PARLIAMENTARY JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES

Minority Report on Matters Arising from The *Company Law Review Act 1998*

Senator Andrew Murray

Australian Democrats

OCTOBER 1999

Minority Report: Senator Andrew Murray: Australian Democrats

Company Law Review Act 1998

Proportional Voting for Directors

The existing method of electing company directors on a limited re-election pattern has been severely criticised for being undemocratic and unrepresentative and for denying the appropriate representation of minority interests. The current system of electing directors facilitates the dominance of control groups and lessens the possibility of support being expressed for particular directors. The result of this is that, for minority interests to be considered, minorities must often rely on expensive and problematic remedies such as recourse to the legal system, the ASX rules and ASIC, which reduces the attractiveness of investing, reduces genuine shareholder participation and facilitates fairly domineering managerial or board control.

These criticisms are just too telling to ignore.

In order to ameliorate this situation a system of preferential voting, also described as cumulative voting, would allow for the election of directors in which all directors would be elected annually with each share obtaining as many votes as there are vacancies. In the United States this procedure is mandated as best practice by federal law for banks and for corporations in some states.

With regard to the witnesses on this topic, most were traditionalists used to the existing system, and not experienced with alternative and improved voting systems, as used successfully in other countries.

The question is therefore, how can alternative voting practices for directors be promoted and trialed?

This type of preferential voting for directors of listed companies needs to specify that the number of directors to be elected will be determined by the company's constitution, all directors would retire each year, each share will obtain as many votes as there were board vacancies and each shareholder could distribute as they thought fit all or some of the votes available to them from their shareholding to any number of those nominated as directors. The consequence of this optional preferential method is that shareholders can ascribe their votes to indicate their preference for a director or directors.

Although the Australian Democrats believe that this system is desirable for all listed and sizeable companies, we accept it is not appropriate to require companies to introduce such a system.

The hearings into this matter have indicated that company directors and bodies which represent their interest clearly have in interest in maintaining the status quo and are resistant to change. However in the face of such resistance, the Australian Democrats would at least argue that this system of voting must be

put as an option to directors of a company at the earliest annual general meeting available, to decide for or against it.

This is another part of our governance proposals. This concerns a democratisation of companies. We believe this advances the corporate governance envelope.

Recommendation:

That the *Corporations Law* obliges listed companies to put a motion to their shareholders to consider whether their constitution should provide that directors be elected on a proportional basis.

Environmental Reporting

The reason that we moved to include section 299(1)(f) into the *Company Law Review Act 1998* is not just our well-known attachment to environmental matters, but the fact that many companies are materially affected financially in terms of environmental situations. I think we only have to recall some of BHP's financial consequences arising from environmental matters to be well aware of that.

Many of the submissions made to the inquiry are unfortunately misconceived. The focus and impetus for our amendment was not to promote greater social responsibility by Australian corporations, but was primarily directed to alerting shareholders to the financial risks that might attach to a company's environmental practices. Suggestions that the requirement would more appropriately be included in environmental legislation are incorrect because this is an issue of identifying material financial risk based on relevant environmental issues. It is not about promoting a particular social behaviour, desirable as that may be.

In early 1998, the Institute of Chartered Accountants released a discussion paper entitled "Leadership – The Impact of Environmental matters on the Accountancy Profession". The paper talks about the trend toward providing information in relation to the environmental implications of business operations.

The paper is interesting in that it details that a majority of annual report user groups (notably shareholders and individuals within organisations with a review or oversight function) do increasingly demand information about the environmental performance of Australian corporations and they seek that information from annual reports.

The ICAA publication contains some further interesting statistics which support our case - such as:

- more than two-thirds of users seek disclosure of environmental information in the annual report;

- less than 10 per cent of preparers see environmental reporting as a threat to their company – that is, they are not concerned about it;
- 64 per cent of users would support an approach to have environmental matters included in annual reports;
- 40 per cent of Australian listed corporations are now providing some form of environmental disclosures within their annual report.

