held that John Elliott had correctly been found liable by Mandie J of a breach of the insolvent

trading provisions of the *Corporations Act*. Whilst another director had his period of disqualification shortened, Elliott lost his appeal. He is likely to seek leave to appeal this decision to the High Court of Australia.

This brief discussion of these interesting cases is not complete without a short reference to the New South Wales Court of Appeal decision in *Rich & Anor v ASIC* (2003) 48 ACSR 6 where, by a majority, the court upheld the ruling by Austin J that the various provisions of the *Corporations Act*, pursuant to which directors could be disqualified in relation to a civil claim for breaches of duties, were not punitive in nature but protective, thus excluding the applicability of a claim by a director that he or she could refuse to disclose information to ASIC on the basis that it might expose the director to penalty. (It is interesting to note that the Victorian Court of Appeal agreed with this interpretation in the *Waterwheel* case referred to above). Rich and his co-directors have obtained leave to appeal to the High Court of Australia. This decision will once again test the viability of our *Corporations Act* and the civil penalty regime which has been in place for over 10 years and which has now been successfully utilised by ASIC in pursuing company directors. The decision in the High Court could have a very significant impact on future corporate regulation in this country.

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