CHAPTER 5

POWERS OF SHAREHOLDERS IN RELATION TO THE MANAGEMENT OF THEIR COMPANIES

5.1 Introduction

5.1.1 It has long been recognised, certainly since the nineteenth century, that the aggregation of members (shareholders) of a large public company are too numerous to play any effective role in the day to day management of the company's affairs.

5.1.2 The general principle at common law is that where the powers of management over the affairs of a company are vested by its articles of association in the directors, then those powers of management can only be exercised by the directors. The shareholders, even if voting by a majority resolution in general meeting, are unable to effectively exercise those powers of management. Nor are the shareholders capable of effectively controlling or interfering with the exercise of those powers by the directors.[1]

5.1.3 The only way in which the general body of shareholders can control the exercise of powers vested by the articles in the directors is by altering the articles of association, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove.[2]

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1 Automatic Self Cleaning Filter Syndicate Co v Cunningham (1906) 2 Ch.34: quoted in Evidence p.S896 (Northern Territory Government).

2 John Shaw & Sons (Salford) Ltd v Shaw (1935) 2KB 113 per Greer L J at p.134: quoted in ibid. This general principle has been followed by the High Court of Australia in National Roads & Motorists' Association v Parker (1986) 4 ACLC 609 and Queensland Press Ltd V Academy Investments No.3 Pty Ltd (1987) 5 ACLC 175*.

5.1.4 Consequently, the constitutive documents of a company, its memorandum and articles of association, invariably make provision for the board of directors to be elected by the members (shareholders) by procedures prescribed in the articles. Typical company articles state that:

> 'the business of the company shall be managed by the directors.'

5.1.5 Under such articles, the board of directors is an independent organ of the company, and is not subject to direct day to day control by the shareholders. Shareholders, without having management powers have other powers as members of the company conferred on them by the articles and by statute.

5.2 Existing Rights of Shareholders

Powers of the General Meeting

5.2.1 The most significant of the powers which are specifically retained by the shareholders at a general meeting under Table A articles provided in the Corporations Law are:

- the power to determine the number of directors (subject to certain provisions);
- the power to elect directors;
- the power to remove directors; and
- the power to establish a director's rate of pay.

5.2.2 It is noted that in the case of a public company, the power to remove directors is a statutory right, provided by section 227 of the Corporations Law,

notwithstanding anything in the company articles or in any agreement. In the case of a non-public company, the removal of directors is governed solely by the articles and there is no inherent power in the members in general meeting to remove directors.

Shareholders' Rights of Veto

5.2.3 The Corporations Law provides shareholders with rights of veto in relation to specific categories of transactions. These include:

- loans to directors and associated interests (s.234);
- payment of retirement benefits to company officers beyond a limit that is related to average remuneration in the last three years and length of service (s.237);
- changes to the company's name, status, memorandum or articles (ss. 167,172, 176 and 382);
- alterations in the share capital by increasing authorised capital or reducing capital, consolidating or sub-dividing capital (ss. 193 and 195);
- a limited company issuing shares at a discount to par value (ss.190);
- a voluntary winding up of the company (s.491);
- changes to rights attaching to shares (ss.197, 198 and 199);
- the provision by a company of financial assistance in connection with purchases of its shares (s.205);

- the acquisition of a substantial interest in the company without an offer to all shareholders (s.623); and

- the implementation of a selective buy-back of shares or a buy-back in a takeover situation (ss.206GA and 206JA).

5.2.4 The ASX Listing Rules also provide shareholders with rights of veto with respect to:

- an acquisition or disposal of assets where the consideration payable or the total value of the assets is in excess of 5% of shareholders' funds of the listed company where the vendor or purchaser of the assets is in certain specified categories of persons having association with the company (Rule 3J(3));

- an issue of security to transfer a controlling interest (Rule 3E(3));

- an issue of equity securities which in a 12 month period, together with other securities of the same class issued during the previous 12 months, exceed 10% of the number of shares in that class on issue at the commencement of the 12 month period (Rule 3E(6));

- an issue of equity securities to directors of the listed company (or persons associated with those directors) except in certain situations (Rule 3E(8));

- alterations in the terms of issued options (Rule 3G(2)):

- entry into a service agreement where the termination benefits under it, when aggregated with termination benefits receivable under all other service agreements then in force, exceed 5% of the listed company's share capital and reserves (Rule 3J(16));

- an increase in directors' fees (Rule 3L(7);

- an issue of equity securities during the 3 month period following receipt of notification that a takeover for a listed company is coming (Rule 3R(3));

- any proposal to sell or dispose of the company's main undertaking (Rule 3S(2));

- a change of activities of the company, if required by the ASX (Rule 3S(3)); and

- implementation of an employee share or options scheme (Rule 3W).

Shareholders' Rights to Information

5.2.5 Shareholders do not have any general right at common law to inspect the books and records of their company. Since 1985 companies' legislation in Australia has enabled a shareholder to apply to the court for an order authorising a company auditor or legal practitioner to inspect the books of the company on behalf of that member. The court must be satisfied that the member is acting in good faith and that an inspection is to be made for a proper purpose (s.319). In addition, specific provisions of the Corporations Law entitle a member to inspect certain books and records as follows:

- the various registers which the Corporations Law requires a company to keep; the register of members (s.210), the register of options (s.215), the register of directors' shareholdings (s.235), the register of directors (s.242), the register of charges (s.271), the register of substantial shareholders (s.715), the register of results of tracing notices (s.724) and register of debenture holders (s.1047);

- section 239 empowers members to obtain disclosure of directors' emoluments; this may not be available to an individual member as the notice requiring disclosure must be served by at least 10% of the total number of shareholders or the request must come from members who together hold not less than 5% of the company's issued share capital;

- the minute books of proceedings of shareholders' meetings can be inspected at any time (s.259); and

- section 1029 requires that any company issuing a prospectus must keep a copy of it, together with copies of all material contracts referred to in the prospectus, for a period of 6 months after the prospectus was lodged and those documents can be inspected by any person; and

- a member or debenture holder can call upon the company to supply a copy of the company's last accounts laid before the company's annual general meeting (s.315).

5.2.6 Chapter 4 of this Report has identified the situations where a listed company is required to notify the Australian Stock Exchange of various items of information. The ASX keeps a file of these for each company and any person can inspect that file at the ASX.

5.2.7 Every company is required by specific provisions of the Corporations Law to lodge various documents with the ASC. Any person can search those documents.

5.2.8 The Corporations Law, Corporations Regulations Schedule 5 and Approved Accounting Standards (and for listed companies also the Listing Rules) specify a great number of matters which must be included in the annual accounts of the company which must be sent to all members of the company at least 14 days before the company's annual general meeting.

5.2.9 In summary, shareholders have a right to seek the appointment and dismissal of directors, specific rights of veto and a right to certain information. These rights give shareholders limited and indirect powers in relation to the management of their companies. Therefore, generally shareholders cannot exercise powers of control, in the sense of direction or initiation, over company management.

5.2.10 It was not seriously proposed by any submission to the Inquiry that shareholders should assume a greater role in the day to day management of companies. It was pointed out that shareholders generally lack the information, the expertise and the desire to direct the affairs of a corporation.[3] Concerns expressed to the Committee concerning the role of shareholders were that:

- there should be a continuous flow of information relevant to the affairs of the company to enable investors to monitor their investment (this was discussed in chapter 4);

- that directors should be more effectively liable to the company and its members for breaches of duties of trust and misconduct;

- that the management (particularly where it was dominant on the board) should be effectively accountable to the directors and to the company for their decisions; and

- that there should be available more immediate remedies for shareholders where they become aware of wrongdoing by the company (this is discussed in chapter 6).

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3 Evidence, p.S202 (Ernst and Young).

5.3 Factors Affecting the Climate of Company Governance

5.3.1 The climate in which business takes place and in which companies operate is dynamic, not static. There have been in recent years profound changes to the climate in which business is done and in which companies operate and that climate is continuing to change. Some of these changes have important consequences for the issues raised in this Inquiry.

Institutional Investors and their Role in Company Affairs

5.3.2 The growth in international stock markets over the last 100 years has been driven by the growth in funds under management of the institutional investor. In the United Kingdom in 1988, investments into pension funds, insurance companies and unit trusts were £26 billion, more than the entire GDP of New Zealand. In America the inflow was US$225 billion. In Australia, it is anticipated that the national flow of funds into superannuation over the next 10 years will be between A$250-500 billion in addition to the existing base of approximately A$100 billion.[4]

5.3.3 Mr McComas in his submission to the Inquiry told the Committee that despite this enormous involvement few institutional investors have thought of themselves as owners. They had been recently described as 'punter capitalists.'[5] Such major investors faced the dilemma of being unable to influence events in the long run and are limited to attending annual meetings and voting on resolutions put before them. However there are indications that the scene is changing and, because of the Australian corporate disasters, fund managers are demanding a new level of responsiveness from the board and management of companies in which they invest. The institutional investor's strategies may lead to the concept of 'proprietor capitalist.'[6] In late 1990 the "Australian Investment Managers' Group" was formed

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4 Evidence, p.S219 (Mr M McComas, County NatWest Australia, September 1990).
5 ibid.
6 ibid.

comprising 41 major Australian institutional fund managers. The stated purposes of the Group are:

- to advance the integrity of the Australian capital market;
- to protect the rights of investors;
- to promote the interests of investors;
- to facilitate investors taking action when warranted;
- to provide assistance to the ASC, ASX, AASB, government agencies, and other relevant organisations in matters relating to investors' interest; and
- to assist companies in understanding the requirements of investors.

5.3.4 Mr McComas observed that the large institutions have to date played a largely passive role. They have elected to exercise their power through the market: by selling out of problem stocks. While some institutions may have exercised influence behind the scenes, they have not sought to use their voting power to influence company policy.[7]

5.3.5 The ASC told the Committee that:

> "... in the next decade, battle lines may be differently aligned, as powerful institutional shareholders emerge, many of them being managers of huge pools of superannuation money. It is a common complaint that, in the English speaking markets, such managers consistently take a short-term view, thus undermining managerial interest in the long-term development of the business. Institutional managers' readiness to sell out, when an above-market bid price is offered, intensifies

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7 ibid.

> managers' preoccupation with the short-term. Concern with this issue is being reinforced by the growth of index portfolio strategies which, if rigorously pursued, remove entirely the funds managers' concern with, or even awareness of, the performance of individual companies. Debate on this subject, and on possible alterations in the balance between owners and managers is occurring in the United States, but a solution has not yet emerged. The issues are likely to be sharpened in Australia because of the overwhelming influence of industry superannuation funds as the 1990s progress. There is a sense in which the fund beneficiaries are the true owners of the shares held by their fund managers, but nobody has successfully found a way to translate this into an influence on how their companies are run. Indeed, the beneficiaries do not normally have any influence on stocks held by their managers, or even an influence on who their managers actually are."[8]

5.3.6 Mr John Green at the Committee's public hearing in Canberra referred to research that showed that if the worldwide trends in individual shareholding continues, by the year 2003 there will be no stock markets.

> "What will happen is that the big superannuation and investment funds will be the investment vehicles for people; you will have your money with them; they will make the decisions; they will buy and sell companies; they will not buy and sell shares."[9]

The Complexity of Company Organisation

5.3.7 There has been a noticeable trend in Australia during the 1980s for the creation of extremely complex corporate organisation. Mr Tom Hadden, senior lecturer in Law at Queens University, Belfast, and visiting Freehill Fellow in Law at the University of New South Wales, submitted that the recent spate of company collapses was in part due to the availability under company law in Australia of the means of creating these complex structures. He suggested that:

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8 Evidence, p.S704 (Australian Securities Commission).
9 Evidence, p.611, Canberra, 7 November 1990.

> "The most obvious example is the creation in many Australian groups of highly complex corporate structures which in themselves facilitate the avoidance of established protection against abuse. Though further empirical work in this area is clearly needed, there is some reason to believe that complex corporate structures are more common in Australia, both in established and in failed groups, than elsewhere. While such structures remain legal it is difficult for regulatory authorities and for independent directors either to prevent abuses or to deal with those primarily responsible when they occur.
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> On this view the low level of 'corporate morality' consists as much in the willingness of Australian businessmen and their professional advisers to adopt structures and practices that would be regarded as unacceptable elsewhere as in their willingness to flout the law. And the most urgent need is to introduce tighter laws and rules which will enable the authorities to prevent the creation of the complex structures which facilitate or conceal the abuse of power by some directors."[10]

5.3.8 Mr Hadden stressed that it would be foolish to suggest that corporate groups are inherently undesirable. They have been developed in all major industrial countries as a convenient structure for managing and accounting for large corporate enterprises.

5.3.9 Two of the most important features of these highly complex groups, as pointed out by Mr Hadden, are the proliferation of non-wholly-owned subsidiaries and associate companies and the creation of cross-share-holdings between companies within the group. These structures enable those in control of the group to position directors in key positions without committing the full amount of corporate or personal resources which would be required to establish a wholly-owned group.[11]

5.3.10 Mr Hadden went on to state that the kind of abuses that such structures facilitate include:

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10 Evidence, p.S989.
11 Evidence, p.S991.

