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THE CORPORATE LAW ECONOMIC REFORM PROGRAMME: AN OVERVIEW

BY

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The Corporate Law Economic Reform Programme: an overview

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"CLERP", or the Corporate Law Economic Reform Programme, came into being on 4 March 1997. At that time the Federal Treasurer, the Hon. Peter Costello, announced the programme and disbanded the simplification task force, which had been in existence since December 1993.

The simplification task force was comprised of three lawyers and a linguist, Dr Robert Eagleson. The simplification process effectively formulated the *First Corporate Law Simplification Act* 1995 (Cth). Complexity and inflexibility were the acknowledged foes; clarity, simplicity and plain language the objectives[1].

The *Second Corporate Law Simplification Bill* was introduced into Parliament, but was not passed before the proroguing of Parliament for the 1996 federal election.

It is a testament to the dedication and accuracy of the task force that although the *Second Corporate Law Simplification Bill* was not

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1 See *Corporations Law Simplification Program*, Task Force Plan of Action, December 1993.

enacted as part of the simplification process, it has been largely incorporated as part of the current reforms; in the *Company Law Review Act* 1998 (Cth)[2].

But that is enough background. Let me return to the present programme.

CLERP represents a structural review of Corporate Law from the ground up in six key areas of corporate and business regulation. Those six areas were each covered by a "Policy Reform Paper", prepared by Federal Treasury. The policy papers covered the following areas:

1. Accounting standards
2. Fundraising
3. Directors duties and Corporate governance
4. Takeovers
5. Electronic commerce
6. Financial markets and Investment Products

It is evident even from the titles of the reform documents there was a focus upon the achievement of economic objectives. CLERP therefore reaches beyond the simplification process. It is concerned with issues of national economic policy. CLERP is intended to effect a

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2 Watts, "The Company Law Review Act 1998", September 1998, *Law Society Journal of South Australia Bulletin*, 14-16.

fundamental review of corporate law: a wide-ranging initiative to improve not only the expression, but also the content and initiative of the law. As the Federal Treasurer said when launching CLERP[3]:

> "CLERP is a program to modernise Australia's Corporations Law and give it an economic focus. ... [Its] aim is to introduce world's best practice in business regulation. It is part of the government's broader goal of making Australia a leading financial centre in the region. CLERP is designed to harmonise Corporations Law with pro-enterprise, pro-jobs and pro-investment objectives."

The economic focus is reinforced by the close relationship of the reforms with the Financial System Inquiry, which culminated in the Wallis Report. The Australian Stock Exchange made two submissions to the inquiry, to the effect that the Corporations Law was excessively long and inflexible, that it dealt with subjects that it need not, that the fundraising provisions were problematic, and advocated the law being reduced to a policy-level document in specific areas[4]. Much of what the ASX advocated appears to have been adopted.

The shift to an emphasis upon economic policy inevitably meant that the legislation would not be the sole preserve of lawyers. Certainly lawyers were heavily involved, but commercial experts, economists and

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3 Quoted in Brown and da Silva Rosa, "Australia's Corporate Law Reform and Market for Corporate Control" (1998) 5(2) *Agenda* at 179.

4 See generally Shaw, "Arguing for an Outcome-oriented Corporations Law" (1997) 15 *Company Law and Securities Journal* 370-372.

business people were brought into the fold. Some of the people here today participated in the process. They will therefore be able to provide a unique insight not only into the effect of the law, but also the process of consultation undertaken in order to develop it.

One of the underlying objectives of CLERP is to ensure business regulation is consistent with the promotion of a strong and vibrant economy; to facilitate business in the Asia Pacific region and elsewhere. And, as recent events in the neighbourhood have suggested, it may turn out to be a highly important achievement to set an example by clear, accessible and reasonably tight corporate regimes. Within these broad objectives is the maintenance of market freedom by removing unnecessary regulation, and providing investor protection and cost effectiveness.

Australia has to compete for business with countries with better, freer business regulation than ours.

Practitioners in New Zealand have commented that Australian Corporations Law is often seen as a prime example of how not to legislate on commercial matters[5]. Goddard (albeit flippantly), in a comparison of the cross-Tasman legislation concluded that Australian

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5 Goddard, "Company Law Reform – Lessons From the New Zealand Experience" (1998) 16 *Companies and Securities Law Journal* 236 at 254.