A common theme of critics of Section 299(1)(f) is that it is inappropriate because on this thinking other social values should be included, such as health and safety. Such analogies are not apposite. Just to give one example, the Kyoto agreement itself requires investors to attend to major financial risk arising from environmental considerations.

Recommendation:

That section 299(1)(f) of the *Corporations Law* remain in the law.

Alternatively

That Section 299(1)(f) be amended to ensure there is no doubt that disclosure is directed to exposing financial risk.

Disclosure of Information Filed Overseas.

The arguments outlined in the Majority's report in favour of retaining this requirement are very persuasive. The benefits of this requirement in terms of international harmonisation of disclosure standards far outweigh the cost that might be incurred in complying with the requirement.

Evidence received by the Committee did not suggest that compliance with this provision since its introduction had imposed an onerous burden on any company.

Recommendation:

That section 323DA of the *Corporations Law* remain in the law.

Reporting of Proceedings

The Australian Democrats are in agreement with the Australian Law Reform Commission that this kind of disclosure is critical to investor confidence.

A number of witnesses raised the question - why are provisions of the *Corporations Law* and *Trade Practices Act 1974* accorded special status? Rather than being an argument against the inclusion of a disclosure provision such as this, it may be an argument in favour of extending the reporting of proceedings to all proceedings against the company for significant alleged breaches of the law.

The Australian Democrats would be supportive of a proposal to require companies to appraise their shareholders of all proceedings against the company for significant alleged breaches of the law, not simply those relating to the *Corporations Law* and the *Trade Practices Act 1974*.

Recommendation

That the *Corporations Law* require companies to report any proceedings instituted against the company for any material breach of the *Corporations Law* or *Trade Practices Act 1974*.

alternatively

That the *Corporations Law* require companies to report any proceedings instituted against the company for any material breach of any law.

Notice of Meetings

The Australian Democrats have supported a 28 day notice period when that issue has been the subject of inquiry during two previous inquiries (Company Law Review Bill 1998 and Draft Second Corporate Law Simplification Bill 1996). We continue to do so for the same reasons.

However our intention was that the 28 days be a maximum and not a minimum, and it may be helpful to look at amending the 28 day provision to ensure that that intention is secured.

Disclosure of Proxy Voting

The Australian Democrats support the disclosure of proxy votes. Our reasons for that support are set out in our minority report to the inquiry into the Company Law Review Bill 1998.

Corporate Governance Board

Company directors have extensive powers regarding the management of the company's business and internal organisation. Some of these internal management powers, which may be termed 'corporate governance powers', include : the power of directors to decide their own remuneration, to appoint and remunerate auditors and other experts, adopt any accounting practices they see fit within accepted accounting standards, nominate themselves for re-election and fill casual vacancies for directors, to initiate changes in the corporate constitution and to control the conduct of shareholder meetings and voting procedures *(Corporations Law,* Schedule 1, Table A).

Directors also possess the powers to themselves manage conflicts of interest with related parties.

The number and extent of these powers has led some commentators to argue that existing practices on unitary boards unacceptably concentrate power with directors to pursue self-interest. It also provides them with absolute power to manage their own conflicts of self-interest.

There are significant deficiencies in this method of controlling companies, and of ensuring full and objective accountability to shareholders. There is a substantial body of research and literature on this subject, and a number of countries have variants of this idea of a corporate governance board.

A sure way to increase the independence and accountability of Boards is to have two Boards, a main board concerned with managerial and operational issues, and one concerned with limited and specific governance issues. The former should quite properly continue to be the senior board and have directors elected relative to *shareholdings*, but to protect minorities, minimise conflict of interest issues, avoid Board `capture', and ensure accountability, the latter needs to be elected by *shareholders.*

In listed companies a separate Board should exercise these internal governance powers, leaving the main board directors to concentrate on the management of the company's business operations, while the second Board would provide the valuable introduction of a system of checks and balances into corporate governance procedures. A separation of powers in other words.

This proposal is a proactive one, designed to prevent problems and improve corporate performance. To those who answer that the stockmarket will police companies with poorly performing Boards in corporate governance, that involves a reactive attitude and a prejudicial one to shareholders since the value of their shares will have fallen.