- **misleading accounts** - the true profitability and worth of the various companies in the group may be concealed by intra-group transactions designed to create profit, to conceal losses or to manipulate the appearance of balance sheets of individual companies; such transactions are particularly hard to detect if companies within the group operate with different accounting periods;

- **cross-holdings** - the difficulty of assessing the true profitability or worth of the group as a whole is increased if there are cross share-holdings between individual companies which inevitably result in a depletion of capital; such cross-holdings also enable those in control of the group to entrench themselves against take-overs bids or attempts by independent shareholders to control activities. They may also be used to support the share price of listed companies within the group;

- **conflict of interest** - the usual problems of conflicting interests between directors and shareholders are intensified within complex groups, particularly in relation to non-wholly-owned subsidiaries and associate companies, since it is natural for those in control of the group to prefer the interests of the group to those of the individual companies or minority shareholders;

- **avoidance of regulatory protection** - it is often easy within a complex group of companies to avoid the impact of regulatory provisions introduced to prevent company malpractice or to achieve other social or economic goals, such as employee protection or prevention of undue concentration of economic power; and

- **avoidance of liability** - it is also possible within a corporate group to avoid liability to trade creditors and others affected by group operations notably in respect of disasters, by relying on the

traditionalrules in respect of the separate corporate personality and limited liability of individual companies.[12]

5.3.11 Regarding cross-holdings, Mr Hadden stated that in Australia such limitations as there are only apply to companies defined as subsidiaries. This enables very substantial cross-holdings up to 50 percent level to be built up, as in the case of the Adelaide Steamship/David Jones Group. This in turn may result, not only in the further confusion of shareholders as to the true meaning of accounts, in a degree of entrenchment by current directors and in the use of the resources of non-wholly-owned associated companies to support the price of shares in other listed companies within the group. He submitted that this was an area for reform.

5.3.12 The Committee notes that, as a result of recent amendments to the Corporations Law, for companies with a balance date of 31 December 1991 or later, the directors are required to prepare a consolidated set of accounts for the "economic entity" constituted by their company and the entities it "controlled" during the financial year (ss.295A and 295B). The notions of "entity" and "control" are defined partly by reference to AASB 1024 and, in effect, not only subsidiaries but other incorporated and unincorporated entities controlled by their company. Under AASB 1024 "control" is defined as "the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity". The purpose of a new standard is to require consolidated financial reports to be prepared to reflect the performance, financial position, and financing and investing of a group of related entities as a single economic entity. Control, rather than ownership, provides the criterion which is fundamental to identification of the group of related entities to which the presentation of consolidated accounts is required.

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12 ibid.

5.3.13 The Committee also notes that Accounting Standard AASB 1017: Related Party Disclosures, which is discussed in Chapter 4 of this Report, is also relevant to the question of cross-holdings. The CSAC report, "Report on Reform of the Law Governing Corporate Financial Transactions" provides a draft Bill which, amongst other things, would prohibit a company from entering into asset transfer transactions with associates, except in compliance with strict members' approval procedures (unless the asset transfer fell within one of the narrow exemptions). This proposal would likewise assist in addressing the question of cross-holdings, at least so far as the creation of them in the future.

The Diversity of 'Investment Products' Available

Unit Trusts

5.3.14 The small investor today may not own shares directly. He may own an insurance policy, have savings in a superannuation scheme, own shares in a company that invests in shares, may purchase units in a Property Trust or simply have a money invested with a building society or Credit Union.

5.3.15 Where the investment is held in a company then the investor has the protection of the Corporations Law. This is not necessarily the case, however with investments in bodies that are not companies such as Trusts. The ASC expressed concern to the Committee that such investors were particularly vulnerable in that they may not necessarily have available to them the range of remedies available to shareholders. The ASC submitted that there is a need for a comprehensive overhaul of regulatory requirements in relation to unit trusts to take account of the very large volume of funds the sector has attracted, and the changes to investment patterns and trust structures consequential upon financial deregulation.[13]

5.3.16 The ASC stated that matters to be considered in such a review could include accounting and audit requirements, specific protections for unit holders

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13 Evidence, p.S713.

against oppression, the extent of permissible limitation of the liability of unit holders, and entry standards into the industry for trustees and managers.[14] In his second reading speech on the Corporations Legislation Amendment Bill (No. 2) 1991 the Attorney-General, the Hon Michael Duffy, MP, stated that the Government recognised the value and importance of this kind of investment and was concerned to ensure that investors were fully protected. It noted that the government had commissioned reports from the Australian Law Reform Commission and the Companies and Securities Advisory Committee, both of which will be reporting to the Government on the matter early next year.[15]

Increasing Importance of Debt in Relation to Equity during the 1980s

5.3.17 Increasingly companies have resorted to debt rather than equity for meeting their capital requirements. This has affected the traditional relationships between directors and shareholders by introducing new factors into the equation. It needs to be noted that the interests of shareholders can be effected as creditors have priority to shareholders in the winding up of a company. In evidence to the Committee, Mr John Green pointed to the ambiguities that now cloud the traditional functions of equity and debt in company finance. Traditionally it is the equity holders that get the 'equity kicks' such as capital gain. Mr Green pointed out that some loans negotiated in recent years built in benefits similar to those usually the province of equity. He cites 'junk bonds' as an example. He said "I think it is a question for the Committee as to whether, in those circumstances, where the creditors are really equity holders, they should have the benefit of being creditors."[16]

5.3.18 These various considerations have meant that the Committee has needed to review the role of directors in relation to the management of companies and proposals to extend the responsibilities of directors to shareholders and the company.

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14 ibid.
15 House of Representatives Debates - 11 November 1991.
16 Evidence, p.612, Canberra, 7 November 1990.

5.4 Duties of Directors to Company

Proposals to Extend the Legal Responsibilities of Directors

5.4.1 As mentioned in chapter 4 of this report the law imposes on directors certain duties to the company and its members. These duties exist in the form of general duties at common law and in the form of duties imposed by statute.

5.4.2 The common law provides that directors have **a duty of good faith** in that they must:[17]

- act bona fide for the benefit of the company as a whole, that is in the interests of the shareholders as a general body or in a manner that is fair as between the different classes of shareholder; and

- have regard to the interests of the company's creditors, at least where the company is insolvent or nearly insolvent.

5.4.3 Many of these duties have been codified and are now contained in section 232 of the Corporations Law. The statutory provisions complement the general law equitable principles and have been perceived as providing for statutory remedies and criminal sanctions for breach of duty, rather than attempting to vary the nature of the duties (these general remedies are augmented by a range of statutory remedies, which are discussed in more detail in the next chapter).

5.4.4 The ASC in particular have made a number of recommendations to the Committee as to how the general duties of directors could be extended and made more explicit.[18] The Committee has also had regard to the findings of the Senate

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17 Evidence, p.S747 (Australian Securities Commission).
18 Evidence, p.S744-787.

Standing Committee on Legal and Constitutional Affairs in its report on Company Director's Duties (the Cooney report) tabled in Parliament in 1989.[19]

5.4.5 The ASC pointed out that the statutory remedies are complementary to the equitable principles and that this represents a strength in that courts can adapt the law to suit new situations.[20] However, several proposals were suggested in the evidence to the Committee to extend the responsibilities of directors to shareholders and the company in the Corporations Law.

Responsibility of Directors to Company Creditors

5.4.6 Creditors have available to them a number of remedies under the general law. However, under the Corporations Law the remedies are limited, indirect or uncertain:

- if a creditor can persuade the court that he has sufficient standing, (being a person "whose interests have been, are or would be affected by the conduct"), he can apply for an injunction to restrain conduct which would amount to a breach of the Law (s.1324). In that situation the court has the power to make other orders such as asset-freezing orders and the like (s.1323). The court also has power to order damages to be paid instead of granting an injunction (s.1324);

- if the creditor has that standing to apply for an injunction, the various breaches of the Corporations Law sought to be restrained could be breaches of statutory duty (s.232), or, if the creditor could somehow connect the directors activity to dealing in securities, engaging in

19 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.

20 Evidence, p.S751

conduct that is misleading or deceptive in relation to dealing in securities (s.995);

- if the creditor has that standing to apply for an injunction, the breach to be restrained or damages order could be in respect of officers authorising or making available information to shareholders where the information relates to the affairs of the company and it is false or misleading (s.1309);

- if the creditor can persuade the ASC to take action, a vast range of civil remedies are open to the ASC, some of which are referred to in paras 2.4.1 to 2.4.7 of this Report. In addition, the ASC may commence representative actions for recovery of damages on behalf of persons with their consent (s.50 of the ASC Act);

- the company itself (either by its board or, if it is in liquidation, by its liquidator) can recover damages that the company has suffered from a defaulting officer if the default is in respect of the officer's statutory duties to the company under section 232. Such action can be taken irrespective of whether a criminal action is commenced and the company has only to prove that the breach has occurred on the balance of probabilities (s.232(8));

- directors (and any person who takes part in the management of the company) are personally liable for debts incurred by the company at a time when there are reasonable grounds to expect that the company will not be able to pay all of its debts as and when they fall due or there are reasonable grounds to expect that, if the company incurs the debt, it will not be able to pay the debts as and when they become due (s.592). Proceedings by the creditor directly against the director for recovery can be brought irrespective of whether a criminal conviction is recorded and proof of the grounds is on the balance of probabilities.

The predecessor to section 592 was used in this way in Commonwealth Bank of Australia v Friedrich[21] with the result that a judgement for over $96 million was entered against the non-executive and honorary chairman of the National Safety Council of Australia Victorian Division;

- as an alternative to suing under s.592, a creditor can wait until the ASC/DPP secures a criminal conviction of an officer for breach of section 592. To obtain an order for payment of their debts creditors then need only point to the conviction (s.593). The advantage for creditors is that the ASC/DPP will bear most of the legal costs. The disadvantages for creditors are the delay in recovery and the fact that it depends on success on the part of the ASC/DPP in the criminal proceedings;

- if the court is satisfied that a person is guilty of fraud, negligence, default, breach of trust or breach of duty in relation to a company and the company has suffered damage as a result, the court can make such orders as it thinks appropriate including ordering the person to pay money or transfer property to the company (s.598). Where the company is insolvent the effect of such an order is to increase the assets available for distribution to creditors. The class of persons who can apply for such an order include the ASC, liquidators and the like, and any other person authorised by the ASC;

- if dividends have been paid other than out of profits (or the share premium account) the directors involved can be made liable to pay the company's creditors (s.205); and

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21 (1991) 9 ACLC 946.

- the usual steps that can be taken by a creditor to wind up a company that is unable to pay its debts (s.460).

5.4.7 The Trade Practices Act also affords creditors remedies against officers of a company. If, for instance, the directors make representations about the financial viability of the company when in fact it is insolvent, those creditors relying upon the representations can use sections 52 and 82 to obtain damages and recovery against the directors personally.

5.4.8 In addition, sub-section 301(5) of the Corporations Law imposes the statutory duty on directors to report annually to shareholders whether there are reasonable grounds to believe that the company will be able to pay its debts as and when they fall due.[22]

5.4.9 The courts have also enunciated a general doctrine that directors, as part of the duty that they owe to the company, owe a duty to the company's creditors. The ASC told the Committee that there is clear authority that directors must have regard to the interests of the company's creditors where the company is insolvent: and referred to two cases decided in 1986, Kinsella v Russell Kinsella[23] and Grove v Flavel.[24]

5.4.10 The Senate Committee noted that existing [general] law does not allow creditors to seek a direct remedy against a director. Creditors will only look to directors personally when the company cannot pay. In these situations, insolvency law will apply. This means that in a majority of cases, a liquidator will act on behalf of creditors.[25]

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22 Evidence, p.S753 (Australian Securities Commission).
23 (1986) 4 ACLC 215.
24 (1986) 11 ACLR 161.
25 Senate Standing Committee on Legal and Constitutional Affairs, op.cit., para 5.40.

5.4.11 The ASC submitted that there should be a general duty imposed by the Corporations Law on directors to act at all times with regard to the interests of creditors. It said that insufficient regard for the interests of existing creditors has been a common source of the problems that have led to concern with corporate practices.[26] The Senate Committee however did not recommend a further statutory duty. It seemed to take the general view that the evolution of the general fiduciary duties of directors to include creditors would eventually provide flexible and powerful remedies available alongside the existing statutory remedies.

5.4.12 The New Zealand Law Commission in a draft company code that it prepared following its report on company law reform, declined to impose any new fiduciary duties on directors in respect of creditors. It pointed out that it is always open to a creditor to contract for higher protection.[27] In a similar vein, Mr John Green, in his evidence, stressed the fact that creditors can and should negotiate their own contracts on a face to face basis and can look after their own interests.[28]

Personal Liability of Directors Contracting Debts, Knowing of the Insolvency of the Company

5.4.13 Section 592 of the Corporations Law makes provision for a director to be liable personally and directly, at the suit of a creditor, where he/she incurs a debt where he/she has an 'expectation that the company will not be able to pay its debts.'