Corporations Law had 1,500 sections contained in 1,600 pages. The New Zealand legislation contains just 400 sections in 240 pages[6]. Although the volume of legislation may be a superficial measure only of complexity, it does give some indication of what other jurisdictions have been able to do. As Blaise Pascal said, in his Lettres Provinciales in 1657, "I have made this [letter] longer than usual, only because I have not had the time to make it shorter." It is pleasing to see that the CLERP Bill represents a trend away from complex, verbose legislation.

With the growth of international business and corporations and the ability of companies to arrange their affairs so as to be able to migrate to favourable regulatory arrangements, Australia's competitiveness as a regional financial centre will be measured not only by tax advantages and other like benefits: it will also be assessed by the sophistication and accessibility of its corporate law regulatory regime. The dual aims will be to facilitate business, whilst retaining the protection which investors, persons dealing with the legal personality and its creditors deserve.

So why are the changes, in the form of CLERP, being proposed now? What are the features that make such change not only practical, but also desirable?

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6 Id at 249.

Markets around the world are being liberalised. Trade is facilitated not only by modern methods of transportation but also by the international structure of companies. They will do business virtually anywhere and with anyone. It may be years since Adam Smith's Wealth of Nations, part of which deals with creation of wealth through largely unimpeded international trade[7], but I am sure he never contemplated a situation in which so many companies would be trading so widely around the globe.

Obviously these new and different conditions necessitate a different form of regulation. It is only proper that in this process, the legislature, through proper and consultative mechanisms, responds to that need and enact reforms such as these. Well expressed, comprehensible legislation produced by the legislature is a preferred alternative to prolonged and expensive litigious processes resolving on a case by case basis the meaning and application of obscure and prolix provisions.

This summary concludes what I have to say about how CLERP came about. It is now relevant to look to the legal status of the reform proposals.

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7 See Black, *Smith's Wealth of Nations* (1863) at 187-299.

The six policy papers I referred to earlier have become the basis for two pieces of legislation. The first is the *Company Law Review Act* 1998 (Cth) which received assent on 29 June 1998. The commencement dates of the amendments are staggered. The Act deals with only one of the Policy Papers - Paper No 5 - Electronic Commerce. But not all the proposals have become law.

The other piece of legislation, or potential legislation, is the *Corporate Law Economic Reform Bill* 1998, which was before the House before the announcement of the recent federal election. It did not pass therefore into law. This Bill deals with Accounting Standards, Fundraising, Directors' Duties and Corporate Governance and Takeovers. The last element of the proposals, Financial Markets and Investment Products will apparently be released in the form of draft legislation by the end of this year.

There is always a degree of uncertainty when discussing changes which are proposed by Bills and reform papers. However, I proceed upon the basis that the government's commitment to the CLERP reforms remains.

Let me now give a very brief overview of the changes effected by the Act and proposed by the Bill. In doing so, I do not mean to tread on the toes of experts in the particular areas, but simply to give delegates a map of the various components of the proposals. This should give some idea of where today's sessions are heading.

I want to begin with the reforms contained in *Corporate Law Economic Reform Bill*. As I mentioned earlier, that Bill deals with Fundraising, Directors' Duties and Corporate Governance, Accounting Standards and Takeovers. I also mention that the provisions of the proposed legislation will be referred to as "sections" rather than clauses, in the interests of compatibility with the Explanatory Memorandum.

Fundraising

The explanatory memorandum to the Bill states the objectives of the reforms to corporate fundraising as being:

> "to minimise the costs of fundraising while improving investor protection".[8]

The proposals, contained in the proposed Chapter 6D, aim to improve disclosure and at the same time, reduce transaction costs. The disclosure requirements display a trend away from technical, complex prospectuses, which is a marked change from the current position – the requirement that all information must be disclosed which investors and their professional advisers would reasonably require and reasonably expect to find in the prospectus for the purpose of making an informed

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8 Corporate Law Economic Reform Bill 1988 (Cth), *Explanatory Memorandum* at 1.

assessment of the assets, liabilities, financial position, profits and losses, and prospects of the corporations, and the rights attaching to the securities[9]. These are fundamental reforms in the approach to information forming the basis for rational investment decisions by those assessing the value of the securities offered by companies.

