Parliament of the Commonwealth of Australia

Corporate Practices and the Rights of Shareholders

Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs

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FOREWORD

The invisible victims of the much publicised corporate failures of recent years are the smaller shareholders. Apart from the obvious damage done to Australia's reputation by this spate of corporate collapses is the concomitant damage to investor confidence through the loss of shareholders' funds.

This report presents the results of an inquiry by the House of Representatives Standing Committee on Legal and Constitutional Affairs into the adequacy and effectiveness of the existing legislative and administrative framework in controlling a wide body of corporate practices.

The Committee thanks all interested individuals and organisations for their assistance and cooperation during the inquiry.

As Chairman, I would like to acknowledge the cooperation of Deputy Chairman, Mr Warwick Smith, MP and my fellow Committee Members during the conduct of the inquiry. Thanks are also due to the Inquiry Secretary Mr Donald Nairn, principal research officers, Ms Sue Morton and Mr David Crawford and the administrative assistants, Mr Jason Sherd and Ms Donna Christophers.

The Committee particularly wishes to record its appreciation for the specialist advice provided by Mr Gregory Bateman of Abbott Tout Russell Kennedy. Mr Bateman made a significant contribution during the latter stage of the inquiry.

This report recommends significant reforms aimed at ensuring acceptable standards of corporate behaviour in Australia. Adoption of the proposals will assist in the process of re-establishing and enhancing the integrity of Australia's securities markets.

MICHAEL LAVARCH, MP
Chairman

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TERMS OF REFERENCE

INQUIRY INTO CORPORATE PRACTICES AND THE RIGHTS OF SHAREHOLDERS

To examine, inquire into and report on the adequacy of the existing legislative and administrative controls over corporate practices which impact on the rights of shareholders, including:

(1) controls over market practices, including market manipulation, warehousing and ramping;

(2) controls over the acquisition of shares by directors, including management buy-out or anologous situations;

(3) disclosure requirements of directors;

(4) powers of shareholders in relation to the management of their companies; and

(5) controls necessary for the protection of shareholders, in particular minority shareholders.

ABBREVIATIONS

AASB	Australian Accounting Standards Board
AGM	Annual General Meeting
ASC	Australian Securities Commission
ASX	Australian Stock Exchange
Corporations Law	The Corporations Law as it applies in all jurisdictions and as set out in the Corporations Act 1989 (Cwth) S.82
CSLRC	Companies and Securities Law Review Committee
CSAC	Companies and Securities Advisory Committee
Griffiths Committee	House of Representatives Standing Committee on Legal and Constitutional Affairs Inquiry into Insider Trading
Griffiths Report	Fair Shares for All - Insider Trading in Australia (1989)
NCSC	National Companies and Securities Commission
NZLC	New Zealand Law Commission

SUMMARY OF RECOMMENDATIONS

RECOMMENDATION 1

The Committee recommends that adequate resources be provided to the Australian Securities Commission and the appropriate sections of the Australian Stock Exchange to enable suitable monitoring - detection, investigation and enforcement - of securities trading. (para 2.5.24)

RECOMMENDATION 2

The Committee recommends that the Australian Stock Exchange take a more active role in relation to the enforcement of the Listing Rules and malpractices in relation to the market of listed securities. To that end, it is further recommended that co-operation between the ASX and ASC be formalised with a view to:

- the ASC using its existing powers (to obtain testimony and documents) in situations where there is reason to suspect that there has been a breach of the Listing Rules or other market malpractice;

- the ASC making information so gathered available to the ASX where it would aid in the enforcement by the ASX of the Listing Rules. The ASX would be subject to duties of confidentiality in respect of the information supplied and, to assist in this, the information would be restricted to the Surveillance and Enforcement Division of the ASX and its legal advisers; and

- the ASC, after consulting with the ASX, making announcements, with the benefit of its existing protections, in relation to matters concerning suspected market malpractice or suspected breaches of Listing Rules.

The Committee further recommends that any necessary amendment of sections 127(4) and 246 of the Australian Securities Commission Act 1989 be made so as to make it clear that:

- the ASC can co-operate with the ASX in the manner recommended by the Committee; and

- the ASC is protected from liability in relation to any announcements which might be made. (para 2.5.32)

RECOMMENDATION 3

The Committee recommends that the Corporations Law be amended to give the Australian Stock Exchange the right to institute proceedings under sections 1114 or 777, without having to give undertakings as to damages. (para 2.5.33)

RECOMMENDATION 4

The Committee recommends that the Attorney-General ask the Companies and Securities Advisory Committee for it to report on ways in which the market practices in Australia can be brought into harmony with practices in the United States and the United Kingdom, particularly in relation to short selling and market stabilisation activities. (para 2.7.10)

RECOMMENDATION 5

The Committee recommends that the Government take steps to enable regulatory authorities to be able to co-operate better with overseas regulatory authorities in the detection and investigation of market manipulation practices. (para 2.7.11)

RECOMMENDATION 6

The Committee recommends that section 623 of the Corporations Law be amended to require that the notice of meeting be accompanied by a report by an expert stating whether the proposed acquisition of shares is fair and reasonable having regard to the interests of shareholders other than the vendor, purchaser, allottee and their associates. (para 3.3.41)

RECOMMENDATION 7

The Committee recommends that section 205(10) of the Corporations Law, relating to the circumstances where a company in general meeting can approve the granting of financial assistance for the acquisition of its own shares, be amended to provide the following further protection:

- the notice of meeting must be accompanied by a solvency declaration by the company's directors, as would apply in a buy-back of shares; and

- a joint and several obligation imposed on both the directors involved in the solvency declaration and the person financially assisted, to indemnify the company, to the extent of the financial assistance given, in the event that the company is

wound-up within the 12 months following the giving of the financial assistance. (para 3.3.45)

RECOMMENDATION 8

The Committee recommends that the Corporations Law be amended so that the requirement for an independent experts report to accompany a Part B Statement by the Target be extended to situations where a person concerned in the management of the Target was associated with or had a material interest in, the Offeror. For this purpose:

- the Offeror should be obliged to disclose in the Part A Statement the existence of any such connection;
- the Law should be amended to require officers of the Target to declare to the Target whether they have any such connection; and
- a material interest should be an entitlement of 5% or more of the Offeror or the holding of securities which, upon conversion, would give rise to such an entitlement.

The Committee further recommends that the Corporations Law be amended to afford the same protections to Target shareholders in the context of an on-market takeover, with the Part D Statement having to be accompanied by an independent expert's report in all situations where it would have been required in the case of a Part B Statement. Further, the Law should be amended to require that any such Part D Statement must be sent to all Target shareholders and not just lodged with the Australian Stock Exchange. (para 3.3.48)

RECOMMENDATION 9

The Committee recommends, in relation to shareholder approved acquisitions, that the ASC consider making a class order under section 730 of the Corporations Law to permit pre-meeting arrangements on the terms identified in paragraph 31 of NCSC Policy Statement No. 116. (para 3.3.51)

RECOMMENDATION 10

The Committee recommends that, in relation to compulsory acquisition of shares pursuant to a court approved scheme under section 414 of the Corporations Law, the Law be amended to provide that the rights of compulsory acquisition are not available unless the thresholds and their calculations are determined in the same manner as would apply to compulsory acquisition under section 701 of the Law in relation to a takeover. (para 3.4.19)

RECOMMENDATION 11

The Committee recommends that, in relation to the compulsory acquisition of shares pursuant to schemes of arrangement, selective reduction of capital or pursuant to a power inserted in the articles, the Attorney-General ask the Companies and Securities Advisory Committee for it to report on ways in which protection against compulsory acquisition on unfair terms can be made consistently available for minority shareholders. (para 3.4.20)

RECOMMENDATION 12

The Committee recommends that a regime of "continuous disclosure" by Listed Companies should be introduced, implemented and enforced through the ASX Listing Rules. (para 4.5.17)

RECOMMENDATION 13

The Committee recommends that the Listing Rules of the Australian Stock Exchange be re-drafted by those versed in statutory drafting so as to have the Rules expressed in a language and style which both facilitates clear interpretation and increases the ability to enforce such Rules in the courts. The Committee further recommends that the Attorney-General announce that he will disallow, under section 774 of the Corporations Law, any further alterations to the Listing Rules which do not comply with the Committee's recommendation on the matter of style. (para 4.5.23)

RECOMMENDATION 14

The Committee recommends that section 777 of the Corporations Law be amended to provide that where the Stock Exchange Listing Rules apply to a listed company, the directors of that company are deemed to be under an obligation to procure the company to comply with the Listing Rules and the directors can be subjected to orders of the court concerning compliance with the enforcement of those Listing Rules. (para 4.5.25)

RECOMMENDATION 15

The Committee recommends that, conditional upon the Stock Exchange Listing Rules being re-drafted in a language and style which facilitates clear interpretation and increases the ability to enforce them, section 777 of the Corporations Law should be further amended to provide that the court may, as one of its orders, impose penalties (payable to consolidated revenue) on the directors of a company which has failed to comply with Listing Rules and such failure has been the occasion

of the Stock Exchange suspending trading in the company's securities. Such amendment would also have to provide protection for, first, directors who are in the process of having the company de-listed and, secondly, the directors should not be subjected to double jeopardy. (para 4.5.26)

RECOMMENDATION 16

The Committee recommends that the provisions of the Corporations Law not impede the prompt application of accounting standards so that the Australian Accounting Standards Board can quickly issue whatever standards are needed at a particular time without having to wait for changes in the Law. (para 4.7.47)

RECOMMENDATION 17

The Committee recommends that the Australian Auditing Standards Board should be given similar recognition in the Corporations Law as the Australian Accounting Standards Board. A unit should be established by the Australian Auditing Standards Board to monitor the compliance with the prescribed auditing standards. (para 4.7.57)

RECOMMENDATION 18

The Committee recommends that section 332(10) of the Corporations Law be amended so that auditors, required by the provision to notify the Australian Securities Commission of malpractices that the audit has revealed, should be obliged to report the matter where they have 'reasonable grounds to suspect' rather than needing to be 'satisfied' that the malpractice has occurred. (para 4.7.59)

RECOMMENDATION 19

The Committee recommends that, where it is established that the auditors of a company have breached proper auditing standards, the Court should have the power to order that the accounts of that company be audited by an auditor appointed by the Court. (para 4.7.61)

RECOMMENDATION 20

The Committee recommends that there be enacted a business judgment rule in the following terms:

A director or officer shall not be liable to pay compensation to a company or suffer the imposition of a penalty in respect of his or her business judgment unless it is made to appear to the relevant Court that at the relevant time the director or officer:

- had an unauthorised interest in the transaction of the company to which the judgment relates;
- had not informed himself or herself to an appropriate extent about the subject of the judgment;
- did not act in good faith for a proper purpose; or
- acted in a manner that a reasonable director with his or her training and experience could not possibly regard as being for the benefit of the company.