5.4.14 The Australian Law Reform Commission (ALRC) in its report on General Insolvency recommended that this provision was unsatisfactory because it:

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26 Evidence, p.S753.
27 New Zealand Law Commission, Draft Company Act, paras 216-218: quoted in Evidence, pp.S595-597 (Attorney-General's Department).
28 Evidence, p.S613.

- gives any benefit of the civil liability to the creditor taking action and thus is only of advantage to a creditor with the resources to take such action;

- fails to provide a liquidator with the standing to bring an action for the benefit of all creditors; and

- requires a multiplicity of actions if all creditors who have been affected by the behaviour of the directors are to be compensated, with the possible result that the first creditors to take action may exhaust the assets of an errant director.[29]

5.4.15 This led the ALRC to recommend the abandonment of the existing provision and its replacement with a provision that is readily enforceable in a manner which permits all creditors to share equally in the sums recovered. The Senate Committee endorsed this recommendation.[30]

5.4.16 The ASC proposed that these concerns could be met by providing a general statutory remedy for creditors that would have the effect of qualifying the remedy available under section 592. This would be achieved by amending section 260 of the Corporations Law: the oppression remedy. A desirable manner of implementing this in the view of the ASC would be to state that directors have a duty to act with regard to the interests of creditors wherever:

- there are reasonable grounds to indicate that it is a reasonable, not a remote, possibility the company will not be able to pay its debts or will not be able to do so if it takes or omits to take a particular course of action;

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29 Law Reform Commission, Report No. 45, General Insolvency Inquiry, 1988, Vol. 1, p.125.
30 Senate Standing Committee on Legal and Constitutional Affairs, op.cit., p.77.

. the reasonable grounds are evident from matters within the knowledge of the director concerned (whether or not he in fact appreciated the implications) or would have been known to him if he had made the inquiries or had the knowledge of the companies affairs that it was reasonable to expect him to have in the circumstances facing the company.[31]

5.4.17 In the ASC's view, it is desirable to give individual creditors a direct right of action against the directors in a situation where the duty to have regard to creditors' interests applies. However, where damages are recovered from directors they should be for the benefit of the company rather than solely for the benefit of the individual creditor. This will ensure that the new creditor's right of action does not conflict with existing relationships between creditors. This end would be achieved, in the ASC's submission, by giving creditors the standing to bring court action under section 260 of the Corporations Law the oppression remedy, to make the remedy available to creditors as well as shareholders and framed in such a way to ensure that creditors have access to a range of other remedies available in the Corporations Law.[32]

Committee's Conclusions

5.4.18 The Committee has not been persuaded that there is a case for providing creditors with a further remedy under section 260, the oppression remedy. Creditors already have available to them other remedies in contract and on winding up or insolvency of the company that are not available to shareholders. There are also the remedies noted above under the Corporations Law and those equitable remedies available through the courts. It is also the view of the Committee that, at least as far as listed companies are concerned, the improved disclosure requirements will

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31 Evidence, p.S754.
32 Evidence, pp.S755-756.

make existing remedies more valuable to creditors as well as shareholders by providing early warning for their use.

Reintroduction of the Ultra Vires Rule

5.4.19 Another witness to the Inquiry Mr Bruce Watson, Director of Grant Samuel and Associates also averted to the difficulty faced by investors in companies which could later embark on activities totally unrelated to those that might have been the companies activities at the time the investment was made.[33]

5.4.20 He advocated the restoration of the rule that a company could not engage in activities that were not expressed in the objects clause of its Memorandum of Association (the ultra vires rule). This he regarded as wholesome control in that a company wishing to depart from its stated objects would have to obtain shareholder approval to vary the objects clause. A company venturing into activities not prescribed in its objects could be halted, in way of injunction, from proceeding with those activities on the ground that they were outside the companies powers, or such actions could be later declared ultra vires, void and unenforceable.

5.4.21 The ASC told the Committee that it was not in favour of the reintroduction of the ultra vires rule. In the ASC's view there were sound reasons for the abolition of the old ultra vires rule. Its operation depended on technicalities associated with the wording of company "objects" rather than on broad principles of justice associated with the requirement for "corporate benefit". The Committee agrees with the ASC that nothing would be achieved by the reintroduction of the ultra vires doctrine.

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33 Evidence, p.S369-382.

The Director's Duty of Care and Diligence - Proposals for a Business Judgement Rule

5.4.22 There has been substantial uncertainty as to the extent of the director's duty of care and diligence. In particular, the extent to which directors may rely on staff recommendations or on other directors, and the extent of their duty to inform themselves generally as to the company's affairs.[34] The ASC noted that there is a perception that the present law casts a very low standard of care on directors:

> "The director's standard of care as defined in Re City Fire Insurance Co Limited [1925] Ch 407 was paraphrased by Sir Douglas Menzies in 1959 as indicating that honest and diligent muddling did not in 1925 give rise to liability."[35]

The case suggests that a director has a duty of care to take reasonable steps to acquaint himself of the company's business and not to rely on others where circumstances indicate that this is dangerous.[36]

5.4.23 This matter was considered in some detail by the Senate Committee. The major recommendations of that Committee were for statutory elaboration of the director's duty of care. The main recommendations included:

- the imposition of an objective duty of care for directors;

- the introduction of a business judgement rule and a requirement that directors be required to attend Board meeting unless there is a reasonable excuse for non-attendance;

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34 Evidence, p.S761 (Australian Securities Commission).

35 ibid.

36 See: Senate Standing Committee for Legal and Constitutional Affairs, Op. Cit., 1989. Parliamentary Paper 395/89.

- amending companies legislation to limit the extent to which directors should be able to rely on the advice of third parties; and

- prescription of the requirements which must be met for the exoneration of directors from what would otherwise be breaches of their fiduciary duties.

It is illustrative to review the evidence received by the Legal and Constitutional Affairs Committee on these proposals.

5.4.24 The Senate Committee endorsed the April 1989 CSLRC Discussion Paper to the effect that directors may avoid liability for breach of the duty of care and diligence on the basis that they have legitimately exercised their 'business judgment' if they:

- act in good faith and are not subject to a conflict of interest or duties;

- exercise an active discretion in the particular matter;

- take reasonable steps to inform themselves about the matter; and

- act with a reasonable degree of care in the circumstances, having regard to any special skill, knowledge or acumen that the particular director has, and the degree of risk involved in the particular transaction.

5.4.25 After the Senate Committee reported, the CSLRC issued its report Company Directors and Officers: Indemnification, Relief and Insurance[37]. In that report the CSLRC provides a suggested version of the statutory provision dealing with the business judgement rule.

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37 Company Directors and Officers: Indemnification, Relief and Insurance - Report No. 10 - May 1990 (Melbourne).

5.4.26 The ASC supported the introduction of a business judgement rule. It would provide directors with a 'safe harbour' from liability for negligence (but not from liability for breach of the duty of good faith) if they could show that all the conditions were met.[38] A 'business judgment' rule would emphasise the need for an orderly and proper deliberative process by the directors. Courts would be less reluctant to 'second guess' directors' commercial judgments.[39] It considers that such a rule would help overcome existing uncertainties in the interpretation of section 232(4) of the Corporations Law and the director's duty of care, but, stated that the introduction of any such rule be so framed so as not to allow directors to shirk responsibility for a major transaction on the basis that the transaction is outside a particular director's area of expertise. The ASC regarded it as appropriate that directors with appropriate expertise should be expected to display a particularly high standard of care, inquiry and attention.

5.4.27 Furthermore in the ASC's view the adoption of the business judgment rule should be usefully supplemented by provisions regulating the extent and impact of delegations by the board to company staff and imposing duties on principal executive officers to provide information to board members. This would reduce the scope for directors to plead ignorance or delegation as an excuse for avoiding liability.

5.4.28 With regard to the Senate Committee's recommendation concerning third parties, the ASC noted the state of uncertainty in the case law concerning the extent to which directors can rely on the judgment of outsiders (third parties) as a defence to proceedings for breach of the duty of due diligence.[40]

5.4.29 The Committee concludes that appropriate amendments should be made to the Corporations Act to implement the recommendations that have been made by the Senate Standing Committee on Legal and Constitutional Affairs and the Companies and Securities Law Review Committee. These amendments would

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38 Evidence, p.S769.
39 Evidence, p.S768
40 Evidence, p.S761

provide for the introduction of an objective test along the lines of a business judgment rule. There should be a business judgement rule in the terms suggested by the CSLRC at para. 81 of its report no. 10 Company Directors and Officers: Indemnification, Relief and Insurance.[41]

RECOMMENDATION 20

5.4.30 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;

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41 CSLRC, Company Directors and Officers: Indemnification, Relief and Insurance, Report No.10, May 1990, p.37.

- **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.**

5.4.31 The Committee also received a submission from Metal Manufactures Limited concerning the decision of the New South Wales Court of Appeal in a case in which the company had been engaged.[42] The case concerned section 556 of the Companies Act 1981 (now section 592 of the Corporations Law) which provides a remedy to a creditor in respect of a debt incurred by the directors of a company when the directors knew or must be taken to have known that the company was insolvent. The creditor can proceed against a director personally to recover the debt in such circumstances. Section 592 allows a defence where a director can show that the debt was incurred without his/her consent.

5.4.32 In the Metal Manufactures case a debt was incurred to Metal Manufactures by a family company of which a husband and wife were the sole directors. The wife took no part in the running of the company's business which was managed by her husband; they both regarded the wife as a director for "signing purposes" only. The Court of Appeal accepted that the wife was not liable to Metal Manufactures because, under the equivalent of section 592(2)(a) the debt was incurred without her express or implied authority or consent. The mere fact that the wife acquiesced to her husband being the company's managing director did not mean she had impliedly authorised or consented to him incurring debts.

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42 Metal Manufactures Limited v Lewis (1987-1988) 13 ACLR 357.

5.4.33 In another decision on the predecessor to section 592, the Statewide Tobacco case[43], the mother of the managing director of a company, herself a director, sought to avoid liability by relying on her lack of knowledge that debts, which were incurred by the managing director, her son, had been incurred and her lack of knowledge of the specific debts in question. The Court distinguished the Metal Manufactures case on the basis that the word "authority" to which the equivalent of section 592(2)(a) referred was not to be interpreted in the way the Metal Manufactures case said but rather that the mother, having agreed to allow her son to manage the company, had conferred general authority upon him to incur debts and those debts were consequently incurred with the mother's implied authority. Accordingly, the mother was held liable for the debts of the company.

5.4.34 A very recent case, Group Four Industries Pty Ltd v Brosnan[44] did not follow the Statewide Tobacco case with the result that the wife in the Group Four case was held not liable for debts of the company of which she was a director. In the Group Four case the husband and wife were the only directors and shareholders. The company had been in financial difficulty right from the start. The husband, while not formally appointed managing director, assumed de facto control of the business. The wife's role was restricted to answering phone calls at home after hours and accepting deliveries. The court noted that section 592 created a criminal liability for the same conduct which allows for civil liability. The court felt that it was far from clear that a general authority for others to incur debts meant that the wife would be denied a defence under the section. The court was of the view that subjective considerations such as the actions and state of mind of the wife were important before the wife could be held liable.

5.4.35 The Australian Law Reform Commission in its report on 'General Insolvency' criticised section 556 (now Corporations Law section 592) for not conferring a right of action on liquidators to recover for the benefit of creditors generally; at present the right is conferred only on individual creditors, to recover

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43 Statewide Tobacco Services Limited v Morley (1990) 2 ASCR 405.
44 (1991) 9 ACLC 1, 181.

for their own benefit (as noted earlier in this section). The Law Reform Commission made this suggestion in the context of its recommendation for a more a generally framed remedy, for the company and its creditors, allowing personal recourse against directors who allow a company to engage in insolvent trading. The Senate Standing Committee on Legal and Constitutional Affairs endorsed the Law Reform Commission recommendation that Company Law be amended to permit all creditors to share equally in sums recovered from directors.

5.4.36 As concluded in para 5.4.17, the Committee does not agree with the ASC that there should be a more generally framed remedy for creditors. However, it does agree that liquidators should have standing under section 592 of the Corporations Law.

5.4.37 It is also desirable to clarify the uncertainties raised by Group Four Industries Pty Ltd v Brosnan, by amending section 592 of the Corporations Law to exclude the defence under sub-section 592(2) where the debt was incurred by or under the authority of a person in whose appointment the defendant director participated.

RECOMMENDATION 21

5.4.38 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.

Exoneration of Directors for Breaches of Trust

5.4.39 The Senate Standing Committee on Legal and Constitutional Affairs recommended that the companies legislation set out the requirements that must be met for the exoneration of directors for breaches of trust. Exceptions to fiduciary duties are generally possible with the 'informed consent' of the person to whom the duty is owed. In company law this principle has resulted in an emphasis by the courts on giving effect to the wishes of the body of shareholders voting in general meeting.[45]

5.4.40 The suggestion of the Senate Standing Committee on Legal and Constitutional Affairs complements a recommendation of the Companies and Securities Law Review Committee in its report No. 10 that on meeting certain disclosure requirements, the shareholders in general meeting should be allowed to authorise in advance transactions otherwise in breach of duty. (In a recent case it has been suggested that it is open to the board itself to exonerate the director).[46]

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45 Hogg v Cramphorn (1967) Ch.254 : Darvall v North Sydney Brick and Tile (1987- 1989) 12 ACLR 537 (on appeal 15 ACLR 230).