The reforms are to be achieved in a number of ways. First, there are changes to the content of prospectuses. For example, the new general disclosure test is for "all information that investors and professional advisors would reasonably require to make an informed assessment"[10]. This may serve to simplify the content of disclosure documents. Perhaps there is some measure of optimism in the explanatory memorandum and the formulation of the test. Although no doubt the test is intended to be an objective one, of reasonable requirement, supplemented by some references to specific matters, it would probably be unwise to be too sanguine about the litigation that may still be generated. One fruitful area of dispute may be as to the obligation to state in a profile statement "the nature of the risks involved in investing in the securities" (s 714). (Just which industries may use profile statements is not yet known. In the United States, profile statements are used for certain mutual funds).

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9 Corporations Law ss 1021, 1022.

10 s 710.

The second aim of the reforms is to reduce the occasions on which disclosure documents are required. Capital raising up to $2m is permitted without the need to issue a prospectus or other disclosure document in some circumstances[11]. Up to $5m can be raised with an "Offer Information Statement" rather than a full prospectus[12]. No prospectus or disclosure document need be issued when a capital raising exercise is undertaken with a "sophisticated investor"[13], who is generally able to safeguard their own interests to a greater extent than typical retail investors.

Shorter prospectuses can be used for retail investors, with technical information available in separate documents[14].

The prospectus reforms come in response to studies which show that potential investors have experienced difficulty in fully understanding them, as a result of their characteristic length and complexity[15].

There are two further important reforms. The overlapping application of the *Trade Practices Act* 1974 (Cth) in respect of misleading

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11 s 708.

12 s 709.

13 See s 708(8).

14 s 712.

15 See CLERP Paper No 2 at 12.

statements contained in prospectuses will be removed. Those questions will now arise only under the Corporations Law itself. Finally, Federal Government Business Enterprises will no longer enjoy immunity from the fundraising provisions[16].

Mr Martin Bennett from Minter Ellison will provide greater insights in to the fundraising component of the proposals. He is experienced in capital raising transactions and is well qualified to speak on the topic.

Directors' duties and corporate governance

Improving corporate governance is the grand objective of the reforms related to this topic. This is a key part of the reforms. The right balance is critical. How do you ensure enterprising and innovative business activity, indeed, to use that much deprecated term, entrepreneurial activity (of the right kind, I emphasize) without compromising accountability by directors? I do not think the question is a small one. It gives rise to further questions. Directors need to be the ultimate decision makers. But on whose advice should they act? To what extent should they involve themselves in the day to day management of the company? Where do the senior executives' responsibilities end? The underlying problem is one which no legislation may satisfactorily fully solve. And under the proposed reforms, it will be

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16 cf s 2A of the *Trade Practices Act* 1974 (Cth) applying that Act to the federal Government Business Enterprises.

important to ensure that directors are not obliged to waste time and money, not so much as to be better informed as to protect their backs.

The CLERP paper indicated that reform was necessary[17]:

> "in light of more recent judicial decisions which appear to increase the responsibility of directors and create a large degree of uncertainty regarding their potential liability".

The objective of the reforms is said to be to "promote optimal corporate governance structures without compromising flexibility and innovation"[18].

The reforms include the introduction of a "business judgment rule", allowing delegation of responsibilities, providing a statutory derivative action to shareholders and clarifying the duties of corporate governers.

It is not the first time that some form of business judgment rule has been considered[19]. While it has always been agreed that a high degree

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17 CLERP Paper No 3 at 9.

18 Id at 10.

19 Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties*, November 1989; Companies and Securities Law Review Committee, *Company Directors and Officers: Indemnification, Relief and Insurance*, 1990; House of Representatives Standing Committee on Legal and Constitutional Affairs, *Corporate Practice and the Rights of Shareholders*, 1991; Companies and Securities Advisory Committee, *Directors' Duty of Care and Consequences of Breach of Directors' Duties*, September 1991.

of accountability should be expected of directors, the limits of that responsibility have always been much more difficult to set.