In this section "business judgment" means a lawful judgment made for the conduct of the company's business operations and, without affecting the generality of the expression, includes a judgement as to:

- the company's goals;
- plans and budgeting;
- promotion of the company's business;
- acquiring assets and disposing of assets;
- raising or altering capital;
- obtaining or giving credit;
- deploying the company's personnel; or
- trading

but does not include a judgement as to -

- matters relating principally to the constitution of the company or the conduct of meetings within the company;
- appointment of executive officers; or
- the company's solvency.

Sub-section (1) does not operate in relation to any other provision of this Act or any other Act or any Regulation under which a director or officer may be liable to make a payment in relation to any of his or her acts or omissions as a director or officer.

In circumstances where, in the absence of this provision, a director or officer would not be liable to pay compensation to the company this provision does not operate to impose any such liability. (para 5.4.30)

RECOMMENDATION 21

The Committee recommends that section 592 of the Corporations Law, relating to the rights of creditors to recover personally from a director of a company who has incurred a debt in circumstances where he/she knew or must be taken to have known that the company is insolvent, be amended in the following way:

- the provision should no longer combine civil and criminal aspects in the one legislative provision. The separate criminal provision should be restricted to fraudulent or dishonest trading whilst insolvent;

- for the civil provision, the defence under section 592(2)(a) should be replaced so that it is a defence if the director did not have personal knowledge of the incurring of the debt. However, such defence would cease to be available if the director concerned had not discharged his or her duty of care and skill, particularly in relation to the matters of conferring delegated authority, and monitoring of that authority, on the person who actually incurred the debt;

- for the criminal provision, it would be a defence if the director could show that the particular debt was incurred either without that director's express authority or without that director's implied authority and actual knowledge. However, the defence would be lost if the accused was not able to show that he had, in all the circumstances, discharged his duties, particularly those of care and diligence; and

- the civil provision should be amended to allow as an additional plaintiff, the liquidator. If the liquidator exercised his or her rights to take action against the directors, any uncommenced action by an individual post-insolvency creditor would be barred. Monies recovered by a liquidator would form part of the assets of the company but post-insolvency creditors would then rank in the winding-up after retrenchment payments in section 556(1)(h). Monies recovered on an individual post-insolvency action would continue to be for the benefit of the successful plaintiff. (para 5.4.38)

RECOMMENDATION 22

The Committee recommends that the Corporations Law be amended to give directors and officers power to rely, in the performance of their duties, on other persons to act or to provide information. Such rule would be in the following terms:

. a director or officer, when exercising powers or performing duties in that capacity, may accept as correct, reports, statements, financial data and other information prepared, and professional or expert advice given, by any of the following persons to the extent only that the director or officer acts in good faith, after reasonable enquiry when the need for enquiry is indicated by the circumstances, and without knowledge that would cause such acceptance to be unwarranted:

(a) any employee of the company whom the director or officer believes on reasonable grounds to be reliable and competent in relation to the matters concerned;

(b) any professional or expert person in relation to matters which the director or officer believes on reasonable grounds to be within the person's professional or expert competence;

(c) any other director, or committee of directors upon which the director did not serve, in relation to matters within the director's or committee's designated authority.

(d) any audit committee operating in relation to a group of companies. (para 5.4.42)

RECOMMENDATION 23

The Committee recommends that the Corporations Law be amended to recognise the power of the company in general meeting to give advance authority for specific conduct of a director or officer in relation to a specific transaction, other than conduct which involves an intent to deceive or defraud. The advance authority procedure would operate on the basis that:

. the disclosure should be such as to make members aware of at least:

(a) material details of the transaction;

(b) any direct or indirect interest of the directors or officers or their associates or their relatives in the transaction;

(c) the benefits to the company that it will obtain that could not be obtained by a transaction that did not require the authority of the company in general meeting; and

(d) the circumstances that indicate that without the authority the director or officer will be in breach of duty and the nature of any liability that could accrue;

- in a group of companies it should be a general meeting of the holding company that gives approval for directors in subsidiary companies to be authorised. In the case of a partly-owned subsidiary the members of both the subsidiary and the holding company should give the approval (as for directors' loans);

- interested directors, their associates and relatives should not be able to vote. The necessary majority should be that for an ordinary resolution;

- the statutory statement of the power of the general meeting to authorise what would otherwise be a breach of duty should be expressed to be subject to section 260 alone; and

- if the company goes into liquidation within 12 months after the authority is given and is insolvent, the Court may order that the director or officer in question should be considered to be in the same position as if the authority had not been given. (para 5.4.45)

RECOMMENDATION 24

The Committee recommends that the Corporations Law be amended to recognise the power of the company in general meeting to release a director or officer from civil liability to pay damages or compensation to the company in respect of a past event. The post-event release procedure should operate on a basis that parallels the procedure for an advance authorisation. (para 5.4.46)

RECOMMENDATION 25

The Committee recommends that the ASX Listing Rules be amended to require every listed company to:

(a) establish an audit committee, with the chairman and a majority, or all, of the members of the audit committee being non-executive directors: where there are not sufficient non-executive directors on the board to comply with this, the function of the audit committee must be performed by the whole board;

(b) require that the audit committee meet regularly and report to the Board;

(c) require that the audit committee have direct access to the *company's auditors (internal and external) and senior* management and have the ability to consult independent experts whenever it concludes such to be necessary;

(d) require that the audit committee review financial information to ensure its accuracy and timeliness and the inclusion of all appropriate disclosures;

(e) ensure the existence and effective operation of accounting and financial controls oversee the audit of the company, including nominating the auditors, approving the scope of the audit and examining the results to provide a link between the auditors and the Board; and

(f) undertake such other functions as are allocated to it by the Board provided that the extra functions do not compromise its ability to perform its primary function as listed above. (para 5.5.22)

RECOMMENDATION 26

The Committee recommends that the Corporations Law be amended to insert a new provision, section 260A which would provide standing to:

- any member or former member, of the corporation or a related corporation;

- any director or officer, or former director or officer, of the corporation or a related corporation;

to establish an interest to seek leave of the Court to proceed on behalf of a company without the need to demonstrate the availability of any of the general exceptions to the rule in Foss v Harbottle.

The provision would otherwise be drafted in the same terms as that proposed by the Companies and Securities Law Review Committee at pages 7 and 8 of its report No. 12 with the following qualifications;

- any present or former director or officer who is the defendant in proceedings for which leave was granted shall be entitled to financial assistance from the company in defending such proceedings on the same basis as that provided by the company to the applicant. If no assistance is provided by the company to

the applicant then, none would be provided to the defendant, officer or director. Any such assistance is to be regarded as an interest free unsecured loan (permission for which is to be recognised by an amendment to section 234);

- in situations where the derivative action is being funded by the company, the Court shall be obliged to be active in case-management by requiring regular reports on steps taken and funds expended on both sides so as to ensure that the shareholders funds are being expended in a reasonable manner;

- that directors and officers be given a statutory right to indemnity for the costs of a successful defence (in the terms of recommendation 33 of the CSLRC in its report No. 10); and

- that the Corporations Law be further amended in relation to the company's ability to maintain suitable insurance for directors, such amendments being in accordance with recommendations 26-32 of the CSLRC Report No. 10. (para 6.3.33)

RECOMMENDATION 27

The Committee recommends that:

(a) section 319 be amended to provide that when the Court accedes to a request for access, such access be provided to 'a suitable person,' to be determined at the discretion of the Court; and

(b) a person with standing to seek leave to proceed on behalf of a company, should be able to invoke section 319 in preparation for an application for leave to pursue a derivative action. (para 6.3.43)

RECOMMENDATION 28

The Committee recommends that the ability of shareholders to force the timely convening of a meeting of shareholders by enhanced be amending section 246 in the following way:

- the meeting must be held as soon as practicable but in any case, not later than one month after the date of the deposit of the requisition;

- if the directors have not convened the meeting within 10 days after the date of deposit of the requisition, the requisitionists are to then have the power to convene the meeting themselves, with the meeting to be held within 2 months of the requisition having been lodged; and

- the ASC should have the power to extend any of those time-frames. (para 6.3.49)

RECOMMENDATION 29

The Committee recommends that section 13 of the Australian Securities Commission Act 1989 should be amended to allow investigation of:

(a) any breach of a unit trust deed;

(b) any act or omission within the scope of the oppression remedy in section 260 of the Corporations Law; and

(c) any breach of directors duty whether or not attracting criminal sanctions. (para 6.4.12)

RECOMMENDATION 30

The Committee recommends that criminal liability provisions of the Corporations Law should be reviewed so that criminal consequences only flow from conduct which is genuinely criminal. To that end the Committee recommends:

- section 232 should no longer combine civil and criminal aspects in the one legislative provision. The separate criminal provision should be restricted to situations where the director has acted in deliberate or reckless disregard of his or her duty;

- the civil and criminal aspects of section 592 (concerning recovery of debts from a director) should be separated and dealt with in the manner referred to in the Committee's earlier recommendation concerning that section; and

- the Attorney-General should ask the Companies and Securities Advisory Committee to report on ways in which the Corporations Law should be further amended so as to decriminalise as many provisions as possible with the remaining criminal provisions to be re-cast so that elements of dishonesty, deceit, deliberate or reckless disregard of obligations, or similar conduct amounting to moral turpitude, would need to be shown before a criminal offence is proven. (para 6.4.17)

CHAPTER 1

INTRODUCTION

1.1 The Inquiry

1.1.1 The House of Representatives Standing Committee on Legal and Constitutional Affairs (the LACA Committee) commenced its Inquiry into Corporate Practices and the Rights of Shareholders on 31 October 1989 at the request of the then Attorney-General, the Hon. Lionel Bowen, QC, MP.