46 Queensland Mines v Hudson (1978) 3 ACLR 176.

The ASC however, argued that a company board should never be able to ratify a potential breach of duty or to do so retrospectively. Nor should there be any situation where ratification of what would be a breach of the criminal law should be possible.

5.4.41 However, the ASC was of the view that the interest of the economy and of shareholders would not be served by unduly restricting the voting power of majority shareholders in an excessively wide range of cases. If this were to occur the benefits of substantial holdings, and the justification for the payment of a premium for control (which under the takeovers provisions of the Corporations Law benefits all shareholders) would be lost. It would not for these reasons be desirable to enforce greater restrictions on the voting power of interested parties than have been recommended in relation to minority force-outs and leveraged buy-outs in chapter 3. The circumstances in which directors and others should be able to ratify an action of a director or officer should be as recommended below.

RECOMMENDATION 22

5.4.42 **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; and

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

5.4.43 In addition the Committee believes it is desirable to confirm in the legislation that the duty of directors should be capable of modification in advance and breaches exonerated but only by the shareholders in general meeting and only on the basis of adequate disclosures.

5.4.44 The power of shareholders to excuse or authorise a breach of duty should be confined to situations where the breach of duty does not attract criminal sanctions and where the only adverse effect of the breach would be on the shareholders. Shareholders should not have power to authorise a breach of directors' duty where the duty involved is the duty to have regard to the interests of creditors. However, the court should be given power to order that the breach of duty not be excused (however the shareholders have voted) if the company goes into liquidation
within 12 months.

RECOMMENDATION 23

5.4.45 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.

RECOMMENDATION 24

5.4.46 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.

5.5 Proposals for Reforms of the Management Structure

Audit Committees

5.5.1 The desirability of audit committees was proposed to the Committee in a number of contexts. The Business Council of Australia endorsed the suggestion for audit committees included in the discussion paper, Corporate Practices and Conduct to which it (amongst others) contributed. The proposal was, as noted in chapter 4, supported by numerous organisations including the accountancy bodies, Mr Henry Bosch and the chartered accountancy firm Ernst and Young. The proposal has been accompanied by some suggestions that such committees should be composed of a majority of non-executive directors.

5.5.2 The Senate Legal and Constitutional Affairs Committee recommended that public listed companies be required to have audit committees with a majority of members being non-executive directors, with direct access to the company's management. Such committees would review financial information, review accounting and financial controls, oversee the audit of the company and perform other allocated tasks.

5.5.3 The report of the Senate Standing Committee on Legal and Constitutional Affairs identifies several important functions for audit committees: to ensure that accounting and financial information is up to date, that timely disclosures are made, that appropriate controls and detailed audit arrangements are in place, and that information obtained by the auditors is responded to in a suitable manner.[47]

5.5.4 The ASC also endorsed suggestions for audit committees.[48] It submitted that it is generally desirable for listed public companies to have some non-executive directors, but the diversity of circumstances in which different companies operate makes it undesirable to impose a mandatory requirement for non-executive directors. The ASC proposed that where there is an insufficient number of non-executive directors to establish an audit committee, the full board of the company should be required to undertake the audit function.

5.5.5 As already mentioned, the need for such an independent input has been proposed by various groups, such as the Australian Shareholders Association, for other reasons not least to ensure greater control over management and to ensure greater accountability of company management to shareholders and to third parties such as creditors.

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47 Senate Standing Committee on Legal and Constitutional Affairs - Report on the Social and Fiduciary Duties and Obligations of Company Directors - Parliamentary Paper No. 395/1984. pp. 119-128.

48 Evidence, p.S771.

5.5.6 The ASC observed that these functions are important in any listed public company, and should be performed whether or not the company's circumstances permit the operation of an audit committee with a majority of non-executive directors.

Independent Directors (Non-Executive) and Cumulative Voting

5.5.7 Many submissions to the Inquiry commented on the need for more effective representation of the interests of investors on the boards of companies, particularly where a company was controlled by a dominant individual or group of individuals.[49]

5.5.8 The inability of boards to control the activities of dominant individuals or groups has been perceived as a feature of some of the company collapses that occurred in the late 1980s. The evidence has stressed the importance of there being independent voices on the boards of companies: independent or non-executive directors.[50] These non-executive directors are not involved in the day to day running of the business, but are sufficiently well informed to ask incisive questions at board meetings, thereby providing a check on the power on the executives... the qualifications of non-executives (should) be specified in a voluntary code of conduct.[51] This would enable directors to exercise an 'objective duty of care.'

5.5.9 The ANZ Banking Group recommended appointing a majority of non-executive directors to the board and that the chairman should be a non-executive director.[52] This view was also taken in the discussion paper, Corporate Practices and Conduct. The Life Insurance Federation of Australia expressed the view that:

> "The best protection for the minority shareholders will come about if there is a properly comprised board. Where there are

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49 Senate Report, op.cit., para 8.16.
50 Evidence, p.S230 (Australian Consumers Association).
51 Evidence, p.S203 (Ernst and Young).
52 Evidence, p.S271.

minority shareholders, it is essential that there be independent directors of competence and integrity who can ensure that the rights of those shareholders are being maintained."[53]

5.5.10 The discussion paper, "Corporate Practices and Conduct", put the view that independence is likely to be assured where the non-executive director:

- has no associations with other companies that could give rise to a conflict of interests which would make it difficult for him to act in the best interest of all shareholders, without favour towards classes of shareholders or interests associated with the directors or groups of shareholders;

- has not been retained by the company, whether personally or through his firm or a company in which he is a director or officer, on a continuing or regular basis; and

- is not, whether personally or through his firm or a company in which he is a director or officer, a significant customer of or supplier to the company.

Another way of expressing the prerequisites of someone to be an independent director would be to say that he must have no current commercial or personal family relationship with the company served and he has a relevant interest in less than 5% of the voting shares of the company.

5.5.11 A number of witnesses commented on the dominant position of institutional investors in the shareholding of major companies and the failure of these institutions to adopt other than a passive role in the affairs of companies.

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53 Evidence, p.S27.

5.5.12 It was suggested that a method by which this latent power of institutional investors could be harnessed is for the institutions either alone or in combination to use their voting power to appoint independent directors to the boards of public companies. This could be achieved for instance by way of cumulative voting. Mr P Davies of Economic Research Pty Ltd proposed the introduction of cumulative voting in place of the system enshrined in the articles of most companies whereby the majority shareholder may elect all directors of the board.

5.5.13 With cumulative voting (a form of proportional representation) a block of shareholders would be entitled to representation in proportion to their shareholding. This would enable minorities to appoint members to the boards of public companies. By way of example, under conventional voting, if there are 5 board vacancies, each share is entitled to 5 votes, but they must be cast for different candidates. This ensures that whoever holds the most shares can elect all the board. By contrast, under cumulative voting, if there are 5 board vacancies, each share is entitled to 5 votes, but they may be cumulated or cast for one candidate.[54] In the United States of America some corporations make provision in their constituent documents for cumulative voting and it is has been made mandatory in some States. It is also optional in Japan.

5.5.14 Any corporation could provide for cumulative voting merely by amending its articles of association. However, the practice is not popular with those that control companies. It is considered that it would provide a means for pressure groups to obtain blocks of shares with a view to influencing company policy.[55]

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54 Evidence, p.S331.

55 *The Senate Legal and Constitutional Affairs Committee in chapter 6 of its report rejected the* concept of pressure groups being represented on boards. It concluded that environmental and consumer controls should be achieved by environmental and consumer legislation: paras 6.25-6.56.

Professional Directors

5.5.15 Mr Davies also put forward the concept of the professional director, who would be available for appointment to boards of corporations to represent the interests of institutional and other shareholders. In advancing the proposition, Mr Davies, saw it as a solution to some of the problems involved in getting truly independent directors on boards and as a means of representing the interests of institutions.[56]

5.5.16 Mr Davies referred to the frequent criticism of many directors that:

- individual directors are often on boards because of the prestige and credibility that their involvement imparts to the enterprise rather than their relevant skills; and that

- some directors are on too many boards to be able to devote sufficient time to the affairs of each company.

Accordingly, there are thus two major constraints at present that limit the ability of the typical independent director to perform the task of a monitor:

- he/she holds the position at the pleasure of the chairman and is thus not truly independent;

- the more outstanding the director is the greater will be his/her competing commitments and hence the less time the director will have for effective monitoring.

5.5.17 Mr Davies referred to a proposal to address these weaknesses advanced in the United States. Messrs Gilson and Kraakman, of the Universities of Stanford

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56 Evidence, pp.S334-335.

and Harvard suggest the creation of a position which will attract people of talent and experience and which will be sufficiently rewarding to persuade them to become full time independent company directors.[57]

5.5.18 They maintain that the attraction of positions on a number of boards at rewarding rates of remuneration would be sufficient to attract top class business professionals prepared to leave positions such as senior partners in accountancy or law firms or professors of business law at major universities. Such professionals would be well equipped to perform the monitoring role envisaged by proponents of non-executive directors on company boards. Such professional directors allegiance would be first of all to the company.[58]

Two Tier Board Structure

5.5.19 Some submissions referred to forms of company structure in force in continental Europe, particularly Germany.[59] This involves two tier boards, the executive management board and the supervisory board. The body of shareholders elect the supervisory board which proceeds to elect the management board. None of the members of the supervisory board are eligible to sit on the executive board, or vice versa. The executive board is the management organ of the corporation. It makes business policy and conducts the daily business of the corporation. The supervisory council (board) appoints and removes members of the management board, thus achieving a mechanism for greater accountability of management to shareholders.

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57 Quoted in Evidence, p.S335; R J Gilson and R Kraakman: Reinventing the Outside Director: An Agenda for Institutional Investors, Working paper No.66, Stanford Law School, August 1990.

58 ibid.

59 Evidence, p.S332 (Mr P Davies).
Evidence, p.S996 (Mr Hadden).
Evidence, p.S1195 (Hon. M Nevill, MLC).

5.5.20 In the countries where this form of management is in force the shareholding of corporations is largely in the hands of banks and large institutions. In putting the idea forward for consideration Mr Davies said:

> "The great advantage of this system is that it provides a formal division of powers. Further, it recognises that the skills required to monitor effectively are different from the skills required to promote a business. The two-tier system provides a means whereby these different skills can be harnessed. In the Australian context, the adoption of European style two-tier boards resolve the ambiguity in the position of auditors. Under the... an auditor is appointed by and reports to the supervisory or lower tier. It owes no favours to the management and is thereby enabled to report objectively on the affairs of the company."[60]

It is salutary to note, however, the collapse of the National Safety Council of Victoria Division. The NSC had a two board structure: a state council comprising 30-40 members elected from its number a "board of directors" of not more that 9 people. It was that board of directors which was sued by the Commonwealth Bank with a judgement of over $96 million being entered against the non-executive Chairman Mr Eise.

Committee's Conclusions

5.5.21 The Committee supports suggestions that publicly listed companies be required to establish audit committees. To this end the Committee endorses the recommendation of the Senate Legal and Constitutional Affairs Committee in its report, Company Directors' Duties.

RECOMMENDATION 25

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

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60 Evidence, p.S333.

- 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;

- require that the audit committee meet regularly and report to the Board;

- 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;

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

- 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

- 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.

5.5.23 The Committee notes suggestions to introduce cumulative voting for appointment to the board of a company. Concerns about the consequences of such a system include that it could result in fettering the ability of companies to conduct and carry out business policies and operations. For these reasons companies are unlikely to voluntarily take-up the proposal. The Committee observes that it would obviously operate as a fetter on the freedom of those in control of companies to make business decisions. It could be made a requirement for the ASX Listing rules but would need the support of the ASX. It could be made a standard provision in the Table A standard form of Articles in the Corporations Law. This would mean that a deliberate decision to have other forms of voting would have to be taken by those forming companies. An article providing for cumulative voting could be to the following effect:

> "On a show of hands every member present shall have one vote and on a poll every member present shall have one vote for each share that the person holds in the Company. On a poll concerning the appointment or removal of directors of the Company, each member shall be entitled to as many votes as shall equal the number of votes which (except for this provision) the member would have been entitled to cast on such a poll with respect to the shares the member holds multiplied by the number of directors upon whose election a member is then entitled to vote, and the member may cast all of such votes for a single candidate or may distribute them among some or all of the candidates, as the member may see fit."

For listed companies, some amendment or waiver of Listing Rule 3K(2) may be required to implement cumulative voting.

5.5.24 The Committee considers that given the power and influence of the large institutions it is quite conceivable that they, either individually or in combination, could decide to use their voting power to alter the articles of companies to provide for cumulative voting. In this event they would then be in a position to put directors on the boards of the large companies in which they had investments. It would not be appropriate in the Committee's view to mandate such activity. Such processes were they to come about should come about as a result of decisions by those setting up new companies or shareholders amending articles of existing companies.