The limit proposed by the CLERP reforms is protection from personal liability in circumstances in which directors' decisions are honest, informed and rational[20]. Clearly such a rule will not protect directors from ill-informed or fraudulent judgments. As Professor Baxt notes, the provision means directors will not have to "worry about hindsight coming back to bite [them] later if the decision turns out to be not quite as successful"[21].

It is important to remember that companies are in business. They are the successors to partnerships and joint stock companies in which, historically people often speculated rather than invested: high risks produce high rewards or large losses. We are a long way now from the South Sea Bubble but few businesses are risk free. Although directors rightly owe fiduciary duties to the company and ultimately the shareholders, they are not the custodians of trustee investments. This is sometimes forgotten when things go wrong.

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20 s 180.

21 Baxt, "Company Law Reform by No Half Measures! The CLERP Program Really 'Takes Off' " (1988) 26 *Australian Business Law Review* 217 at 218.

Directors will, as I have said, be able to delegate functions to other persons and to rely on the advice of experts in certain circumstances[22]. The new delegation provisions are clearly an attempt to meet the decision of the NSW Court of Appeal in *Daniels v Anderson*[23], adopting a narrow view of delegation in the corporate context.

But important also is the statutory derivative action through which shareholders will be able to pursue an action in circumstances in which the company will not[24]. The new Part is entitled "Proceedings on behalf of a company by members and others". The creation of the derivative action was recommended in a series of recent reports[25].

The derivative action attempts to overcome the difficulties which can be encountered under the common law, as one of the exceptions to the rule in *Foss v Harbottle*[26]. Under the proposal, the "proper plaintiff" rule at common law will be abolished. Of course, limitations will be

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22 s 189.

23 (1995) 37 NSWLR 438.

24 Part 2F.1A

25 See for example Companies and Securities Law Review Committee, *Enforcement of the Duties of Directors and Officers of a Company by means of a Statutory Derivative Action*; House of Representatives Standing Committee on Legal and Constitutional Affairs, *Corporate Practices and the Rights of Shareholders*, 1991; Legal Committee of Companies and Securities Advisory Committee, *Statutory Derivative Action*, 1993.

26 Corporate Law Economic Reform Bill 1998 (Cth), *Explanatory Memorandum* at 19.

imposed upon persons who can bring such actions. A salutory requirement is that leave be dependent upon the existence of a serious question to be tried[27].

Clarification of duties of officers and employees comes by way of Part 2D.1. The re-writing of the duties is aimed at making it "easier for company officers to know what is expected of them"[28].

Ms Kathleen Farrell from Freehills will take us into greater detail of directors' duties and corporate governance.

Accounting Standards

Jan McCahey from the Australian Securities and Investment Commission will discuss the reforms arising from the Accounting Standards proposals. Those reforms have the overarching aim of making accounting standards more useful for business and are contained in the proposed Part 12. This is to be achieved by establishing a peak advisory body, the Financial Reporting Council, which will be given the role of broad oversight over the accounting standard setting process[29]. It will report to the Minister and provide advice. It will also ensure a move

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27 s 237(2)(d).

28 Corporate Law Economic Reform Bill 1998 (Cth), *Explanatory Memorandum* at 26.

29 s 225(2)(a).

towards harmonising, and then adopting, International Accounting Standards Committee (IASC) standards[30].

It is hoped that these initiatives will make the standard setting process more responsive to the needs of both preparers and users of financial statements. At present no one would deny that many standards are open to varying interpretations.

Takeovers

Perhaps the topic which has provoked the most controversy, at least on a review of the available literature, is that of the reforms proposed for takeovers. While there has been an attempt, as the explanatory memorandum claims, to "promote a more competitive market for corporate control"[31], Professor Baxt, Brown and da Silva Rosa claim "It doesn't go far enough!"[32]

The takeover reforms will be effected by allowing a bidder to exceed the current statutory threshold of 20 per cent of total voting rights

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30 CLERP Paper No 1 at 22.