1.1.2 With the dissolution of the House of Representatives in February 1990 for a general election the Committee ceased to exist. The Committee was re-established by the new Parliament and on 15 May 1990 the Inquiry was re-referred to the Committee by the new Attorney-General, the Hon. Michael Duffy, MP. The terms of reference were unchanged and the Committee had access to the Inquiry evidence and records of the previous Parliament.

1.1.3 A Sub-committee was appointed to conduct the Inquiry. The terms of reference for the Inquiry were re-advertised in June 1990 in the national press. Approximately 80 submissions were received from interested individuals and organisations including banking corporations, chartered accountants, various law societies and legal firms, academics, federal government agencies and representatives of shareholders.[1]

1.1.4 During eight days of public hearings in Canberra, Sydney and Melbourne the Sub-committee heard from more than fifty persons. An edition of the

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[1] A list of people and organisations who made submissions is at Appendix A.

Committee's newsletter which highlighted pertinent issues raised in submissions and at public hearings was also publicly distributed during the course of the Inquiry.

1.1.5 The Committee notes that many of the organisations which gave evidence before the Committee in 1990 have since brought forward their own recommendations for change in the areas of corporate practices and shareholders' rights. The Committee welcomes this process. The Committee feels that it has stimulated and acted as a catalyst for some of the changes being brought forward by others since the Committee began its Inquiry. The Committee addresses some of those other proposals in this Report.

1.2 Background to the Inquiry

The Collapse of Prominent Corporations and Concerns About Corporate Behaviour

1.2.1 The Committee commenced the Inquiry at a time when the performance of the system for regulating corporate affairs in Australia was being seriously questioned. Several prominent business enterprises had gone into receivership (Rothwells Limited, the Hooker Corporation, Qintex Australia Limited) and concerns were being reported about the practices of corporate executives and companies.[2]

1.2.2 In the Annual Report for 1989-90 of the National Companies and Securities Commission (the body then responsible for the administration of the companies and securities legislation throughout Australia), the Chairman, Mr Henry Bosch, commented that:

> "One of the remarkable features of the year was the number of receiverships of large and sometimes prominent business enterprises. In several cases those collapses revealed behaviour that was at best highly unethical and damaging to shareholders and which may eventually be proved to be illegal. In a few cases considerable information about these practices

2 The Australian Financial Review, 17 November 1989.

has become public and this knowledge has reinforced the marked changes in public attitudes mentioned in last year's annual report. Considerable anger and frustration and in some cases outrage has been expressed and there have been frequent calls for the Commission to take action to prosecute those involved in criminal charges."[3]

1.2.3 During that year the National Companies and Securities Commission (NCSC) conducted several special investigations into the activities of leading business corporations including:

. Independent Resources Limited;

. Ariadne Australia Limited;

. Bond Corporation Holdings Limited;

. GPI Leisure Corporation Limited - The Spedley Group;

. Qintex Australia Limited;

. Budget Corporation Limited;

. Rothwells Limited; and

. Sunmark Corporation Limited and associated companies.[4]

1.2.4 During the period since the Inquiry commenced a noticeable trend in the corporate sector has been the number of prominent enterprises that have entered into receivership, including several of the companies mentioned immediately above.

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3 National Companies and Securities Commission, Annual Report, 1989-1990, p.8.
4 ibid, pp.50-60.

Increase in Gross Private Sector Debt in the 1980s

1.2.5 A major feature of the 1980s was that the private sector moved from being, in aggregate, a significant net owner of debt assets, such as bank deposits, bond and debentures, to being a net debtor. That is, the gross debt of the private sector rose significantly relative to its stock of debt assets.[5] (In contrast the net debt of the public sector, expressed as a percentage of GDP, is now lower than it was at the start of the 1980s). It is generally agreed that business debt accounted for much of the surge in debt in the second half of the 1980s.[6]

1.2.6 The Economic Planning Advisory Council (EPAC)[7] has recently noted that while corporations maintained their level of savings throughout the 1980s, these savings were insufficient to finance their expanding investment program. Total gross private sector debt as at June 1990 was $458 billion.[8] Growth in private debt during the 1980s averaged 17% per annum.[9] As noted earlier, most of the growth in gross private debt occurred in the business sector. The Australian Bureau of Statistics (ABS) figures on foreign investment estimate the gross foreign debt of private trading enterprises at about $51 billion in June 1990; compared to $5 billion in 1980.[10]

1.2.7 EPAC recently noted that over the past decade the market capitalisation of the Top 25 Australian companies listed on the Australian Stock Exchange increased significantly, but so did the total liabilities of these companies. The debt of those companies, expressed as a proportion of equity, rose from 28.6% in 1981 to 51.8% in 1990.[11] EPAC also noted that data for 210 major Australian companies

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5 Economic Planning Advisory Committee, Background Paper No.14, The Surge in Australia's Private Debt: Causes, Consequences, Outlook, June 1991, p.17.

6 ibid, p.9.

7 The EPAC was established by the Commonwealth in 1983 to provide independent advice on the medium to longer term economic outlook.

8 EPAC, op.cit., p.9.

9 ibid.

10 ABS Cat. No. 5306.0, Foreign Investment in Australia, September 1990, Table 7.

11 EPAC, op.cit., p.30.

shows that their debt over the same period increased from $9.1 billion to $65.2 billion.[12]

1.2.8 It is therefore well established that the increase in private debt was very much a corporate phenomenon. Australian and overseas banking and financial institutions provided the source of capital to the corporate sector. Figures provided by the Reserve Bank of Australia indicate that credit to the business sector by financial intermediaries rose from $43 billion in 1981 to $213 billion in June 1990.[13]

1.2.9 It has been reported that the Australian banking system is now carrying an enormous load of corporate bad debts, as almost every bank in Australia lent money to one or more of the prominent corporations that have collapsed since 1987.[14] Westpac Banking Corporation was reported in October 1990 to have 'problem loans' totalling $2 billion.[15] The Australian Bankers' Association in its submission to the current Inquiry of the House of Representatives Standing Committee on Finance and Public Administration into the banking industry indicated that, for three major publicly listed banks, funding for bad and doubtful debts represented 0.2% of assets in 1980 and 0.9% by 1990.

1.3 Role of the Commonwealth in Corporations Law

Introduction

1.3.1 In Australia regulation of companies has, historically, been a matter of State rather than Commonwealth legislative power. In the late 19th century most of the Australian colonies passed legislation based on the British Companies Act 1862. After Federation, company law remained a State matter, and amendments to

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12 ibid, p.29.
13 Reserve Bank of Australia Bulletin, December 1991, Table D.4, p.555.
14 Australian Business, October 3, 1990, p.36.
15 ibid.

the British legislation were generally reproduced in the various State Acts. By the late 1950s the problems caused by the inconsistencies that had arisen between the States' companies legislation were serious enough to cause the various governments to consider uniformity. The Commonwealth and States co-operated in drafting a uniform Companies Bill. In 1961 and 1962 Companies Acts based on the draft Bill were passed by each State and the Commonwealth made ordinances for the Australian Capital Territory, Northern Territory and the Territory of Papua New Guinea. The Uniform Companies Acts, however, failed to bring uniformity as the States and Commonwealth continued to separately amend their legislation.

1.3.2 In 1967, the Company Law Advisory Committee to the Standing Committee of State and Commonwealth Attorneys-General appointed a committee under the chairmanship of Sir Richard Eggleston, to examine the existing scheme. There were several significant amendments made to the legislation as a result of the committee's reports and recommendations.[16] In 1971 a series of Acts dealing with matters such as takeovers, insider trading, and accounts and audits were enacted in all States except New South Wales.

Report of the Senate Select Committee on Securities and Exchange, 1974

1.3.3 In response to allegations about the activities of the corporate and securities industry during the mining boom of the late 1960s in Australia, the Senate established a Select Committee on Securities and Exchange in 1970.

1.3.4 The Select Committee presented its report in 1974 and its principal finding was that:

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16 Second Interim Report of Company Law Advisory Committee, 1969 (Parliamentary Paper 43/1969).

> "the regulation of the securities markets, of the intermediaries which operate in those markets, and of some of the activities of public companies and investment funds, is in need of fundamental reform."[17]

1.3.5 The main recommendations were that an Australian Securities Commission, similar to the Securities and Exchange Commission of the United States of America, should be established to regulate the securities market and that there be "one nationally uniform body of law."[18] The national commission was intended to eliminate and prevent the type of abuses which the Committee had identified in the course of investigations of the business practices surrounding the mineral boom.

1.3.6 The then Commonwealth Government prepared a Corporations and Securities Industry Bill which provided for the regulation of the securities markets, the securities industry and takeovers and the establishment of a Corporations and Exchange Commission. The Bill lapsed with the dissolution of the Commonwealth Parliament in November 1975.

The Co-operative Scheme

1.3.7 The Commonwealth and all the States agreed to the establishment of a co-operative scheme for uniform companies and securities legislation throughout Australia, under an agreement made on 22 December 1978 (known as the Formal Agreement). The Commonwealth enacted legislation (applicable in the Australian Capital Territory) which was applied by all of the States (and by the Northern Territory in 1986).

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17 Senate Select Committee on Securities and Exchange, Australian Securities Markets and their Regulation, 1974, Vol.1, p.1. Parliamentary Paper No. 98/74.

18 ibid, p.488.