5.5.25 In relation to two-tier Boards while such structures have obvious attractions they are a part of the culture of company law which is very different to that in common law countries. Should the large institutions decide to employ the latent voting power they have they could bring about changes to the articles of companies to make provision for two-tier boards. The Committee however makes no recommendation on this matter.

5.6 Reforms to Existing Powers of Shareholders

The General Meeting

5.6.1 The Law Commission of New Zealand recently stated in a report on company law reform that:

- the general meeting has not historically operated to protect shareholders from directors' abuse of their powers of management, but rather has often been used as a cipher by directors to absolve themselves of responsibility; and

- there are more effective methods for the protection of shareholders from abuse of management power than the general meeting.[61]

5.6.2 The New Zealand Law Commission (NZLC) proposed a draft Companies Act which contemplates significant reforms to shareholders' rights including:

- redefinition of the distribution of power within a company by direct operation of the statute;

- a fuller restatement in the statute of the duties and powers of directors;

- recognition of additional circumstances in which the interests of existing shareholders need special protection; and

- a comprehensive system for protection of minority shareholders including:
  - dissentient right to be brought where class rights are affected;

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61 NZLC, Company Law Reform and Restatement, Report No.9, June 1989, p.48: quoted in Evidence, p.S595 (Attorney-General's Department).

- improved standing to enforce through the courts obligations owed by officers to the company or directly to shareholders.[62]

The New Zealand Draft Act therefore does not seek to protect minority shareholders by requiring more decision-making to be taken by the general meeting.

5.6.3 The NZLC report observes that there still remains the difficulty of ensuring that minority shareholders are not oppressed by a complacent or interested majority in general meeting. It comments that if more power is to be given to shareholders in general meeting elaborate rules would need to be devised to ensure that:

. shareholders have sufficient information to make informed judgments on matters referred to them; and

. interested shareholders are disqualified from voting.

The NZLC stated that the greater the role for the general meeting in management of the company, the greater the need to develop a concept of fiduciary duty owed by the majority to the minority. It stated that this was a developing area of the law which if carried too far, may undermine the concept of the share as property and may make company decision-making and enforcement of obligations procedurally complex.

5.6.4 The ASC discussed possible alterations to the power to requisition shareholder meetings given the expenses of court proceedings, shareholders often wish to seek redress of grievances through a general meeting of shareholders. According to the ASC, problems arise with the effective implementation of shareholders' rights to convene general meetings, as directors can manipulate the

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62 Evidence, pp.595-596 (Attorney-General's Department).

timing of a requisitioned meeting to suit their convenience. (This matter is discussed in more detail in Chapter 6).

Minority Shareholders Buy-out Rights

5.6.5 One of the recommendations of the New Zealand Law Commission to enhance the powers of shareholders is to confer a right of buy-out.[63] The proposed Draft Company Law confers a right on shareholders to require the company or other shareholders to purchase the shares if any shareholder is unfairly prejudiced by the conduct of the company, and also where there is an alteration of class rights or a fundamental change to the company, whether or not the company's action is unfairly prejudicial to the shareholder. This is designed to ensure that in the case of fundamental change to the nature of the enterprise and to the class rights enjoyed by the shareholder, a dissenting minority shareholder does not have inevitably to accept the decision of the majority. The shareholder will instead have the option of leaving the company.

5.6.6 The risk of the manipulation of buy-out rights by directors, for example by promoting unreasonable amendments to the articles/constitution, is protected against, by the general duties attaching to the actions of directors and by an oppression remedy similar to section 260 of the Corporations Law.

5.6.7 The proposed buy-out remedy incorporated in the New Zealand Draft Act recognises not only that there is a level of change to which it is unreasonable to require shareholders to submit, but also that in many cases the presence of a disgruntled minority shareholder will be of little benefit to the company itself. The company can apply to the court for relief where a buy-out would be unfair to it. This is designed to protect against minority oppression of the majority.

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63 NZLC Report, op.cit., pp.49-50.

Committee's Conclusions

5.6.8 The Committee notes that apart from remedies presently available to shareholders under the general law or conferred by the Corporations Law (which are discussed in the next chapter) the shareholder is limited to the traditional powers of voting to remove directors, selling their shares or using the forms of company law such as the general meeting to obtain information or to highlight actions of which he/she disapprove.

5.6.9 The question of minority shareholders buyout rights referred to in para 5.5.6 has not been debated sufficiently in Australia for the Committee to reach a final decision on the matter. However, such a right would certainly provide a control for shareholders to influence companies decision-making processes.

5.7 Unit Trusts and Other Collective Schemes: Management and Supervision

5.7.1 As mentioned earlier in this chapter of the report the ASC brought to the Committee's attention several urgent issues related to the protection of the rights of unit holders. The ASC submitted that the Committee could interpret its terms of reference broadly to emphasise the corporate practices elements and should make recommendations concerning:

- the enforcement of covenants in unit trust deeds;
- clarify the standard of conduct required for trustees and managers; and

. provide the ASC with a sound legal basis for overcoming problems in the administration of trusts in financial difficulties.[64]

5.7.2 The matter has since been addressed by the Commonwealth Government which passed legislation to amend the Corporations Law so that these concerns are met. The Committee is fully in accord with these changes and does not see any need to address the matter further.

64 Evidence, p.S788-803.

CHAPTER 6

CONTROLS NECESSARY FOR THE PROTECTION OF SHAREHOLDERS, IN PARTICULAR MINORITY SHAREHOLDERS

6.1 Remedies of Shareholders

Introduction

6.1.1 As described in the previous chapter, a number of legislative controls are available to shareholders wishing to exercise their rights. If they were effectively enforced, the controls would greatly improve shareholders' ability to take action against companies alleged to be in breach of good corporate practices.

6.1.2 Overcoming impediments which have previously prevented shareholders, particularly minority shareholders, from enforcement of their rights is a major focus of this Inquiry. Suggestions are made in this chapter to extend the rights of shareholders with regard to the management of companies.

Existing Legal Remedies Available to Shareholders.

6.1.3 If it appears that the affairs of the company are not being conducted properly, shareholders have a number of options available to them. The main option is to withdraw their investment by selling the shares. However, if they retain their shares and are prepared to resort to legal proceedings to seek a remedy, then they must choose the form which their course of action will take. The following forms of action are available under the Corporations Law:

- application under section 260 for remedy in cases of oppression or injustice in the conduct of the company's affairs;

- application under sections 460-461 for an order for the winding up of the company;

- application under section 777 for an order to enforce the ASX Listing Rules;

- application under section 1324 for an injunction, or other order in respect of conduct in contravention of the legislation;

- application under section 598 for an order against persons concerned with the corporation;

- application under section 597 for an order to examine persons concerned with the corporation;

- application under section 319 to obtain court approval to inspect company records;

- application under sections 246 and 247 to requisition a general meeting of the company;

- complaint under section 536 about the conduct of a liquidator;

- application under sections 1005 and 1013-1015 to seek compensation where a shareholder is victim of market rigging and/or insider trading;

- application under sections 995 and 1005 seeking the new general remedy for misleading or deceptive conduct;

- application under section 212 to seek rectification of the share register;

- application under sections 197, 198 and 414 to object to reductions of capital, infringements of class rights and compulsory acquisition;

- application under sections 705, 737, 739 or 740 to seek damages or other relief where the takeovers provisions of the legislation have been breached; and

- application under section 205 to oppose the company giving financial assistance in connection with its shares.[1]

6.1.4 Of the rather bewildering array of both statutory and general law rights, the statutory remedy for shareholder oppression, is the most likely to be used. Section 260 of the Corporations Law enables any shareholder to initiate action if he or she believes either:

- that affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members, or in a manner that is contrary to the interests of the members as a whole; or

- that an act or omission, or a proposed act or omission, by or on behalf of the company, or a resolution, or a proposed resolution, of a class of members, was or would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members or was or would be contrary to the interests of the members as a whole.

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1 Evidence, pp.S824-825 (Australian Securities Commission); CSLRC, 'Enforcement of the Duties of Directors and Officers of a Company by Means of a Statutory Derivative Action,' Companies and Securities Bulletin, August 1990.

6.1.5 The Committee was told that any breach of the fiduciary duty or good faith, and a number of other practices, would fall within the scope of this very general remedy.[2]

6.2 Effectiveness of the Existing Remedies

Costs of Litigation

6.2.1 As noted throughout the report numerous submissions, particularly those from private citizens, confirmed that some shareholders are less than satisfied with the standard of company management, and that they are frustrated by their limited ability to take action to protect their interests and gain redress from alleged abuses.[3]

6.2.2 The Committee received a considerable amount of evidence about the cost of litigation which effectively prevents shareholders from pursuing the legal remedies open to them. While the available legal remedies are numerous there has been reluctance by shareholders "to take effective action... (because) the costs of them doing so are very great indeed."[4]

6.2.3 The ASC submitted that:

> "the high cost of litigation means that either members' rights can only be vindicated by shareholders with sufficient resources to bear the cost, at least on an initial basis or that some element of funding must be provided."[5]

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2 Evidence, p.750 (Australian Securities Commission).
3 See generally, Vol. 6 of the Submissions to the inquiry.
4 Evidence, p.S60-61 (Life Insurance Federation of Australia).
5 Evidence, p.S828 (Australian Securities Commission).

6.2.4 Other factors which inhibit court action by shareholders are the risk of liability to pay the cost of the other side if unsuccessful and the obligation to give undertakings as to damages where interlocutory injunctions are obtained.[6]

Standing to Institute Proceedings

6.2.5 There is conflict between the traditional approach of the Courts that management needs to be protected against unreasonable interruption of its functions, and that in some circumstances litigation may be actuated by nothing more than the strategic imperatives of a hostile minority or a disgruntled shareholder.[7] The other view is that where directors are themselves the wrongdoers their control of the board requires that "some means must be found for the company to sue. The law, otherwise, would fail in its purpose. Injustice would be done without redress."[8] This difficulty of a shareholder obtaining standing to sue on behalf of a company leads to a consideration of the law regarding derivative actions in paras 6.3.1-6.3.14.

Other Problems with Existing Remedies

6.2.6 In its submission the Northern Territory Government stated that the effectiveness of some of the controls imposed for the protection of shareholders, and the practical value of many of the rights and privileges conferred on shareholders, are greatly diminished in the situation of a company being controlled by a majority shareholder and the directors of the company being associated with that majority shareholder. In this event it is highly unlikely that the company, as long as the directors retain a majority of the companies voting rights, will institute legal proceedings against the director.

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6 ibid.

7 CSLRC, Enforcement of the Duties of Directors and Officers of a Company by Means of a Statutory Derivative Action, Discussion Paper No. 11, August 1990, para 38.

8 Wallersteiner v Moir (No.2) (1957) 1 QB 373 to 390.

6.2.7 The company will ordinarily only commence legal proceedings against the directors for breach of their statutory or common law duties in the event that the company goes into liquidation or the director accused of breach of duty loses control of the company.[9]

6.2.8 Furthermore, it was pointed out that inadequate disclosure rules in the past have meant that remedies such as the shareholders derivative action for fraud on the minority and the statutory remedies of winding up the company or seeking relief for oppressive of unfairly prejudicial behaviour rely on the bringing of action and litigation after the event when it is often too late to recover.

6.3 Extending Shareholders Rights

Derivative Action

6.3.1 In addition to the various statutory remedies mentioned above, a member can sue in respect of a wrong done to the company, as a representative of the other shareholders, pursuing the remedy (derivative action) under the exceptions to what is often known as the rule in Foss v Harbottle.[10]

6.3.2 The rule in Foss v Harbottle is a composite of two principles:

- ... the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so (the 'internal management' principle); and

- ... in order to redress a wrong done to the company, or to recover monies or damages alleged to be due to the company, the action should

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9 Evidence, p.S901.
10 (1843), 2 Hare 461, 67 ER 189.

prima facie be brought by the company itself (the 'proper plaintiff' principle).[11]

A number of exceptions to the rule exist (ultra vires, fraud on the minority, special majorities and personal rights).

6.3.3 Generally speaking the prima facie effect of the rule and its exceptions is:

> "That the company is the only party allowed to sue in respect of a wrong done to it, so long as the wrong is one which a simple majority of shareholders in general meeting has authority to ratify."[12]

6.3.4 It is only under an exception to the rule in Foss v Harbottle that a member is 'entitled to be indemnified by the company against all costs and expenses reasonable incurred by him in the course of the agency' even if the action is unsuccessful.[13]

6.3.5 The scope of the exceptions to the rule in Foss v Harbottle is unclear. For instance, it is unclear whether or not there is a general exception enabling a member to bring a 'derivative action' where the company cannot or will not bring or continue an action, where it is in the interests of justice that the action be brought or continued.[14] There is also uncertainty as to the availability of remedies under the Corporations Law once the right to bring the derivative action has been established. While on a certain view sections 1324 and 232 of the Corporations Law provide standing to any member in respect of a breach of directors duties, on a different view it could be held that there was no intention discernible from the Law

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11 G.P. Stapledon, 'Locus Standi of Shareholders to Enforce the Duty of Company Directors to Exercise the Share Issue Power for Proper Purposes,' Companies and Securities Law Journal, Vol. 8, No.4, 1990, p.213.