31 Corporate Law Economic Reform Bill 1998 (Cth), *Explanatory Memorandum* at 12.

32 Baxt, "Australian Corporate Law Reform – Two Steps Forward, One Step Back" (1998) 1(5) *Inhouse Counsel* 53; Brown and da Silva Rosa, "Australia's Corporate Law Reform and the Market for Corporate Control" (1998) 5(2) *Agenda* 179.

before being obliged to make a general takeover offer – the so-called "mandatory bid"[33]. Compulsory acquisition will be more widely available to shareholders with a large interest in a company[34].

Resolution of takeover disputes will be undertaken by a new specialist body, the Corporations and Securities Panel, which will replace the current jurisdiction of the AAT in that field and exercise the primary role in takeover dispute resolution[35]. Who are to constitute the Panel? The legislation qualifies for membership persons with the appropriate degree of knowledge and experience in the fields of business, company administration, financial markets and economics and accounting[36].

The view one takes of the reform proposals must inevitably be informed by the role one sees takeovers as performing. If takeovers, as Brown and da Silva Rosa observe, "create value through the removal of underperforming management or the exploitation of potential synergy"[37], then a regulatory regime which facilitates takeover action would be advocated. However minds may differ on this. Under peformance is not

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33 s 611.

34 Part 6A.1.

35 Part 6.10 Division 2. See also *Australian Securities Commission Act* 1989 (Cth) Part 10.

36 *Australian Securities Commission Act* 1989 (Cth) s 172.

37 Brown and da Silva Rosa, "Australia's Corporate Law Reform and the Market for Corporate Control" (1998) 5(2) *Agenda* 179 at 188.

always the attraction for so-called predators. Some surveys have suggested that the target shareholders often end up with more than the predator. Elimination or reduction of competition, corporate imperialism or simple misjudgment sometimes triggers takeovers.

Tony Bancroft from Mallesons takes us into the proposals to reform takeover regulation.

The four areas I have just discussed are all contained within the *Corporate Law Economic Reform Bill*. Let me now move to provide a brief overview of the reforms which are to appear in draft legislation later this year: financial markets and investment products.

Financial markets and investment products

The lowest degree of certainty exists in respect of this group of proposals because this is the only element yet to be transposed into legislation or draft legislation. But it is also the element which can be most closely tied to the findings of the Financial System Inquiry (The Wallis Report) and the Government's proposal to establish a new regulatory framework for the financial system.

The CLERP Policy Paper observes that there are problems with the current regulatory framework for financial markets. The reforms must, according to the CLERP policy paper[38]:

> "take account of the realities of the modern commercial environment and permit market participants to respond to the challenges presented by financial innovation and globalisation in a timely and sensitive manner [and] facilitate the mobilisation and investment of savings by the development of new and diverse markets and financial products, while at the same time enhancing efficiency, integrity and investor confidence."

The development of new financial products will be facilitated and competition is to be encouraged. Clearly in these highly technical areas, where change is constant, it is easy for regulation to lag behind market developments. The CLERP recommendations relate to disclosure, a licensing regime for those operating financial markets, and participation in an over-the-counter derivatives market.

I can really say little more than this on the topic, because the draft legislation has not yet been released. No doubt, Zein El Hasson of Corrs Chambers Westgarth will provide us with more information, of not only what the reforms are, but also of the status of the legislative draft.

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38 CLERP Paper No 6 at 8.

Electronic commerce

In contrast with the reform proposals to financial markets and investment products, the area of greatest certainty in the current discussion is electronic commerce. The proposals have been enshrined in legislation, as part of the *Company Law Review Act* 1998 (Cth).

The aim is to introduce into the corporate regulatory realm a feature which has become a routine part of life in many other parts of personal and professional lives. I wish I could claim the same level of exploitation of the medium in either my personal or professional life.

Adrian McCullagh will give us an introduction into the legal implications of engaging in electronic commerce.

CLERP Criticism

It is relevant to be aware that like all law reform, CLERP is not without its critics. Baxt says the reform programme does not go far enough, especially in the areas of the Courts' notions of the Corporate group and takeovers[39]. Likewise, Brown and da Silva Rosa criticize

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39 See Baxt, "Australian Corporate Law Reform – Two Steps Forward, One Step Back" (1998) 1(5) *Inhouse Counsel* 53; Baxt, "Australian Corporate Law Reform: Two Steps Backward and One Step Forward" (1998) 26 *Australian Business Law Review* 376 at 377.