The corporate governance board proposal would both simplify and reduce the role, responsibilities and workload of the main board directors as well as increasing their credibility by removing the powers which permit the perception or actuality of a conflict of interest. This should thereby improve the accountability of directors and the internal governance of companies and lead to better business management decisions by directors. Ultimately, this is about re-establishing the balance of company governance in favour of shareholders, rather than management.

It is essential that the separate governance board be elected on the democratic basis of one vote per shareholder rather than one vote per share.

Although the Australian Democrats believe that this system is desirable for most sizeable and listed companies, we appreciate shareholders must have the right to determine how the company they own is governed. Consequently, we believe that all listed companies of sufficient size should be obliged to put a motion that a corporate governance board be established and allow shareholders to vote on that motion, to decide for or against.

Recommendation:

That all listed companies of sufficient size should be obliged to give their shareholders the option of establishing a corporate governance board at the next annual general meeting of the company.

Obligation to Report Suspicions of Fraud

The Australian Democrats believe that directors and executive officers should be obliged to report to the auditor any suspicion they may have about any fraud or improper conduct involving the company.

The report of the majority is flawed in a number of respects:

- It views the role of the auditor as only extending to an examination of the accounts to ensure compliance with the *Corporations Law* – the role of the auditor is much wider than this.
- Whilst the terms 'suspicion' and 'improper conduct' are capable of subjective interpretation, like many other terms contained in the *Corporations Law*, there is no magic in these terms and they are to be attributed an ordinary meaning. The suggestion of different interpretations is not a valid reason for not pursuing this important safeguard.
- The suggestion that the imposition of this duty of disclosure to the auditor will reduce a director's responsibilities under the law is completely baseless. Directors and officers duties and obligations would be unaffected except for the requirement to make disclosure to the auditors.
- Auditors are professionals who are accustomed to dealing with irregularities and suspicions of fraud. To suggest that they would be placed in a position of uncertainty when presented with information that might indicate a fraud or misconduct ignores the fact that they already make decisions relating to this type of information when it arises from their audit procedures.

Recommendation

That the *Corporations Law* require directors and executive officers of a company to report to the auditor any suspicion they might have about any fraud or improper conduct involving the company.

Director's Power to Call a Meeting

In its report on the Draft Second Corporate Law Simplification Bill 1996, the Joint Committee recommended that individual directors be given a right to requisition meetings. The Committee commented:

> *The Committee accepts that recent events in relation to some companies have demonstrated a need for individual directors of listed companies to be able to act independently in the interests of all shareholders. The*

> *right to call a members meeting gives some substance to this independence and it should not be a right that can be withdrawn through the constitution of a listed company.*

The Democrats continue to take the view that a single director should have this right. In their report arising out of this inquiry, the majority of the Committee comment:

> *Strong arguments were made for retaining this power on the grounds that its public benefit outweighed the infrequent occasion when a director may abuse the power.*

Since the enactment of this provision, the Committee were advised that not one director (out of many hundreds) had used the provision. It is quite evidently a 'reserve power' and has great value as such.

Recommendation:

That section 249CA of the *Corporations Law* be retained.

Requisitioning a General Meeting

In our report on the Company Law Review Bill, we commented:

> *It is vital that minority shareholders retain the ability to call meetings. It is equally vital that such shareholders are effectively dissuaded from using this power frivolously or vexatiously.*

We still hold that view, and consequently we cannot agree with the majority that the threshold for calling a meeting should be a holding of 5% of issued share capital by the requisitioning members.

Thresholds need to be sensible but not unreasonable.

We believe that there may be merit in revising upward the threshold of 100 members, especially for large mutual organisations. We also believe that the shareholding held by each member should be defined as a 'marketable parcel.' We are disappointed that the majority was not able to formulate a number of options that could be put to the Parliament in the alternative.

Given the choice between the existing regime and that proposed by the majority of the Committee, the Democrats favour a provision approximate to the existing regime.

Senator Andrew Murray