12 Stapledon, op.cit., p.216.

13 Wallersteiner v Moir (No.2) (1975) 1 QB 373, p.391-392.

14 Scarel Pty Limited v City Loans and Credit Corporation Pty Limited (1987-88) 12 ACLR 730 p.733-736.

to abolish the limitations on standing arising from the rule in Foss v Harbottle, so that those rules still apply.[15]

6.3.6 Therefore, it is not entirely clear that section 1324 of the Corporations Law completely overcomes the difficulties facing minority shareholders who wish to seek remedies for breaches of directors duties.

6.3.7 A clearer statutory right to bring action applies where a Court order is first obtained under para 260(2)(g) of the Corporations Law. However to obtain such an order it is necessary first to establish oppression, an act or omission contrary to the interests of the members as whole, or some other ground for relief under sub-section 260(2). Therefore, to obtain the right to pursue the directors the shareholder must virtually prove the entire case. As the initial proceedings could raise complex issues there might be substantial delay in instituting proceeding with consequent cost implications.

6.3.8 There is widespread consensus that due to the restrictive nature of the rule in Foss v Harbottle, existing law does not provide adequate means for the enforcement of the duties of directors and officers where the company improperly refuses or fails to take action.[16] The main proposal to improve the ability of shareholders to take proceedings to enforce their rights is to implement a form of statutory derivative action. A model under consideration is the law in force in Ontario, Canada. The Companies and Securities Law Review Committee prepared a discussion paper advocating reform along these lines.[17] The proposal has received support in evidence to the Committee from the Law Council of Australia, the Business Council of Australia and the Australian Securities Commission.[18]

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15 Evidence, p.S828 (Australian Securities Commission).
16 CSLRC, Discussion Paper No.11, op.cit., p.2.
17 ibid.
18 Evidence, p.457, Canberra, 10 October 1990.
Evidence, p.S469.
Evidence, p.S830.

6.3.9 In a submission to the Inquiry the Companies and Securities Advisory Committee of the Law Council of Australia stated that it would be incorrect to exaggerate the inadequacies of the substantiative law relating to derivative actions. Avenues do exist under existing law for the disgruntled member to take derivative proceedings under the existing exceptions to the rule in Foss v Harbottle and the provisions of the Corporations Law.

6.3.10 This appears particularly to be the case where the member can show that he/she has suffered a personal wrong as well as a wrong to the company. It added that in many cases it will be difficult, if not impossible, for a member to show that a breach of duty to the company has adversely affected his personal right. To that extent the substantiative law remains less than adequate.

6.3.11 The Company and Securities Advisory Committee of the Law Council stressed however, that the real barriers to a derivative action are the practical ones of lack of resources and lack of access to information. It submitted:

> "What is desirable in our view, is a comprehensive new provisions of the Code [now Corporation Law] along the lines of Section 245 of the Ontario Business Corporations Act 1982 which addresses these practical issues in addition to providing a wide range of interested persons with standing to seek leave of the court to commence proceedings."[19]

6.3.12 The Business Council of Australia in its submission to the Inquiry stated that:

> "If a shareholder has been wronged by the directors through a directors breach of duty then it is the company and/or the directors which should be ultimately responsible for the legal costs. The use of derivative actions on the Ontario model should be given closer consideration."[20]

6.3.13 Under the Ontario provision, shareholders and former shareholders, directors or officers or former directors or officers have standing as of right. The

[19]Evidence, pp.S296-313.
[20]Evidence, p.S446.

court must grant leave to other "interested parties" (who in the discretion of the court,is a proper person to make an application under this part).

6.3.14 The complainant must give 14 days notice of an intention to apply for leave to the directors of the corporation (ex party applications are only allowed in cases of extreme urgency) and the Court must be satisfied that

- the directors of the corporation or its subsidiary will not bring, diligently prosecute, defend or discontinue the action;

- the complainant is acting in good faith; and

- it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued

6.3.15 The leave once granted is to bring an action in the name or on behalf of the corporation or any of its subsidiaries, or intervene in an action to which any such body corporate is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate.

6.3.16 The Companies Advisory Committee of the Law Council of Australia submitted that, in considering such a remedy, there is a clear need to protect directors and officers of companies from unreasonable interruption of their day to day affairs. Moreover, the Committee is of the view that it is essential to ensure that directors and others are adequately protected against unmeritorious litigation. In this regard it has noted the potential of the derivative action to become a device in forensic strategy. For these reasons the Committee believes that, initially, standing to bring proceedings should be restricted to shareholders, former shareholders, directors and company officers or former directors and company

officers. The Committee is not prepared at this stage to recommend that creditors and other interested parties have access to the procedure.

6.3.17 The Law Council submitted that there should thus be adequate notice to the company of the intention to apply for leave (the law Council proposed 14 days), and that while the onus of proof should not be so heavy that an applicant would be disadvantaged as a result of not having full access to company information, he/she should at least have to establish an arguable case that the breach complained of had occurred.

6.3.18 In Ontario the onus of proof is on the applicant to bring before the Court more than a mere suspicion to warrant the granting of leave. The onus is also on the applicant to satisfy the Court that the intended action is in the interests of the company and its shareholders. The supporting affidavit should at least indicate that there has been some improper conduct on the part of the directors. The applicant is not required to prove his case on the application. He must, however, show that the intended case is not without merit.[21]

6.3.19 A feature of the Ontario procedure is the discretion available to the Court to grant an indemnity for cost in certain circumstances. The availability of such a procedure removes a major constraint inhibiting share holders who currently seek to take derivative actions: the high costs of proceeding. This deterrent is exacerbated in some jurisdictions by the requirement for the applicant to give security for costs before the action will be entertained.

6.3.20 The Committee is also of the view that the provision of such an indemnity should be very strictly supervised if misuse is to be avoided. The Law Council was of the view that where the court decided not to grant such an indemnity,the court should be given a discretion to require an applicant to give security for costs.[22]

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[21]op cit, p.464.
[22]Evidence, p.S304.

The Committee agrees that this would serve as a deterrent to the bringing of unmeritorious proceedings.

6.3.21 The Law Council was also of the view that the discretion to grant an indemnity ought not to be exercised lightly. In Ontario the court can "make an order requiring the Corporation ... to pay reasonable legal fees and any other costs reasonably incurred by the complainant in connection with the action" (section 246(d) Ontario Business Corporation Act). Whether the indemnity is granted depends on the particular case. The complainants financial capacity is the major factor but is not decisive; a capacity to bring the action does not necessarily deprive the complainant of an indemnity.[23]

6.3.22 The Law Council submitted that:

> "Any indemnity should cover the applicants own costs and the costs of the defendant directors in the event that the action was unsuccessful. The indemnity would run until judgment but be capable of being revoked at any stage of the proceedings, on the application of the company or any member or of the Court's own motion."

6.3.23 The Law Council further submitted that the Court should be empowered as it is in Ontario, to order the company to pay to the applicant interim costs, upon condition that, if the action is ultimately unsuccessful, the Court may order the applicant to repay some or all of these costs to the company.

6.3.24 The Law Council regarded it as very important that the discretion of the Court in regard to the award of costs be affirmed in the legislation itself. This was to ensure that worthy applications were not frustrated for want of support and to avoid abuse of the procedure. It was its view that the viability of this remedy was closely tied to the ability of any complainant to get access to information. This is dealt with in the next section.

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[23]Ibid, Turner v Mailhot (1985), 28 DLR 222, p.S304.

6.3.25 Regarding the conduct of the action the Committee was told that in the USA and in Canada the action is managed by the applicant and his solicitor under the supervision of the Court. The Court should retain control over the settlement or discontinuance of any derivative proceedings. Court leave should be necessary,and the Court should have a wide discretion, as in Ontario, to grant leave for any settlement or discontinuance on such terms as it sees fit.

6.3.26 The Law Council commented that such a restriction is necessary to prevent unmeritorious proceedings from being commenced with a view to a favourable settlement for the complainant rather than to enforce a duty owed to the company for the benefit of all persons affected by the conduct.

6.3.27 The Law Council also submitted that the Court should not be empowered to make orders for the removal of directors or officers of the company prior to the adjudication of the derivative proceedings. But it should be empowered to make such interlocutory orders that can be made now, restraining the relevant directors or officers from engaging in clearly specified conduct detrimental to the interests of the company.

6.3.28 In Ontario the Court can order at the conclusion of proceedings that any damages be payable to the applicant or any other person. Where an applicant has been indemnified for costs the court can order that the damages be used to pay the applicants costs rather than that resort be had to the general funds of the company for that purpose.

6.3.29 The provision as drafted by the CSLRC does not provide as is provided in Ontario for the Court to order a shareholders meeting to ascertain whether it is the wish of the body of shareholders to support a proposed derivative action. The Committee believes that this is an important qualification to the availability of the derivative action and the Court should have a discretion to convene such a meeting in appropriate circumstances.

Committee's Conclusions

6.3.30 The Committee is persuaded that a statutory derivative action along the lines of that in force under the Ontario Business Corporations Act should be introduced. However, it should not be as extensive as has bee proposed by the CSLRC in its report no 12. While there might be various legitimate concerns about the introduction of such a measure the Committee was persuaded that the legislation if properly drafted and administered could avoid many of the possible pitt- falls. It was necessary to avoid the following:

- the use of the procedure as part of a forensic strategy;

- that the procedure makes directors so vulnerable to suit that able people won't take up positions as directors and could only get liability insurance on usurious terms or even that such insurance might become unprocurable;

- that complainants could pursue actions on such tendentious grounds that companies and their directors and officers are exposed to undeserved financial damage and damage to their reputations;

- that proceedings proliferate because of the ability of complainants to get indemnified at the expense of the company;

- that use of the procedure further exacerbate the congestion of the court lists;

- that directors and company officers might not be properly indemnified under the present provisions of the Corporations Law where they successfully defend derivative actions;

- that the procedure should provide for the consultation of the body of shareholders regarding derivative actions brought in the name of the company as a whole.

6.3.31 Provided these various concerns are met the Committee believes that the Statutory derivative action will become a valuable addition to the corporate armoury.

6.3.32 The CSLRC, in its Report No. 12 released in November 1990, recommended the enactment of its draft new section which would become section 260A of the Corporations Law. The new provision would radically alter the existing law concerning standing to challenge the directors decisions, and effectively abolish the rule in Foss v Harbottle.

RECOMMENDATION 26

6.3.33 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.

Access to Company Documents

6.3.34 Section 319 of the Corporations Law provides for a member of a company who suspects that its affairs have not been properly administered to obtain access to the records of the company. Such access can only be obtained pursuant to an order of the court and is not granted to the applicant personally but to a registered company, auditor or duly qualified legal practitioner on the applicant shareholders behalf. The court is required to be satisfied in respect of the application that 'the member is acting in good faith and the inspection is to be made for a proper purpose.'

6.3.35 The CSLRC considered that section 319 was valuable and that its availability and application should be extended by its amendment so that:

- any of the persons who could apply for leave to bring derivative proceedings would be eligible to apply under section 319;

- persons applying under section 319 who were not shareholders would be required to satisfy the Court that the predominant reason for the application is their reasonable apprehension that the company has a right of action which will not be vindicated unless they act on the company's behalf by applying to bring derivative proceedings;

- in addition to auditors and legal practitioners, an inspection of books of a company can also be made by any other person who in the opinion of the Court is a proper person to undertake the inspection;

- it would expressly provide that the Court's discretion extends to authorising inspection of the records of boards of directors and of any person to whom the board delegates a function of the board; and

- it would expressly provide that the Court's discretion extends to authorising inspection of the records of any corporation which is related to the company.[24]

6.3.36 Section 319 has also been considered by the New Zealand Law Commission for the purposes of its report on a Draft Code of Company Law.[25] The NZLC used the Australian section 319 as a model for its proposal for access to company books and records. It recommended a measure whereby an application for

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[24] CSLRC, Enforcement of the Duties of Directors and Officers of a Company by means of a Statutory Derivative Action, Report No.12, November 1990.

[25] NZLC, Company Law Reform and Restatement, Report No. 9, Wellington, June 1989.

inspection could be made by a shareholder, a creditor or a law officer of the crown when the court would be able to make an order for a 'suitable person' to inspect.

6.3.37 The ASC and the Companies Sub-committee of the Law Council of Australia support the extensions of the provision.[26] These bodies favour an extension to give the court wide discretion and consider that a 'suitable person' test should apply.

6.3.38 The Company Law Sub-committee of the Law Council submitted that in preparing the application for leave the persons with standing to seek leave should have access to a remedy similar to pre-trial interrogatories. It considered that this objective could be achieved by amending section 319 to make it applicable and available for the purposes of the derivative action.[27]

6.3.39 Mr McComas of County NatWest submitted in relation to his proposal for the Listing Rules to require greater disclosure by listed companies, that shareholders should have an extensive right to seek and be provided with information.[28] This would presumably be achieved by the listing rules requiring that listed companies and companies seeking listing, be required to provide in their articles of association that shareholders have such rights.