1.3.8 The objectives of the scheme were:

- to ensure uniform legislation throughout Australia relating to companies and the regulation of the securities and futures industries;

- to provide for uniform administration of the legislation;

- to ensure that the parties to the Formal Agreement co-operate with each other concerning the content and administration of the legislation; and

- to provide for the effective administration of the legislation with the minimum of procedural requirements.[19]

Features of the Co-operative Scheme

1.3.9 The important features of the co-operative scheme were:

- the scheme provided for substantially uniform companies and securities legislation throughout Australia;

- the National Companies and Securities Commission was established by the Commonwealth Parliament in 1979 as the regulatory agency responsible for the administration of the companies and securities laws and for reviewing the regulation of the industry;

- the State administrative and regulatory bodies, the Corporate Affairs Commissions, continued to administer their application of the Commonwealth's laws under the delegated authority of the NCSC;

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19 NCSC, Annual Report 1989-90, p.1.

- a Ministerial Council was created which had responsibility to supervise the operation of the co-operative schemes and review existing laws;

- the parties to the Formal Agreement undertook not to unilaterally introduce amendments to the legislation; and

- in 1983 the Accounting Standards Review Board was established to develop approved accounting standards.

Deficiencies of the Co-operative Scheme

1.3.10 The Co-operative Scheme was comprehensively reviewed by the Senate Standing Committee on Legal and Constitutional Affairs in its report tabled in 1987 entitled, Report of Parliament in Relation to the National Companies Scheme. Some of the problems with the scheme were:

- the lack of accountability. The NCSC was accountable only to the Ministerial Council. It was not accountable to any Minister of the Crown (State or Commonwealth);

- no single Minister was responsible for the administration or reform of the scheme;

- there was no effective parliamentary scrutiny. The Commonwealth was obliged to procure the passage of legislation without the ability to amend it, thereby derogating from the responsible nature of the Commonwealth Parliament;

- the division of functions between the NCSC and its State and Territory delegates led to administrative inefficiencies, duplication and additional costs to both government and business;

- the NCSC and the Corporate Affairs Commission lacked adequate resources to investigate and prosecute flagrant breaches of the co-operative legislation.

1.3.11 The Senate Committee concluded that the scheme had outlived its usefulness and recommended that the Commonwealth Parliament should enact comprehensive legislation covering the field currently regulated by the co-operative scheme. The Committee relied on an Opinion of the former Commonwealth Solicitor-General Sir Maurice Byers, prepared for the Constitutional Commission, that the Commonwealth possessed constitutional power to enact comprehensive legislation covering company law, takeovers and the securities and futures industries.[20]

Other Parliamentary Reviews

Report of the Joint Select Committee on Corporations Legislation

1.3.12 In May 1988 a comprehensive package of bills relating to the regulation of corporations was introduced into the Commonwealth Parliament. The Senate resolved to refer the legislation to a Select Committee in October of that year. The Joint Select Committee on Corporations Legislation[21] presented its report in April 1989. The Committee recommended a number of amendments to the legislation involving alterations to the proposed investigative and information gathering powers of the national regulatory body, fundraising by public companies, insider trading, company formation and takeovers.

1.3.13 The Committee in essence said there was a need for a national companies regulatory scheme. A minority report endorsed by Opposition members of the Committee argued that the co-operative scheme should be retained and strengthened.

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20 Senate Standing Committee on Legal and Constitutional Affairs, Report to Parliament in Relation to the National Companies Scheme, 1987, p.89.

21 Joint Select Committee on Corporations Legislation - Report - Parliamentary Paper No. 117/89.

1.3.14 Two other significant reports relating to the activities and practices of companies were also tabled in the Parliament that year.

Report on Insider Trading - House of Representatives Standing Committee on Legal and Constitutional Affairs.

1.3.15 In November 1989 the House of Representatives Standing Committee on Legal and Constitutional Affairs reported on its Inquiry into the adequacy of existing legislative and administrative controls over insider trading[22]. It made twenty-one recommendations; amongst the most prominent were that:

- insider trading should remain a criminal offence and the term 'insider' should encompass corporations as well as natural persons;
- a statutory definition of inside information should be developed;
- monetary penalties for natural persons and corporations should be substantially increased;
- the detection and prosecution of insider trading remain an enforcement priority of the regulatory agencies;
- adequate resources be available to the regulatory authorities to enable suitable monitoring of securities trading;
- the Australian Stock Exchange pursue a rigorous approach to market surveillance;
- representative groups within the securities industry develop codes of conduct; and

22 Insider Trading in Australia, Parliamentary Paper No. 288/89.

- a criminal conviction for insider trading is not a prerequisite for a person to obtain a civil remedy against a person conducting insider trading.[23]

Report on Company Directors' Duties - Senate Standing Committee on Legal and Constitutional Affairs

1.3.16 Also in November 1989, the Senate Committee on Legal and Constitutional Affairs presented its report on the duties of directors.[24] The report comprehensively examined the area of directors' duties, having regard to the concerns that have arisen in recent years, especially regarding the uncertainty and non-enforcement of directors' duties. Some of the major recommendations include:

- the introduction of an objective duty of care and a 'business judgement rule' under which directors would be excused from liability provided they had complied with minimum standards of competence and *diligence;*

- limits on the extent to which company officers can delegate responsibility to others;

- the establishment of audit committees to be required for all larger public listed companies and encouraged for smaller companies;

- development by professional bodies of a code of ethics for directors and measures to facilitate participation by directors in courses and programs dealing with their duties and responsibilities;

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23 House of Representatives Standing Committee on Legal and Constitutional Affairs, Fair Shares for All : Insider Trading in Australia, 1989, pp.xv-xxii.

24 Senate Standing Committee on Legal and Constitutional Affairs, Company Directors' Duties: A Report on the Social and Fiduciary Duties and Obligations of Company Directors, 1989, Parliamentary Paper No: 395/89.

- an Inquiry into the appropriate mix of individual and corporate liability for corporate misconduct; and

- a reduction in the use of criminal sanctions in the area of directors' duties and a corresponding increase in provisions for civil penalties and remedies.

The New Commonwealth Corporations Law

Background to the Legislation

1.3.17 On 1 January 1991 a new national scheme for the regulation of companies and securities law commenced throughout Australia.

1.3.18 In 1989 the Commonwealth Parliament enacted the Corporations Act, the Australian Securities Commission Act and related legislation which was designed to nationally regulate the entire field of companies and securities law. The constitutional validity of the legislation was however challenged by the States in the High Court of Australia. In February 1990 the High Court held that the constitutional power of the Commonwealth did not extend to the enactment of laws dealing with the incorporation of companies.[25]

1.3.19 In June 1990 the Commonwealth, States and Northern Territory reached agreement (the Alice Springs Agreement) on a revised national scheme designed to achieve a national scheme using Commonwealth and State powers. It was agreed that the Commonwealth Corporations Act 1989 and the Australian Securities Commission Act 1989 would form the substantive legislation of the new scheme.

1.3.20 To give effect to the agreement the Commonwealth introduced amending legislation, the Corporations Legislation Amendment Bill 1990, in November 1990. When introducing the Bill, the Attorney-General, the Hon. Michael Duffy, MP, said:

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[25] New South Wales v Commonwealth of Australia (1990) 1 ACSR 137.

> "The National Scheme embodied in (the) legislative package will offer for the first time in the nation's history a single and truly national regime that can guarantee a sound and well regulated environment for corporate activity. Without such environment, business in this country cannot prosper as its should and investors, both at home and abroad will lack the security and confidence that is essential to our future economic growth and well being."

The new scheme was supported by the opposition.

1.3.21 During December 1990 each State and the Northern Territory enacted application legislation adopting the Corporations Law, set out in section 82 of the Commonwealth Corporations Act 1989 as a law of that State or Territory.

Principal Features of the Corporations Law

1.3.22 The Corporations Law covers all matters previously covered by the Companies Code, the Companies (Acquisition of Shares) Code, the Securities Industry Code, the Futures Industry Code and the other minor Codes, with the addition of new provisions relating to share buy-backs.

1.3.23 The legislation covers the following areas:

- incorporation of companies;
- shares, debentures and prescribed interests;
- public offers of securities;
- takeovers;
- charges;

- liquidations, schemes of arrangement, receiverships;
- stock exchanges and securities brokers;
- futures exchanges and futures brokers;
- offences;
- company officers, including directors;
- accounting and audit; and
- foreign companies.[26]

1.3.24 The Corporations Law is a mammoth piece of legislation contained in two volumes and covering more than 1300 provisions.

The Administrative Structure

The Australian Securities Commission

1.3.25 The principal objective of the new companies scheme is the establishment of a single national regulatory framework.[27] The Australian Securities Commission (ASC) has been established, by Commonwealth statute, as the sole administering authority for companies and securities regulation in Australia, replacing the NCSC and former State Corporate Affairs Commissions. The ASC is formally accountable and responsible to the Commonwealth Attorney-General and the Commonwealth Parliament.

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26 Building societies, cooperatives, credit unions, incorporated associations and State statutory corporations will continue to be subject only to State laws and are not regulated by the Corporations Law (except that if such a body carries on business in more than one State then it must, in addition, register under Chapter 4 of the Corporations Law).

27 Parliament of the Commonwealth of Australia, Explanatory Memorandum, Corporations Legislation Amendment Bill, 1991, p.7.

1.3.26 The objectives of the Commission in performing its functions are specified in its Act; these include:

- the maintenance, facilitation and improvement of the performance of companies, securities and futures markets, in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy;

- the maintenance of investor confidence in the securities and futures markets;

- the achievement of uniformity throughout Australia in how the ASC and its delegates perform those functions and exercise those powers;

- the effective administration of national scheme laws; and

- the enforcement of national scheme laws.

1.3.27 The Australian Securities Commission Act 1989 also provides for the establishment of the following five bodies concerned with corporate affairs.

Corporations and Securities Panel

1.3.28 Section 171 of the Australian Securities Commission Act 1989, provides for a Corporation and Securities Panel which can declare a proposed takeover or conduct by persons in relation to a company's affairs to be unacceptable in the public interest, where there has not been an informed market in relation to the takeover or the conduct. Matters are referred to the Panel by the ASC. The first members of the Panel were appointed in July of this year and are mainly leading members of the business community.[28]

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[28] The High Court of Australia, in October of this year, ruled that the Panel had the necessary constitutional underpinning to discipline players in a takeover.