CLERP for not going further with respect to deregulating takeovers[40]. There is also some published commentary by Dyer, who notes the potential for defensive litigation remains and that some functions of the Corporation and Securities Panel overlap with the ASC[41].

But even on a reading of the various commentaries, one thing becomes quite clear – the general agreement that CLERP is a significant improvement on the current position. I therefore now open the central part of the sessions here today with the issue of fundraising.

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40 Brown and da Silva Rosa, "Australia's Corporate Law Reform and the Market for Corporate Control" (1998) 5(2) *Agenda* 179-188.

41 Dyer, "A Revitalised Panel?" (1998) 16 *Companies and Securities Law Journal* 261-278.

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A. Journal Articles

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3. **Baxt, R.** CLERP: A Breakthrough for Directors. (1998) 14 (4) *Company Director* 27 – 28.

4. **Baxt, R.** Company Law Reform by No Half Measures! The CLERP Program Really "Takes Off." (1998) 26 *Australian Business Law Review* 217 – 220.

5. **Brown, P and da Silva Rosa, R.** Australia's Corporate Law Reform and the Market for Corporate Control (1998) 5(2) *Agenda* 179 – 188.

6. **Dyer, A.** A Revitalised Panel? (1998) 16 *Companies and Securities Law Journal* 261 – 278.

7. **Goward, D.** Company Law Reform: Lessons from the New Zealand Experience. (1998) 16 *Companies and Securities Law Journal* 236 – 260.

8. **Hone, G.** Fundraising and Prospectuses: the CLERP Proposals. (1998) 16 *Companies and Securities Law Journal* 311 – 322.

9. **Joldeski, E.** Corporate Law Reform (1997) 13 (6) *National Accountant* 14 – 16.

10. **Parker, C.** A New Era in Financial Reporting? The CLERP Reforms. 19 (24/9/97) *Butterworths Corporation Law Bulletin* 5 – 7.

11. **Shaw, A.** Arguing for an Outcome Oriented Corporations Law (1997) 15 *Companies and Securities Law Journal* 370 – 372.

12. **Whincop, M.** Nexuses of Contracts, The Authority of Corporate Agents, The Doctrinal Indeterminacy: From Formalism to Law and Economics. (1997) 20 *UNSW Law Journal* 274 – 310.

13. **Watts, G.** The Company Law Review Act 1998, *The Law Society of South Australia Bulletin* September 1998 14-16.

B. Internet and Online Resources

All of the documents listed below can be accessed at <www.treasury.gov.au> under the Corporate Law Reform hypertext link.

1. Policy Framework Precis.
2. Accounting Standards Policy Reform Precis.
3. Fundraising Policy Reform Precis.
4. Directors' Duties and Corporate Governance Policy Reform Precis.
5. Takeovers Policy Reform Precis.
6. Electronic Commerce Policy Reform Precis.
7. Financial Markets and Investment Products Policy Reform Precis.
8. Corporate Law Economic Reform Bill Precis.
9. Corporate Law Economic Reform Program, Proposals for Reform, No 1, *Accounting Standards – Building International Opportunities for Australian Business* (1997).
10. Corporate Law Economic Reform Program, Proposals for Reform, No 2, *Fundraising – Capital Initiatives to Build Enterprise and Employment* (1997).
11. Corporate Law Economic Reform Program, Proposals for Reform, No 3, *Directors' Duties and Corporate Governance* - Facilitating Innovation and Protecting Investors (1997).
12. Corporate Law Economic Reform Program, Proposals for Reform, No 4, *Takeovers – Corporate Control: A Better Environment for Productive Investment* (1997).
13. Corporate Law Economic Reform Program, Proposals for Reform, No 5, *Electronic Commerce – Cutting Cybertape - Building Business* (1997).

14. Corporate Law Economic Reform Program, Proposals for Reform, No 6, *Financial Markets and Investment Products – Promoting Competition, Financial Innovation and Investment* (1997).