Committee's Conclusions

6.3.40 If a statutory derivative action by leave were introduced as is proposed by the Committee in paragraphs 6.3.14 of this report it may well be that the applicant would need, in advance of the application, to obtain access to the books in aid of an application for leave to proceed.

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26 Evidence, p.S812 and evidence, p.S289.
27 Evidence, p.S290.
28 Evidence, p.S209.

6.3.41 The Committee believes that section 319 is too restrictive limiting access to auditors and lawyers as the sole agents of the applicant. The section should 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.

6.3.42 The Committee is also of the view that a person with standing to seek leave to proceed on behalf of the company, should be able to invoke section 319 in preparation for the application for leave to pursue the derivative action.

RECOMMENDATION 27

6.3.43 **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.**

Power to Requisition Shareholders Meetings

6.3.44 As has been noted, one of the principal powers of control over management that shareholders can exert is the power to convene general meetings of the company. Under section 246 of the Corporations Law, shareholders have a statutory right to requisition the calling of a meeting and that statutory right cannot be excluded by the articles. The power to requisition is exercisable by 100 members or a member who is entitled or members who are together entitled to 5% of the total voting rights of all members entitled to vote at General Meetings. Section 247 gives a direct power to shareholders holding at least 5% of the capital of the company to convene a meeting. However, this is a power that can be excluded by the articles.

6.3.45 Section 227 confers a power on a meeting of shareholders to remove a director before the end of a directors period of office. It applies notwithstanding

anything to the contrary in the companies articles. It contains requirements to ensure natural justice to any director so impugned. Thus, special notice is required which must be sent to the director who is entitled to be heard on the resolution at the meeting. It is also provided that the director can, under 227(5), make representation in writing concerning the resolution which the requisitioners must circulate.

6.3.46 If the requisition for a meeting is lodged under section 246, the directors must respond to it within 21 days. The power to convene the meeting otherwise passes immediately to the requisitioning shareholders, who can recover the costs of convening the meeting from the directors, personally. For this reason it is rare for the directors to fail to respond to a requisition within the 21 day statutory period.

6.3.47 It was drawn to the Committee's attention that despite this provision, directors can sometimes manipulate the timing of the meeting to their own advantage. This can happen because under sub-section 246(1) which requires the directors to convene the meeting as soon "as practicable, but at any rate not later than 2 months after the date of the deposit of the requisition", it has been possible in some cases for some directors to exploit the interpretation of the expression "as soon as practicable". This is because the expression is not interpreted by the courts to mean, necessarily, as soon as possible or in the least possible time, but on what is practicable for the directors exercising their management power.[29] This means that there is at least the potentiality for directors to postpone compliance legally to a time later than the 28 day statutory limit.

6.3.48 The Committee believes that it is desirable to clarify the situation, but so as to ensure that where the power to convene the meeting passes to the requisitioners under section 246 and the meeting has been convened to remove a director under section 227 that the director so impugned loses none of the rights

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[29] Vision Limited v Pangea Resources Limited, (1988) 13 ACLR 529 at 539.

available to him/her under the Corporations Law. With this proviso the Committee recommends that:

RECOMMENDATION 28

6.3.49 ***The Committee recommends that the ability of shareholders to force the timely convening of a meeting of shareholders be enhanced by 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.**

6.4 The Powers of the Australian Securities Commission

Suggestions for Improvement

Representative Actions

6.4.1 The Australian Securities Commission Act 1989 provides an extensive range of new powers to the national regulatory body. Under section 50 of the ASC Act the Commission can initiate court action to seek remedies for other parties. Comparable powers were previously exercisable only as a result of special investigations. For instance, where, following an investigation, the ASC believes a company should pursue a negligent director for compensation for breach of duty under section 232(8) of the Corporations Law, which will have the power to do so under section 50 of the ASC Act, without the consent of the Board of which the defendant was a member.

6.4.2 The ASC can seek orders under section 230 of the Corporations Law excluding directors from participating in the management of any corporation where a breach of duty on that person part has been established.

Enforcement Powers of the ASC

6.4.3 The ASC's power to bring criminal proceedings derives from section 1315 of the Corporations Law. However, for all but minor regulation prosecutions the Commonwealth Director of Public Prosecutions is the prosecuting authority and will conduct cases pursuant to its published prosecution policy. Offences against the Corporations Law are treated as breaches of a nationally operating criminal law. The Corporations Law also confers powers on the ASC to bring civil action to prevent breaches of the legislation, and to recover damages. The power to seek an injunction in section 1324 is important in this connection. The provisions of the previous Companies Code have been extended to include a power to seek injunctions against aiders and abettors and those knowingly concerned in offences.

6.4.4 Section 1323 allows the ASC to seek the appointment of a receiver to a company to protect the rights of shareholders on an interim basis where an investigation prosecution or civil proceeding under the Corporations Law has been instituted. The recent amendments to the Act extends this power to seek the appointment of a receiver to trust property.

6.4.5 The ASC can seek awards of damages and compensation under sections 1324 and 1325. The power in section 1325 extends beyond that in the superseded legislation to cover situations like those covered by section 87 of the Trade Practices Act. Sub-section 1325(3) empowers the ASC to seek orders for compensation to consenting parties who have suffered loss because of breaches of the legislation concerning market trading, prospectuses and prescribed interests, even though they are not party to the proceedings. This means that damages can be recovered on their behalf without their necessarily having to be joined as parties to proceedings. Such parties will thus be able to avoid the legal expenses and other risks attendant

on taking proceedings on their own behalf. The ASC will also be able to proceed under section 593 against a company officer who has incurred debts knowing that the company was insolvent. The ASC can also apply under section 598 for a wide range of orders where a person has been guilty of a breach of duty to a company and the company has suffered or is likely to suffer loss as a result of that breach.

Investigative powers

6.4.6 Under the new arrangements the Commonwealth Attorney-General can direct an investigation in any jurisdiction pursuant to section 14 of the ASC Act on the grounds of public interest. The powers exercisable during an investigation, such as the right to require examination on oath under section 19 and the right to make and publish interim and final reports under sections 16, 17 and 18, are the same, whether the investigation is initiated by the Minister or by the ASC on its own initiative.

6.4.7 Provided that the power is not exercised to exhort confessions or admissions of guilt in derogation of an accused persons right to silence, the ASC will have the power to commence an investigation even after criminal proceedings have begun: see Hamilton v Oades.[30] Recent amendments to the ASC Act clarify the right of the ASC to exercise the powers of the NCSC and continue NCSC investigations.[31]

6.4.8 The ASC is concerned that section 13 of the ASC Act confers investigative powers solely in connection with 'contraventions,' that is criminal offences. Nor does the investigative power extend to investigations of the affairs of unit trusts. The ASC does not have a general mandate to investigate issues of oppression. The ASC submits that its investigative mandate should extend to civil matters and also to investigations and issues raised in relation to unit trusts if its mandate is to be comprehensive.

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30 (1989) 15 ACLR 123.
31 Corporations Legislation Amendment Act 1991.

6.4.9 The ASC also believes that it is important to put beyond doubt its ability to proceed where there has been a breach of directors fiduciary duties. It is satisfied that it has such powers where there is a breach of the criminal law involved. However, having regard to the importance it attaches to the bringing of civil proceedings for breach of directors duties, the ASC considers that its powers of investigation in civil actions should be put beyond doubt.

Committee's Conclusions

6.4.10 The ASC brought to the attention of the Committee certain areas where it considered its enforcement powers under the Corporations Law to be deficient. Under the Corporations Act the investigative and enforcement powers of the ASC have been greatly improved from those that prevailed under the co-operative scheme. The Committee notes that Australian Securities Commission Act 1989 rationalises the maze of diverse investigative powers contained in the co operative scheme legislation. Under the previous scheme the various investigative powers were scattered throughout the various acts that together constituted the legislation.

6.4.11 The Committee agrees that several amendments are necessary to improve the power of the ASC to take effective action in relation to breaches of the law not amounting to crimes.

RECOMMENDATION 29

6.4.12 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.

Greater Use of Civil Rather than Criminal Penalties

6.4.13 The Senate Legal and Constitutional Affairs Committee in its report suggested the partial decriminalisation of provisions of the Corporations Law based on the fiduciary duties of directors (section 232).[32] The South Australian Full Court decision in the Australian Growth Resources Corporation case[33] had held that *criminal sanctions are available for any breach of the general law fiduciary duty* under sub section 232 (2)because "the section... embodies a concept analogous to constructive fraud, a species of dishonesty that does not involve moral turpitude."[34] The ASC observed that the result of the universal imposition of criminal sanctions in this areas has the effect of making courts hesitant about reaching adverse findings against directors.[35]

6.4.14 It would be more appropriate in the view of the ASC if the standard of criminal liability was limited to situations where the officer in question acted "in deliberate or reckless disregard of his or her duties."[36]

6.4.15 Such decriminalisation is also in line with the strongly held conviction of the ASC that much greater emphasis should be placed on the use of administrative action and civil litigation to prevent harm to investors and to recover assets. The Senate Committee Report recommended that section 232 of the Corporations Law be amended so that criminal liability under that section only applies where conduct is genuinely criminal in nature.[37] It noted evidence to the effect that the problem with section 232 was that it was cast in terms of negligence. Criminal conduct should have a subjective element and this should be made clear. The ASC stressed the decriminalisation of company law. The cost and delays involved in mounting prosecutions is much greater than with civil proceedings with much greater

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32 Senate Standing Committee, op.cit., paras 4.70-4.71.
33 Australian Growth Resources Corporation Pty Limited v Van Reesema (1988) 13 ACLR 261.
34 Evidence, p.S770 (Australian Securities Commission).
35 ibid.
36 ibid.
37 Senate Standing Committee, op.cit., paras 13.5-13.15.

uncertainty of outcome because of the criminal onus of proof to be satisfied, and the ability of the defence to take procedural points. Civil remedies mean that it is not the Crown alone that needs to proceed with consequential saving of public funds. It also means that the ASC could intervene where appropriate with financial support or by taking over actions commenced by others.

6.4.16 One of the reasons for the ASC's support of the statutory derivative action, is that its introduction would greatly increase the scope for private enforcement actions. Its availability would take some of the pressure off the ASC which would have more resources available to pursue the matters having the maximum overall public benefit.

Committee's Conclusions

There are numerous provisions in the Corporations Law which create criminal liability. Many should remain as criminal provisions. Some create both criminal and civil liability in the one section. Section 592 is an example of this and the Committee's recommendation is designed to separate the criminal aspects from the civil and put it into a separate provision. In this way two things can be achieved:

- a court will be more ready to find civil liability proven; and

- criminal liability provisions can be reserved for situations which are genuinely criminal in nature, elements of fraud, dishonesty or deception should be a guide for criminal provisions in the Corporations Law.

The combining of civil and criminal liability in section 232 for breach of directors duties is the most significant provision where this reform is needed.

RECOMMENDATION 30

6.4.17 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.**

Use of Evidence Obtained in an Investigation

6.4.18 The ASC suggested the deletion of section 68(3) of the ASC Act, which excludes from use in evidence material obtained in an investigation, where a right to immunity on grounds of self incrimination has been claimed. It submitted that the exclusion contained therein is far wider than comparable exclusions in the superseded legislation. The Commission suggested its use could render ineffective many of the improved investigative powers because it will limit their follow through in enforcement proceedings.[38]

6.4.19 In support of this suggestion the ASC stated:

> "... if the provision is not amended, ASC enforcement strategies may often require it to minimise the risk to a

[38] Evidence, p.S842.

> subsequent prosecution case of finding that key evidence is rendered inadmissible, by the 'use-indemnity-use' extension of the privilege against self incrimination. This will often make it necessary to conduct investigations along traditional lines by assembling as much evidence as possible before using compulsory powers against potential defendants."[39]

6.4.20 There is a need in complex corporate law cases to interview professionals associated with the offence such as accountants and lawyers who may themselves have acted as accessories in the offence and who should be prosecuted as such. At present, it was contended, such follow-up action is not possible because of section 68(3). The approach required by the section provides a strong disincentive to the use of compulsory powers to gather evidence.[40]

6.4.21 To accede to the proposal would, in the Committee's view, do away with a protection which is part of the common law right of privilege against self-incrimination.[41] It notes that the privilege against self-incrimination is constitutionally guaranteed in the USA and yet does not seem to have impeded the effective investigation and enforcement action of the United States Securities and Exchange Commission. The Committee has not been persuaded that the proposal of the ASC is justified.

MICHAEL LAVARCH, MP
Chair
November 1991

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39 ibid.
40 ibid.
41 see Sorby v Commonwealth (1983), 152 CLR 281.

ADDENDUM

DISSENT IN ACCORDANCE WITH STANDING ORDER 343

RESERVATION

by

Mr W Smith, MP, Mr A Cadman, MP, Mr P Costello, MP,
Mr M Ronaldson, MP, and Rt Hon I Sinclair, MP

We have reservations about that part of Recommendation 26 empowering **former** shareholders and **former** directors to have standing to bring a statutory derivative action.

It is feasible that a former shareholder will be interested in such proceedings if, for example, he was a shareholder at the time a wrong was committed to the company. If he has subsequently disposed of those shares they may have been disposed of at a price lower than would have been the case had the wrong been pursued on behalf of the company.