Companies and Securities Advisory Committee

1.3.29 This Committee advises the Attorney-General on matters relating to corporate regulation and proposals for law reform. In June 1991 the Attorney-General commissioned the Committee to examine the need for a legislatively based continuous disclosure regime and the nature of any such regimes.[29]

Australian Accounting Standards Board

1.3.30 The Australian Accounting Standards Board is responsible for the formulation and promulgation of accounting standards.

Companies Auditors and Liquidators Disciplinary Board

1.3.31 This Board attends to disciplinary matters in relation to the duties and functions of auditors and liquidators. Its members were appointed in May 1991.

Parliamentary Joint Committee on Corporations and Securities

1.3.32 The Committee is prescribed by the statute and its duties are to inquire into and report on the ASC and the operation of the companies and securities law. Its members were appointed in March 1991.

Ministerial Council for Companies and Securities

1.3.33 The Commonwealth Attorney-General is permanent Chairman of the Council. It continues to represent all of the States and the Northern Territory. Consistent with the operation of the ASC as a national Commonwealth agency, the Council has no control or power of direction over the ASC.

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29 News Release, No. 29/91, 2 July 1991, Attorney-General, Hon. M Duffy, MP.

1.3.34 On the other hand, in relation to legal policy issues the Council is to be consulted in relation to all legislative proposals involving amendment of companies and securities laws.

1.3.35 However, the Commonwealth has sole responsibility in relation to legislative proposals for the national markets (ie takeovers, securities, public fundraising and futures). In relation to other legislative proposals, that is "traditional" company law type matters, the Ministerial Council is to approve the legislation before its introduction into the Commonwealth Parliament, but the Commonwealth is not obliged to introduce any such proposal with which it does not concur.

1.3.36 For the purposes of voting on the introduction of legislative proposals for which the Commonwealth and the States share responsibility the Commonwealth has 4 votes and each state and the Northern Territory has 1 vote. The Commonwealth also has a casting vote.

1.3.37 When introducing measures into the Commonwealth Parliament, the Commonwealth is required to table in the Parliament the outcome of the advice of the Ministerial Council arising out of its consideration of the proposal. The Commonwealth has undertaken to use its best endeavours to consult the members of MICO concerning amendments moved in the Parliament during the passage of the legislation.[30]

1.4 Approach of the Committee

1.4.1 Subsequent to the commencement of the Committee's Inquiry there have been major changes to the regulatory system, principally the introduction of the

[30] see Explanatory Memorandum to the 1991 amendments to the Corporations Law.

national companies scheme. As the Attorney-General told the Parliament in May this year:

> "We now have in place in Australia a single national regulatory structure that provides an effective framework in which the Government can begin the major task of redressing the damage done to our business reputation and the confidence of investors in our markets during the 'decade of greed'."[31]

1.4.2 The Committee notes that widespread concerns with the standard of corporate practices in Australia have resulted in recent major changes to law enforcement policy and administration in regard to corporate law. The major initiative being the establishment of the ASC and the allocation of resources to it at a level without precedent in the history of Australian corporate regulation.

1.4.3 Whilst it is too early to judge the efficiency of the new scheme, the Committee observes that the new structures and resources are a significant improvement when compared to the co-operative scheme.

1.4.4 The Committee in addressing the numerous issues raised during the Inquiry is conscious of not merely responding to past abuses which, due to other factors, may not readily recur. The Committee in the report is concerned about the rights of smaller non-institutional investors in public companies, ie: companies limited by shares and listed on the Australian Stock Exchange (ASX). In framing its recommendations the Committee has been conscious of not increasing the legislative and regulatory burdens on the corporate sector.

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31 Parliamentary Debates, House of Representatives, 29 May 1991, p.4213.

CHAPTER 2

CONTROLS OVER MARKET PRACTICES, INCLUDING MARKET MANIPULATION, WAREHOUSING AND RAMPING

2.1 Identification of Market Manipulation Practices

2.1.1 The 1974 report of the Senate Select Committee on Securities Exchange is the major detailed public study in Australia on the conduct of stock market manipulation. The report was largely concerned with practices which occurred during an exceptional boom in the shares of exploration and mining companies during the late 1960s and early 1970s. It noted that:

> "the deliberate manipulation of the market for listed shares on the organised exchanges has at times been widely practised in Australia. Although this manipulation has been known to prominent market traders, the practices have seldom been exposed publicly. They have not been effectively regulated."[1]

2.1.2 The Committee in its report identified three types of manipulative practices: pooling, churning and organised runs. Subsequently during the 1980s other practices have developed such as warehousing and ramping. These practices are described below.

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1 Senate Select Committee on Securities and Exchange, Australian Securities Markets and their Regulation, 1974, Vol.1, p.207.

Common Forms of Market Manipulation

2.1.3 The most common forms of manipulative market practices identified by the Senate Select Committee were:

- ***pooling***: where a group of investors subscribe a sum for purchase and sale of shares among themselves to give the impression of active trading in a stock. The objective being to raise the price of the shares and provide the opportunity for the investors to sell their shares at a profit;

- ***churning***: traders acquire a share holding and then place buying and selling orders for that share, at about the same price or at slightly rising prices, to build up the turnover; and

- ***organised runs***:[2] where groups of people create activity in a share by spreading rumours and actively 'pushing' a stock to cause a sharp rise in the price of the share. The purpose is to attract buyers at rising prices to enable the organisers of the run to sell their shares for a quick and substantial profit.[3]

2.1.4 The Senate Committee noted that each of the practices have common features and are all:

> "designed to artificially stimulate market turnover and share prices for the purpose of profiting, at the general public's expense, from the distortions inflicted on the market."[4]

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2 A 'run' is the term describing a spirited rise in one stock.
3 Evidence, p.S475-476 (submission of the Attorney-General's Department).
4 Senate Select Committee on Securities and Exchange, op.cit., p.207.

2.1.5 Other forms of market manipulation are:

- ***ramping*** : is the term applied to transactions resulting in a quick movement in the share price just before the close of trading. The aim is to mislead the market by giving the impression of strength or a high degree of interest in a stock, enabling the shares to be sold at an artificial list price the next day or bolstering the price for the purpose of the financial statements of a company as at a particular day;

- ***warehousing***: occurs when one party holds shares really controlled by someone else whose identify is not disclosed; and

- ***matched orders and wash sales*** : (these practices were first identified in American case law). A matched order involves entering an order for the purchase/sale of shares with the knowledge that similar orders will be entered into by other parties (this American practice parallels churning). Wash sale involves transactions which involve no change in beneficial ownership but create a misleading appearance of active trading in the security.[5]

2.2 Current Legislative Controls over Market Manipulation

2.2.1 The current legislative controls relating to market manipulation are found principally in Chapter 7 of the Corporations Law. Section 995 provides civil liability where a person, in connection with any dealing in securities, engages in conduct that is misleading or deceptive or is likely to mislead or deceive.

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5 Evidence, pp.S477-478 (Attorney-General's Department).

2.2.2 Other sections in Chapter 7 of the Corporations Law deal with more specific examples of market manipulation, including pooling, churning and organised runs. Those sections are:

- market manipulation (s.997);
- false trading and market rigging transactions (s.998);
- false or misleading statements in relation to securities (s.999);
- fraudulently inducing persons to deal in securities (s.1000); and
- dissemination of information about illegal transactions (s.1001).

Penalties for contraventions of these provisions are a fine of $20,000 or imprisonment of 5 years, or both for natural persons and $100,000 for corporations.

2.2.3 New provisions were inserted in the Corporations Law (which became operative on 1 August 1991) to deal with insider trading. The new provisions (sections 1002 - 1002U of the Corporations Law) strengthen the law relating to insider trading. The introduction of these new provisions follows the adoption of the report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, Fair Shares for All: Insider Trading in Australia, 1989.

2.2.4 The practices of ramping and warehousing are both prohibited by legislation. With regard to warehousing, sections 707-716 and 741 of the Corporations Law provide that where aggregations of interest exceeding 5% of the company's capital are involved, and there is no disclosure, a party acting as a "warehouse" is in breach of the substantial shareholding provisions. If aggregations exceeding 20% are involved, section 615 of the Corporations Law is also breached. Where warehousing is suspected there is also power to seek information as to the controllers of the shares under sections 717-727 of the Corporations Law.

2.3 Adequacy of Existing Legislative Controls - Evidence to the Committee

2.3.1 Several organisations that made submissions to the Inquiry commented that the existing legislative controls are adequate, but the problem has been, in recent times, with the enforcement of the legislation. The Attorney-General's Department (AGD) stated that the legislation, "would appear adequately to prohibit the various forms of market manipulation."[6] The Australia and New Zealand Banking Group Limited stated that the legislation, "together with the stock exchange rules and codes of professional conduct within the securities industry, covers the field as thoroughly as might be expected from any written code."[7] Similarly, Westpac Banking Corporation believed that, "it is not the legislation that is the problem, rather the ability of the regulators to detect breaches."[8] Similar comments were made to the Committee by the Law Institute of Victoria[9] and Mr John Green, Partner with Freehill, Hollingdale and Page.[10] The Australian Stock Exchange commented that, "the major problem with respect to laws governing market practices is a problem of effective enforcement rather than content of the law."[11]

2.3.2 Finally, the ASC told the Committee that the remedies presently available to combat warehousing are sufficient, provided they are enforced.[12]

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6 Evidence, p.S503.
7 Evidence, p.S268.
8 Evidence, p.S275.
9 Evidence, p.S1040.
10 Evidence, p.S616.
11 Evidence, p.S123.
12 Evidence, p.S819.

2.4 Corporate Regulation and Enforcement

Australian Securities Commission

Investigative Powers

2.4.1 The Australian Securities Commission (ASC) is the sole authority in Australia responsible for the regulation of companies and the enforcement of legislative controls over market practices. The Australian Securities Commission Act 1989 provides the Commission with an extensive array of investigative and enforcement powers.

2.4.2 Section 13 of ASC Act confers on the ASC powers to make "such investigation as it thinks expedient for the due administration of a national scheme law," wherever it had reason to suspect that there may have been committed:

- a contravention of a national scheme law; or
- a contravention of any other Commonwealth, State or Territory Law concerning the management or affairs of a body corporate or fraud or dishonesty in relation to a body corporate, securities or futures contracts.

2.4.3 The ASC is also empowered to make an investigation where it has reason to suspect that unacceptable circumstances (within the meaning of Corporations Law Part 6.9) have, or may have, occurred:

- for the purposes of determining whether or not to make an application to the Corporations and Securities Panel; or
- otherwise with a due administration of a national scheme law.

2.4.4 The wide powers of the ASC to conduct an examination of persons are triggered if, on reasonable grounds, it either suspects or believes that a person can

give information relating to a matter that it is investigating or proposes to investigate under section 19 of the ASC Act.

2.4.5 Section 14 of the ASC Act allows the Minister to direct the ASC to investigate a matter where such investigation would be in the public interest. Investigations undertaken by the ASC at the direction of the Minister are not denoted as 'special investigations.'

Enforcement Powers

2.4.6 The ASC has the power to bring criminal proceedings (s.1315). However, for all but minor regulation prosecutions (for example failure to keep registers or non-lodgement of documents) the Commonwealth Director of Public Prosecutions is the prosecuting authority and will conduct cases pursuant to its published prosecution policy.

2.4.7 The ASC has a wide range of civil remedies available to it under the Corporations Law. Some of these are designed to preserve the assets of a company in a situation of suspected wrong doing, others are designed to recover assets or damages, whilst others are designed to protect the community from further possible misbehaviour. The principal civil remedies that the ASC can seek from a court under the Corporations Law include:

- injunctions in respect of any conduct that would, on the balance of probabilities, constitute a contravention of the Corporations Law (s.1324);

- asset freezing orders (including the appointment of a receiver) where proceedings have commenced or even as early as when an ASC investigation is underway in relation to what may constitute a breach of the Law (s.1323);

- orders where there has been a breach of the Law relating to trading or dealing in securities or a breach of Listing Rules (s.1114);

- orders where there has been a breach of the Law relating to dealing in futures contracts or business rules relating to that activity (s.1268);

- freezing of dealers' and brokers' bank accounts (s.874-878) and (s.1224-1227);

- the appointment of a liquidator where the ASC is undertaking an investigation of the affairs of a company (s.464);

- orders for compensation on behalf of persons who have suffered loss because of breaches of legislation concerning stock market trading, prospectuses and prescribed interests (s.1325);

- where the ASC has investigated the affairs of the company, it may apply for a range of orders, designed to relieve oppressive conduct (s.260);

- the ASC can apply for a wide range of orders where a person has been *guilty of breach of duty to a company and the company has suffered or* is likely to suffer loss as a result of that breach (s.598);

- the ASC may commence representative actions for recovery of damages on behalf of persons with their consent (s.50 of the ASC Act);

- the ASC can initiate action, in the name of the company, to obtain remedies for management or trading offences by defaulting officers (s.232(8), s.234(7) or s.592 with s.50 of the ASC Act);

- the ASC can intervene in any proceedings relating to a matter arising under the Corporations Law (s.1330);

- orders directed to securing compliance with ASX Listing Rules (s.777);

- the ASC may apply for orders to exclude directors and others participating in the management of a company, where breach of duty can be established or where the person has been involved in the management of 2 or more insolvent companies (s.230 and s.599);

- the ASC can apply for orders requiring corrective advertisements or publication of information in the context of dealing in securities and prospectuses (s.1004); and

- the ASC can prohibit trading in specified securities where it determines this is necessary to protect investors or the public (s.775).

Australian Stock Exchange Limited

2.4.8 Under the new scheme a stock market can only be conducted by an approved stock exchange or securities organisation. Each capital city exchange is now a wholly-owned subsidiary of the national body, the Australian Stock Exchange Ltd (ASX), a company incorporated by an act of the Commonwealth Parliament as if it were a company limited by guarantee in the Australian Capital Territory.[13] A Stock Exchange is a market place for trading in the securities of domestic and foreign issuers, and in derivatives based on those securities, and in the direct and indirect debt of public bodies.[14]

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13 Australian Stock Exchange and National Guarantee Fund Act 1987 (Commonwealth).

14 Under s.769 of the Corporations Law to earn approval to conduct a stock market as a stock exchange the applicant must be a Body Corporate; must show that its business rules generally give it adequate power to set standards for training and entry and to discipline its members. It must show that it has Listing Rules governing the admission of companies and the granting of quotations for their securities that will protect the public; that it is a member of the Stock Exchange Guarantee Corporation or has its own fidelity fund to meet losses cause by the default

2.4.9 The ASX commenced operation on 1 April 1987 in succession to the Australian Associated Stock Exchanges, a body established in 1937 to coordinate activities of the previous stock exchanges. The Exchange is largely self-regulating as the governing legislation leaves the control largely in the hands of a governing body, responsible for admission to membership and disciplinary matters. The role of the ASX is to provide and maintain a fair, efficient, well-informed and internationally competitive market for trading securities, so as to secure the confidence of investors and companies in the conduct of the market.[15]

2.4.10 The ASX Listing Rules govern the admission of companies to the privilege of having their securities quoted on the Exchange. The rules are designed to ensure that companies whose securities are traded comply with certain standards as to keeping the market informed, that the listed companies maintain in their Memorandum and Articles of Association certain standard provisions embodying shareholder democracy, and that they consult shareholders on major transactions. Accordingly, the rules provide for the regulation of aspects of companies' activities.

2.4.11 The ASX does therefore have a narrow but significant regulatory role over companies. Its regulatory powers over listed companies are based upon the contractual agreement whereby companies agree to bind themselves to comply with the Listing Rules. The authority of the ASX over listed companies is restricted to ensuring that they comply with the Rules. The range of actions available to the Exchange to enforce its Listing Rules is limited. The methods available to the ASX to enforce these rules include moral suasion, public and private inquiries of listed companies, the issue of press releases, suspensions and delisting. The Exchange would not normally undertake court action to enforce its Listing Rules, because, if

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of any of its members. (Ford, H A F, Principles of Company Law, Butterworths, 1990, p.832).

15 Evidence, p.S1022 (Australian Stock Exchange). This is the same as given by the ASX in its Discussion Paper "The Role of the Australian Stock Exchange and its Listing Rules" (October 1990)(para 7). The description is also consistent with the role attributed to the Stock Exchange by the Senate Select Committee on Securities and Exchange, Australian Securities Markets and their Regulation, 1974 Volume 1 para 15.6 in which it was said that the function of the Stock Exchange included the regulation of its members and supervision of the market to ensure that it is "viable, orderly, fully and speedily informed, honest and fair".

the action was unsuccessful, it may be liable for damages. The role of the ASX does not extend to investigating or prosecuting criminal activities.[16]

Enforcement and Market Surveillance

2.4.12 In 1989/90 the ASX allocated $4.17m for supervision of compliance of Australian listed companies, $2.24m for supervision of compliance by Exchange members and $1.45m for surveillance of the market.[17] The Companies Division of the Exchange has an enforcement and compliance program. At 30 June 1990 trading in the securities of 95 companies was suspended as part of the compliance program, because of the failure to comply with the Listing Rules. The Division also had 10 major investigations in hand.[18] In the 12 months until July 1991 the ASX delisted 255 companies and suspended 343 companies for varying periods of time.[19] The ASX Surveillance Division has established a computer surveillance system to detect and investigate unusual market movements. Between March 1989 and June 1990, 77 suspected breaches of the companies law were detected by the new surveillance system, 28 related to market rigging or manipulation, 22 related to insider trading while 10 concerned warehousing.[20]

2.5 The Problem of Enforcement - Evidence to the Committee

Lack of Resources Available Under the Co-operative Scheme

2.5.1 The Committee was continually told during the course of the Inquiry of the erosion of confidence in the stockmarket and Australia's business reputation because of the number of major company failures, the activities of particular

16 Evidence, p.S1026 (Australian Stock Exchange Limited) and ASX Discussion Paper, The Role of the Stock Exchange and its Listing Rules, October 1990.
17 ibid, p.S118.
18 ibid.
19 The Australian Financial Review, 22 July 1991.
20 Evidence, p.S142 (Australian Stock Exchange).

entrepreneurs and the perceived failure of enforcement actions by the relevant authorities during the period of the co-operative scheme.[21]

2.5.2 As noted earlier many organisations argued that the problem with regard to companies law and regulation is not the legislation but in enforcement. The Securities Institute of Australia told the Committee:

> "There are already in place considerable laws, codes, statutes and legislation; however there must be a concomitant emphasis on resources, both human and financial for enforcement. It is considered that it is in the area of enforcement, rather than the coverage of the laws themselves that controls have been lacking. It is strongly suggested that vigorous enforcement and pursuit through the appropriate arenas of justice will act as a strong deterrent to actual or potential miscreants."[22]

2.5.3 It would appear that one of the failures of the previous co-operative schemes was the lack of resources available to the principal regulator agency, the NCSC. Its appropriation in 1989-90 was $6.7m.[23] (Under the co-operative scheme the Commonwealth provided 50% of the Commission's annual budget, the remainder was provided by the States and the Northern Territory).

2.5.4 The failure to provide adequate resources for administration and enforcement under the co-operative scheme has been acknowledged by the Commonwealth. The Attorney-General's Department told the Committee at a public hearing in Canberra that:

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21 Evidence, p.S228 (Australian Consumers Association).
Evidence, p.S33 (Shareholder Action Group).
Evidence, p.S246 (Mr B Watson, Director, Grant Samuel and Associates).
Evidence, p.S721 (ASC).

22 Evidence, p.S77.

23 NCSC, Annual Report, 1989-90, p.68.

> "We believe there has been a substantial problem in administration, the lack of consistent administration and the lack of adequate resources being put into administration of company law requirements."[24]

2.5.5 Mr. Henry Bosch, the former Chairman of the NCSC told the Committee of the importance "of adequate resources for the national regulator."[25] A point he had stressed publicly many times during his period as Chairman.