But the recommendation as made by the majority requires no connection to be shown between a former shareholding and the wrong complained of. There is no requirement that the shareholding and the wrong be contemporaneous. Even if there were such a requirement it is unclear how a former shareholder would profit from a successful action by the company. In such circumstances it is in our opinion too broad to recommend that such a person be able to take action on behalf of the company without further qualification and specification.

It may be said that the Court has a discretion to grant an application to bring a suit on behalf of the company and would take contemporaneity into account in determining whether to grant the application. If this is intended, in our opinion this should be made clear in the proposed sub-section (5) of S320A as recommended in CSLRC report No.12. The question for determination by the Court should be whether the corporation has been wrongly injured and who is the most appropriate person to enforce the corporation's right of action. In determining this second question the Court should have regard to whether the person proposing to take the action has a material interest.

Either the legislation should require that the interest be material by restricting applicants to current shareholders or directors or if the wider class of former shareholders or directors are permitted to apply, their material interest in the outcome of the suit should be a matter to be taken into account by the Court in determining whether to grant leave to them to bring an action on behalf of the company.

Warwick Smith, MP

Alan Cadman, MP

Peter Costello, MP

Michael Ronaldson, MP

Ian Sinclair, MP

November 1991

APPENDIX A

SUBMISSIONS

1.	Professor R Baxt Chairman Trade Practices Commission Belconnen, ACT	15/2/90
2.	Mr P Meeking Federal President Australian Institute of Valuers and Land Administrators Inc. Deakin, ACT	19/7/90
3.	Mr D A Purchase Life Insurance Federation of Australia Incorporated Melbourne, VIC	23/7/90
4.	Mr N F Burch Secretary Shareholders Action Group Hobart, TAS	15/2/90
5.	Mrs R Allan Managing Director The Securities Institute of Australia Sydney, NSW	28/2/90
6.	Mr K W Eastwood President Australian Society of Certified Practising Accountants Melbourne, VIC and Mr G P Allen President The Institute of Chartered Accountants in Australia Sydney, NSW	31/7/90

7.	Mr R G Walker Chairman Australian Shareholders' Association Sydney, NSW	24/8/89
8.	Mr R L Coppel Deputy Group Managing Director Australian Stock Exchange Ltd Sydney, NSW	22/8/90
9.	Ernst and Young Chartered Accountants Sydney, NSW	22/2/90
10.	Mr M J McComas Director County NatWest Sydney, NSW	12/7/90
11.	Ms L Sylvan Manager Policy and Public Affairs Department Australian Consumers' Association Marrickville, NSW	7/2/90
12.	Mr R S Lynn National Audit Partner Coopers and Lybrand Sydney, NSW	3/1/90
13.	Mr B J Watson Director Grant Samuel and Associates Sydney, NSW	6/6/90
14.	Mr B Weeks Director Assisting the Chief Executive ANZ Banking Group Ltd Melbourne, VIC	23/2/90
15.	Mr J A Wilson Secretary Westpac Banking Corporation Sydney, NSW	9/7/90

16.	Messrs T Rumble and M Chiba Business Law Committee Young Lawyers Section Law Society of NSW Sydney, NSW	16/2/90
17.	Mr P G Levy Companies Committee Business Law Section Law Council of Australia Canberra, ACT	4/10/90
18.	Mr T E Bostock C/- Mallesons Stephen Jacques Melbourne, VIC	5/9/90
19.	Mr P H Davies Managing Director Economic Research Pty Ltd Sydney, NSW	6/6/90
20.	Ms C V Currie Managing Director Cencaz Pty Ltd Mosman, NSW	a) 11/9/90 b) 19/10/90
21.	Mr A K Smith Sydney, NSW	16/2/90
22.	Mr W E Kable Legal Counsel Metal Manufactures Ltd Sydney, NSW	22/6/90
23.	Mr C Speed Assistant Director Business Council of Australia Civic Square, ACT	8/10/90
24.	Mr B O'Callaghan Senior Assistant Secretary Companies and Securities Branch Business Affairs Division Attorney-General's Department Barton, ACT	20/7/90

25.	Mr J M Green Freehill Hollingdale and Page Sydney, NSW	a) 3/9/90 b) 6/11/90
26(a).	Mr K M Eastwood President Australian Society of Certified Practising Accountants Melbourne, VIC and Mr N Burton Taylor President The Institute of Chartered Accountants in Australia Sydney, NSW	2/11/90
26(b).	Mr N Burton Taylor President The Institute of Chartered Accountants in Australia Sydney, NSW	7/11/90
27.	Mr A Hartnell Chairman Australian Securities Commission Sydney, NSW	4/12/90
28.	Mr E S Magner and Ms J Tolmie Faculty of Law University of Sydney Kensington, NSW	15/2/90
29.	Mr Daryl W Manzie Attorney-General Northern Territory Government Darwin, NT	15/2/90
30.	Mr P R McCarthy Director Wilson HTM Ltd Brisbane, QLD	20/2/90
31.	Mr P Little Senior Lecturer in Business Law School of Accountancy Qld University of Technology Brisbane, QLD	21/2/90

32.	Mr I Macleod Managing Director St Cloud Ltd Helensvale, QLD	5/6/90
33.	Mr S Turnbull Principal MAI Services Pty Ltd Sydney, NSW	27/6/90
34.	Ms L E Partridge and Fr A Gilbert Redcliffe, QLD	a) 30/6/90 b) 30/7/90
35.	Mr T Hadden Faculty of Law Queens University Belfast, NORTHERN IRELAND	6/7/90
36.	Ms R Carroll Department of Management The University of Western Australia Nedlands, WA	12/7/90
37.	Mr R Coppel Deputy Group Managing Director Australian Stock Exchange Ltd Sydney, NSW	31/8/90
38.	Mr L Masel Melbourne, VIC	6/9/90
39.	Mr G L Hughes Acting President Law Institute of Victoria Melbourne, VIC	24/10/90
40.	CONFIDENTIAL SUBMISSION	26/8/89
41.	CONFIDENTIAL SUBMISSION	14/8/89
42.	Mr J Tucker Geelong West, VIC	16/11/89
43.	Mr P Baxter Healesville, VIC	15/11/89
44.	Mr N L Picking Alexandra Hills, QLD	22/11/89

45.	Ms C Bennett Surrey Hills, VIC	28/11/89
46.	Mr C E Tompson Surrey Hills, VIC	29/11/89
47.	Dr G V T Ranzetta Karratha, WA	4/12/89
48.	Mrs B Bond Rosanna, VIC	27/11/89
49.	Mr C E Tompson Surrey Hills, VIC	9/12/89
50.	CONFIDENTIAL SUBMISSION	27/10/89
51.	Mr I J Kendle Mirrabooka, WA	14/1/90
52.	G & H Wilson Booragoon, WA	8/2/90
53.	CONFIDENTIAL SUBMISSION	15/2/90
54.	A Cane Kingscote, SA	25/5/90
55.	G S & H L Dodson Rosny Point, TAS	14/4/90
56.	CONFIDENTIAL SUBMISSION	23/5/90
57.	CONFIDENTIAL SUBMISSION	18/6/90
58.	Mr K Waters Sorrento, WA	10/6/90
59.	Mrs N Edson Narromine, NSW	19/6/90
60.	CONFIDENTIAL SUBMISSION	3/7/90
61.	CONFIDENTIAL SUBMISSION	30/5/90
62.	CONFIDENTIAL SUBMISSION	25/6/90

63.	J R Spender Caloundra, QLD	5/6/90
64.	Mr R Gardini Manuka, ACT	13/9/90 14/11/90
65.	C K Bayliss Umina, NSW	14/6/90
66.	Mr A McDonald Whittlesea, VIC	1/8/90
67.	Mrs M Jones Orange, NSW	13/8/90
68.	CONFIDENTIAL SUBMISSION	3/9/90
69.	Mr M Nevill, MLC Parliament House Perth, WA	17/9/90
70.	D Bradley Willoughby, NSW	11/9/90
71.	Mr P H Vanderhorst Fellow Taxation Institute of Australia Mooroolbark, VIC	12/12/90
72.	Mr E L Waterman Acting Secretary The Treasury Canberra, ACT	9/12/90
73.	Mr E Blain Warrnambool, VIC	27/12/90
74.	Mr J M Green Freehill Hollingdale and Page Sydney, NSW	11/3/91
75.	Mr R Willims Department of the Premier Economic and Trade Development Queensland Government, QLD	20/3/91
76.	CONFIDENTIAL SUBMISSION	8/4/91

77.	Mr and Mrs N and M James Adamstown Heights, NSW	8/7/90

APPENDIX B

EXHIBITS

1.	The Australian Institute of Valuers and Land Administrators Incorporated	Guidance Notes with Background Papers on: The Valuation of Fixed Assets and Certain Other Non-Current Assets for Reporting Purposes.
2.	Mr B Watson, Director, Grant Samuel and Associates	Statement to the House of Representatives Committee by Mr B J Watson, dated 4 September 1990.
3.	Mr B Pentony, University of Canberra	An Agenda for Corporate and Securities Law Reform. Discussion Paper No 1/1990.

APPENDIX C

WITNESSES

MELBOURNE: 1 AUGUST 1990

. *Private Citizen*
- Professor R Baxt

. *Australian Institute of Valuers and Land Administrators*
- Mr P P Gill, General Councillor
- Mr P S Meeking, Federal President

. *Life Insurance Federation of Australia Inc.*
- Mr D Davis, Research Officer
- Mr L L Hall, Convenor, Investment Committee

. *Shareholder Action Group*
- Mr N F Burch, Secretary
- Mr D Jenkins, Chairman

. *Securities Institute of Australia*
- Mr R G McCrossin, Councillor

. *Australian Accounting Research Foundation*
- Mr I Langfield-Smith, Senior Project Officer, Legislation
- Mr R Nairn, Member, Legislation Review Board
- Mr G Pound, Technical Director, Auditing

MELBOURNE: 2 AUGUST 1990

. *Private Citizen*
- Mr H Bosch

SYDNEY: 3 SEPTEMBER 1990

. *Australian Shareholders' Association*
- Mr B T Birthistle, Director
- Mr P L Kent, Deputy Chairman
- Mr A E F Rofe, Director
- Professor R G Walker, Chairman

. *Australian Stock Exchange Limited*
- Mr J H Berry, Manager, Surveillance
- Mr R L Coppel, Deputy Group Managing Director

- Mr M M Kinsky, General Counsel, National Companies Division
- Mr R J Schoer, National Director

. *Ernst and Young*
- Mr C N Westworth, Partner

. *County NatWest Australia Corporate Service Ltd.*
- Mr M J McComas, Director

. *Australian Consumers Association*
- Mr R Drake, Policy Officer

SYDNEY: 4 SEPTEMBER 1990

. *Coopers and Lybrand*
- Mr R S Lynn, National Audit Partner

. *Australian Institute of Company Directors*
- Mr G Bartels, Director-General
- Mr I R L Harper, New South Wales Councillor

. *Grant Samuel and Associates*
- Mr B J Watson, Director

. *ANZ Banking Group Ltd.*
- Mr G J Camm, General Manager, Investor Relations

. *Westpac Banking Corporation*
- Ms L Maddock, Manager, Public Policy
- Mr D O'Bryen, Senior Manager, Legal Division

. *Law Society of New South Wales*
- Mr M Z Chiba, Member, Business Law Committee, Young Lawyers Section
- Mr A J Rumble, Chairman, Business Law Committee, Young Lawyers Section

CANBERRA: 10 OCTOBER 1990

. *Law Council of Australia*
- Mr S J Walker, Member, Companies Committee

. *Private Citizens*
- Mr T E Bostock
- Mrs C V Currie
- Mr P H Davies

CANBERRA: 17 OCTOBER 1990

. *Private Citizen*
  - Mr A K Smith

. *Metal Manufactures Ltd*
  - Mr W E Kable, Legal Counsel
  - Mr M G O'Brien, Consultant

. *Business Council of Australia*
  - Mr R C Gardini, Regulatory Consultant
  - Mr C R Speed, Assistant Director

CANBERRA: 7 NOVEMBER 1990

. *Attorney-General's Department*
  - Mr J H Broome, First Assistant Secretary, Business Affairs Division
  - Mr P J Noonan, Acting Assistant Secretary, Companies and Securities Branch
  - Mr G Tanzer, Principal Legal Officer, Companies and Securities Branch

. *Freehill, Hollingdale and Page*
  - Mr J M Green

. *Institute of Chartered Accountants in Australia*
  - Mr N Burton Taylor, President
  - Mr G P Allen, Immediate Past President

. *Australian Accounting Research Foundation*
  - Mr J F Donges, Chairman, Australian Auditing Standards Board
  - Mr W J McGregor, Director

. *Australian Society of Certified Practising Accountants*
  - Mr G C Paton, National Treasurer

CANBERRA: 19 DECEMBER 1990

. *Australian Securities Commission*
  - Mr A G Hartnell, Chairman
  - Mr N R Korner, Consultant

. *Centre for National Corporate Law Research, University of Canberra*
  - Mr B D Pentony, Deputy Director