2.5.6 The Attorney-General's Department informed the Committee that under the new scheme the Commonwealth has substantially increased the level of funding to the national regulatory agency. The 1990-91 Commonwealth Budget provided the ASC with an appropriation of $37.7m for its first year of operation and $118.2m over the forward estimates period.[26] "An extra $210 million will be provided over the next 4 years - resources for corporate regulation will increase by nearly 50%."[27]

2.5.7 The Attorney-General in his second reading speech to the House of Representatives earlier this year on the Corporations Legislation Amendment Bill 1991 commented that the Commonwealth has "substantially increased resources for corporate regulation and enforcement by comparison to that which was provided under the former co-operative scheme..."[28]

2.5.8 On 1 January 1991 the ASC became the sole agency responsible for the administration and enforcement of the national Corporations Law. The ASC told the Committee that "mobilisation of staff and resources in the pursuit of corporate malpractice are critical to the restoration of investor confidence," and a major initiative is the establishment of the Commission "and its resourcing at a level without precedent in the history of Australian corporate regulation."[29]

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24 Evidence, Canberra, 7 November 1990, p.575.
25 Evidence, Melbourne, 2 August 1990, p.157.
26 Budget Statements 1990-91, Budget Paper No.1, p.3.278.
27 Budget speech 1991, p.10.
28 Parliamentary Debates, House of Representatives, 29 May 1991, p.4213.
29 Evidence, p.S703.

2.5.9 The ASC emphasised that:

> "enforcement of the law will be its (the ASC's) prime focus and commitment. The creation and funding of the ASC involve a recognition by the Government that enforcement under the co-operative scheme was inadequate, because resources were insufficient and there was a lack of a coherent administrative structure..."[30]

Suggested Amendments to the ASC's Enforcement Powers

2.5.10 In its evidence to the Committee the ASC made some suggestions for amendments to its enforcement powers. It suggested that the period which the Commission may suspend a stock from trading on the stockmarket should be extended from 21 days to 3 months by amending section 775 of the Corporations Act; and furthermore:[31]

- whilst section 1114 of the Corporations Law provides the ASC with the power to institute proceedings without having to give undertakings as to damages, the Commission's powers to release information obtained during investigations should be extended for the purpose of maintaining an informed market in shares, as 'timely disclosure' will assist in preventing or containing losses to investors;

- section 68 of the ASC Act should, as a matter of urgency, be amended to limit the right to claim privilege against self-incrimination, or privilege against incurring liability to civil penalties, to statements made at compulsory investigation; and

30 Evidence, p.S837.
31 Evidence, p.S817.

- consideration should be given to amending section 1330 of the Corporations Law to release the ASC from liability to cost orders where it intervenes in proceedings to assist the Court.[32]

Role of the Australian Stock Exchange in Enforcement

2.5.11 The ASX told the Committee that there is a widespread misperception about its powers and role with regard to regulation of companies. The ASX emphasised that:

> "It is not a corporate policeman... (the) authority of the ASX over listed companies is limited to ensuring that they comply with the Listing Rules... The ASX does not have power to enter company offices, inspect records or conduct hearings. Its regulatory powers over listed companies and trusts (companies) are based on the contractual agreement each company enters into by executing the listing agreement whereby companies agree to bind themselves to comply with the Listing Rules."[33]

2.5.12 The principal remedy available to the ASX to enforce its Listing Rules is to suspend trading in the securities of a company pending compliance with the Listing Rules. Other actions available to the ASX are to seek court orders under sections 1114 and 777 to enforce observance of Listing Rules or to delist a company.

2.5.13 The ASX noted that some commentators consider that the Exchange should be more active in enforcing its Listing Rules. However the ASX stated that it can be sued for defamation if it publishes information which is later found to be incorrect, and it is possibly liable for damages if court proceedings are unsuccessful. The ASX, inhibited by the level of proof required to obtain an order, and the lack of legislative protection afforded by the absence of any privilege, errs on the side of caution.[34]

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32 Evidence, p.S719-720.
33 Evidence, p.S1022.
34 Evidence, p.S119-120.

2.5.14 The ASX stated that there are times when it is "aware of facts strongly suggestive that manipulative practices are going on in relation to a particular stock but is unable to warn the market because of the possibility of an action being brought against it."[35]

2.5.15 The Australian Shareholders' Association commented that the sanctions available to the Stock Exchange are "not terribly effective."[36] The ASX is aware of the deficiencies and limitations of its sanctions, it observed that suspension of trading in a companies' securities can "harm innocent shareholders who are not party to the perceived mischief."[37]

2.5.16 Accordingly the ASX suggested it be granted the right to institute proceedings under sections 1114 or 777 of the Corporations Law, without having to give undertakings as to damages and that it not be liable for any action or damages in relation to proceedings it takes under these sections. The ASX also proposed that it be granted a qualified privilege, similar to that which applies to auditors, liquidators and receivers (s.1289). It argued that there will be occasions when it will need to make statements to the market about matters affecting a listed company, which may be held to be defamatory.

Extent of Market Manipulation in Australia

2.5.17 The Attorney-General's Department commented that:

> "because secrecy is of the essence in market manipulation, there does not publicly exist any clear or verifiable information on the extent to which manipulation is currently occurring in Australia... few cases have recently been brought before the courts."[38]

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35 ibid.
36 Evidence, 3 September 1990, p.232.
37 Evidence, p.S119.
38 Evidence, p.S500.

2.5.18 Professor Baxt, then Chairman of the Trade Practices Commission, said in his submission to the Committee:

> "There is little doubt that there are manipulative practices occurring in the Australian securities market... (however)... I do not have first hand evidence of those practices..."[39]

2.5.19 As noted earlier in this chapter the Surveillance Division of the ASX in the 12 month period to June 1990, following commencement of its computer monitoring system, detected 77 possible breaches requiring investigation by the regulatory authorities. Members of the Surveillance Division commented in a paper forwarded to the Committee by the ASX that:

> "it is of concern that in the short period the Surveillance Division has been functioning it has detected so many matters which have needed investigation by the authorities... (however) ... in the context of the whole market... 88% of possible offences detected related to companies outside the top 150 companies by market capitalisation."[40]

2.5.20 The Attorney-General's Department concluded with regard to this matter that the main problems in combating market manipulation are detection and enforcement. The Department stated that there are few sign posts in cases of manipulation: the practices may be spread over a long period of time; the purpose of the activity may not be obvious and the activity may involve a long series of transactions or the careful placing of a particular false rumour.[41]

Committee's Conclusions

2.5.21 The Committee accepts that it is difficult to assess the full extent of market manipulation in Australia, particularly as so few cases are brought before the

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39 Evidence, p.S2.
40 Evidence, p.S139.
41 Evidence, p.S502.

courts. However, anecdotal evidence, and the experience of the ASX Surveillance Division, indicate that the practices are continuing despite legislative prohibition. It is apparent that the main problems in combating market manipulation are detection and proof, rather than the content of the law.

2.5.22 The Committee believes that the Corporations Law is generally adequate to prohibit the various forms of market manipulation; and is supportive of the ASX's attempts to upgrade surveillance capabilities.[42] It is important however that participants in the securities industry be aware that the Parliament and the public will not tolerate market manipulation, that it is illegal and that regulatory authorities will act to enforce the law.

2.5.23 It is well established that one of the weaknesses of the previous co-operative scheme was the lack of resources available to the regulatory authority. The Committee believes that continued funding for the ASC at satisfactory levels is essential if the benefits of the improved regulatory structure are to achieve the necessary impact on corporate malpractices in Australia. The Committee also supports the provision of adequate resources for the detection, surveillance and enforcement sections of the ASX by the industry.

RECOMMENDATION 1

2.5.24 The Committee recommends that adequate resources be provided to the Australian Securities Commission and the appropriate sections of the Australian Stock Exchange to enable suitable monitoring - detection, investigation and enforcement - of securities trading.

2.5.25 Both the ASX and the ASC are central to the detection and investigation of market malpractice and enforcement of the Corporations Law. The Committee notes the debate about the appropriate role of the ASX and believes scope should exist for the ASX to play a larger self-regulatory role on the market. Naturally,

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[42] The Committee inspected the computer surveillance system of the ASX and was most impressed with its potential.

primary regulatory function will vest with the ASC and co-operation between the two bodies is essential. The Committee believes that the ASX should not be discouraged from adopting a stringent approach to the enforcement of Listing Rules.

2.5.26 The ASX submitted to the Committee that it should have qualified privilege akin to that available to auditors to protect it where it considers that it has reasonable grounds to publish information or make statements to the market concerning the activities of listed companies.

2.5.27 The Committee is opposed to the ASX having qualified privilege in such circumstances. It believes that while the ASX has an important regulatory role it should be limited to enforcing the Listing Rules. It considers that where the ASX is contemplating a course of action such as releasing information or making a statement to the market it is appropriate that it should be liable for the consequences where its decision is not soundly based.

2.5.28 But, the Committee believes that there should be a regulatory mechanism available for prompt action to inform the market where information available to the ASX suggests the possibility of a false market eventuating. The Committee has noted the co-operative relations between the ASX and the ASC and the submissions of both organisations that such arrangements need to be fostered. The ASX and the ASC should be co-operative rather than competitive in performing their respective regulatory roles. It believes that a liaison committee of the ASX and ASC should be established to which such information could be referred by the ASX.

2.5.29 This committee should have available to it the powers and the qualified privilege of the ASC. It should have investigative powers to summon company directors, subpoena records and, where considered appropriate to publish information or to make statements to the market under qualified privilege.

2.5.30 However, the Committee supports the submission of the ASX that it should not be required to give undertakings as to damages when it institutes proceedings under sections 1114 or 777 in the enforcement of its Listing Rules.

2.5.31 The Committee notes that the suspension from trading of listed companies by the ASX does create difficulties for some shareholders, however, the Committee regards it as imperative that the ASX take a self-regulatory role and employ those sanctions which it is entitled by law to apply.

RECOMMENDATION 2

2.5.32 **The Committee recommends that the Australian Stock Exchange take a more active role in relation to the enforcement of the Listing Rules and malpractices in relation to the market of listed securities. To that end, it is further recommended that co-operation between the ASX and ASC be formalised with a view to:**

- **the ASC using its existing powers (to obtain testimony and documents) in situations where there is reason to suspect that there has been a breach of the Listing Rules or other market malpractice;**
- **the ASC making information so gathered available to the ASX where it would aid in the enforcement by the ASX of the Listing Rules. The ASX would be subject to duties of confidentiality in respect of the information supplied and, to assist in this, the information would be restricted to the Surveillance and Enforcement Division of the ASX and its legal advisers; and**
- **the ASC, after consulting with the ASX, making announcements, with the benefit of its existing protections, in relation to matters concerning suspected market malpractice or suspected breaches of Listing Rules.**

The Committee further recommends that any necessary amendment of sections 127(4) and 246 of the Australian Securities Commission Act 1989 be made so as to make it clear that:

- **the ASC can co-operate with the ASX in the manner recommended by the Committee; and**
- **the ASC is protected from liability in relation to any announcements which might be made.**

RECOMMENDATION 3

2.5.33 The Committee recommends that the Corporations Law be amended to give the Australian Stock Exchange the right to institute proceedings under sections 1114 or 777, without having to give undertakings as to damages.

2.6 Insider Trading

2.6.1 Insider trading has been a matter of considerable concern within the securities industry and the wider community for some years, contributing to the general deterioration of public confidence in the securities market. The ASC told the Committee that, "the area of market practice which most undermines investor confidence is the area of insider trading."[43]

2.6.2 The LACA Committee has (as noted in chapter 1) already produced a report on this subject, "Fair Shares for All: Insider Trading in Australia," in 1989. The Government's formal response to the report, tabled in the House of Representatives on 11 October 1990, accepted the majority of the Committee's recommendations for legislative amendments. In December 1990 draft legislation and an explanatory paper were released for public exposure and in May of this year legislation amending the sections of the Corporations Law dealing with insider trading was passed by the Commonwealth Parliament. The new provisions concerning insider trading came into effect on 1 August 1991.[44]

2.6.3 The key elements of the new provisions concerning insider trading are:

. the definition of an "insider" encompasses corporations and partnerships as well as individuals;

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43 Evidence, p.S810.

44 Corporations Legislation Amendment Act 1991.

- there will be no need for the prosecution to establish a connection between the person in possession of inside information and the company to which the information relates: instead any person, including a tippee, who is in possession of inside information will be prohibited from using it to trade in or subscribe for securities of the company;

- the provision of a statutory definition of inside information based on a "reasonable person" test; a person will be prohibited from trading in securities whilst knowingly in possession of information that is not generally available and if it were generally available a reasonable person would expect it to have a material effect on the price or value of securities;

- information is defined as being generally available where it is disclosed in a manner which would, or would be likely to, bring it to the attention of persons who commonly invest in securities of a kind whose price or value might be affected by the information and where a reasonable period of time for the dissemination of information has elapsed;

- extension of the offence to trading in options, convertible securities and prescribed interests such as unit trusts;

- the onus of proof remains on the prosecution; and

- monetary penalties are increased to $200,000 for natural persons and $1,000,000 for corporations.

2.6.4 The Attorney-General, Hon. M Duffy, MP, following the passage of the legislation by the Parliament said that:

> "the operation of these provisions will be monitored to see whether they are effective in preventing insider trading and in restoring investor confidence in the securities market."[45]

2.6.5 The ASC commented on the exposure draft legislation in its submission to the Committee arguing that the provisions should facilitate enforcement. However it pointed out:

> "enforcement of insider trading laws will not always be simple, as questions of proof are difficult in the fast moving stock market trading situation."[46]

2.6.6 The ASC also stated that:

> "criminal sanctions against insider trading are important but technicalities and the heavy burden of proof on the prosecution in criminal proceedings will often create obstacles to a conviction."

2.6.7 For this reason the ASC emphasised the importance of the availability of civil remedies for insider trading.[47] The ASC noted that sections 1005 and 1325 of the Corporations Act do already provide for a civil remedy allowing compensation.[48]

Committee's Conclusions

2.6.8 It is realistic to conclude that it will continue to be difficult to obtain convictions for insider trading even under the new legislation. Proceedings, whether or not ultimately successful, will, like all criminal proceedings, continue to be

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45 News Release, No.22/91, 29 May 1991, Attorney-General, the Hon. M Duffy, MP.
46 Evidence, p.S811.
47 ibid.
48 ibid. Under these provisions a person who has suffered loss or damages as a result of a contravention can sue the offender and can succeed on a lower standard of proof (the balance of probabilities) rather than the criminal standard of proof (beyond a reasonable doubt) which is required to obtain a conviction. Furthermore, civil proceedings brought under those sections do not prejudice the right to bring criminal proceedings.

expensive and protracted. The Committee believes it is important that the ASC/plaintiff be able to proceed for civil remedies regardless of whether the defendants are eventually prosecuted. However, it is apparent that the availability of a civil remedy allowing compensation is clear under sections 1005 and 1325 of the Corporations Law.

2.6.9 The Committee notes that an additional remedy is also available under section 1002(U), as recently introduced by the Corporations Legislation Amendment Act 1991, which empowers the Court, where it finds contravention of section 1002G (prohibited conduct by person in possession of inside information), to make a variety of orders similar to those in relation to unacceptable conduct in the context of a takeover in section 613 of the Corporations Law.[49]

2.6.10 The Committee believes there is no need for any further legislative provision to allow civil recovery for insider trading as the existing provisions of the Corporations Law are sufficient.

2.7 International Considerations - Differences in Market Regulation

2.7.1 It was brought to the Committee's attention that differences in market regulation exist between different countries and this can cause problems in enforcing controls over market practices. Two practices restricted or proscribed in Australia, but permissible in the United Kingdom and the United States of America, were drawn to the Committee's attention by the ASX: ***short selling*** and ***market stabilisation***.

2.7.2 ***Short selling*** refers to the practice of selling more securities than are actually owned by the seller. The sale is made in anticipation of the market falling

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[49] Parliament of the Commonwealth of Australia, Explanatory Memorandum, Corporations Legislation Amendment Bill 1991, p.107.

at which time the seller will then be able to acquire enough shares at a buying price lower than the selling price in order to cover the 'short' before the seller has to deliver the scrip (certificate of shares) to the buyer.[50]

2.7.3 In the United Kingdom for example, short selling is permitted more extensively than it is in Australia. If, therefore, securities of an Australian public listed company are quoted for trading on the ASX and also on the International Stock Exchange, London, sellers in London will be permitted to short sell in circumstances where such conduct is not permitted in Australia. If there is extensive trading in London, the effect could be to force down the price of the securities in both London and Australia, potentially creating a false market. It would be difficult for the ASX to deal with the matter except by co-operation with the International Stock Exchange (London), and London may well be reluctant to alter its normal rules and practices with respect to short selling in order to deal with a single case.

2.7.4 Section 846 of the Corporations Law prohibits short selling except where certain specified conditions are met. The ASX submitted that this section of the Corporations Law has been drafted without regard to questions of territorial scope.

> "It is not clear, on the face of the legislation, whether the sale must occur in Australia, the securities must be securities of an Australian issuer, and the seller and buyer must be connected with Australia. In the absence of legislative indications, a court would be required to construe the section, and may well construe it narrowly in view of the criminal consequences of the contravention."[51]

2.7.5 As a first step the ASX suggested that legislation should be amended to specify the degree of territorial connection with Australia, which is necessary for the Australian section to apply.[52]

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50 Ford, op.cit., p.856.
51 Evidence, p.S131.
52 ibid.

2.7.6 ***Market stabilisation*** is another area where Australian legislation contrasts with the approach in the United Kingdom and the United States of America. Under section 997(7) of the Corporations Law, persons are prohibited from taking part in two or more transactions likely to have the effect of maintaining or stabilising the price of the securities, with intent to induce other persons to sell, purchase or subscribe for the securities. In the United Kingdom and the United States of America stabilisation is permitted, subject to certain clearly identified guidelines.

2.7.7 The ASX observed that different market stabilisation practices constitute an impediment to simultaneous multi-national issues of securities. The Exchange suggested the Australian law should be altered to permit stabilisation, subject to certain clearly identified guidelines, which will ensure adequate disclosure of the stabilisation activities of the market.[53]

Committee's Conclusions

2.7.8 Internationalisation of securities markets and dealings means that enforcement action that cannot swiftly cross national boundaries, particularly for investigative purposes, will often be futile. Ensuring that Australian legislation is increasingly in harmony with that of major trading markets such as United Kingdom and the United States of America, is seen to be an area needing attention. One of the areas that should be given consideration is the area of short selling.

2.7.9 The Committee notes that in the exposure draft legislation on insider trading, released by the Attorney-General in December 1990, provision was made for Australian regulatory agencies to provide mutual assistance to corresponding overseas agencies.[54] These provisions were not, however, incorporated in the subsequent legislation. Accordingly the Committee repeats the recommendation of

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53 ibid.

54 Insider Trading - Proposed Amendments to the Corporations Law, Draft Legislation and Explanatory Paper, prepared for the Attorney-General, the Hon. M Duffy, MP, December 1990, p.5.

the Griffiths Committee that steps be taken which will enable regulatory authorities to be able to co-operate with overseas regulatory authorities in the detection and investigation of market manipulation practices.

RECOMMENDATION 4

2.7.10 The Committee recommends that the Attorney-General ask the Companies and Securities Advisory Committee for it to report on ways in which the market practices in Australia can be brought into harmony with practices in the United States and the United Kingdom, particularly in relation to short selling and market stabilisation activities.

RECOMMENDATION 5

2.7.11 The Committee recommends that the Government take steps to enable regulatory authorities to be able to co-operate better with overseas regulatory authorities in the detection and investigation of market manipulation practices.

2.7.12 Finally, with regard to the matters discussed in this chapter concerning illegal market manipulation practices, it is the Committee's express wish that contraventions be pursued by the responsible authorities and prosecuted to the limit. It is important that participants in the securities industry realise that the Commonwealth Parliament and the general community will not tolerate market manipulation and that regulatory agencies will act to enforce the law and prosecute offenders.