Submission to the Senate Finance and Public Administration Legislation Committee

Corporations (Aboriginal and Torres Strait Islander) Amendment (Strengthening Governance and Transparency) Bill 2018

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INTRODUCTION

This submission is in response to the issue of the Corporations (Aboriginal and Torres Strait Islander) Amendment (Strengthening Governance and Transparency) Bill 2018 (The Bill). The aim of this submission is to provide an informed debate on the key issues considered by the Bill. Some of the suggestions that have been provided are of a policy nature and observe the need to empower Aboriginal and Torres Strait Islander Corporations members (CATSI Corporations), provide this business structure with more flexibility and remove unnecessary red tape attached to the running of these corporations.

If any of the responses require further explanations, please contact Dr Marina Nehme

SUMMARY OF OBSERVATIONS MADE IN THIS SUBMISSION

This submission makes the following recommendations:

- Support the change to the classification of CATSI Corporations;
- Recommend a review of the replaceable rules in the CATSI Act to allow for more flexibility in the running of CATSI Corporations;
- Clarify the rules regarding review of the financial reports;
- Change the rules attached to membership and directorship of companies to make them more mainstream and more aligned with the rules in the *Corporations Act 2001* (Cth);
- The independent directors should be appointed by members and not directors;
- Review the need for Annual General Meetings for small CATSI corporations; and
- Support the introduction of enforceable undertakings to ORIC as this sanction will provide the Registrar with a flexible tool to deal with alleged breaches of the law.

CLASSIFICATION OF ABORIGINAL AND TORRES STRAIT ISLANDER CORPORATION

The current criteria that applies to the determination of the classification of the CATSI Corporations is in line with the distinction that applies on companies registered under the *Corporations Act 2001* (Cth).[1] However, in view of the differences that exists between these types of entities, there was always a question of whether the test is appropriate.

The proposed test which solely focuses on revenue is much simpler and more appropriate. It will also take into account changes in the financial circumstances of a corporation. Accordingly, it is more flexible than the current regime. Such a change is in fact welcomed due to its simplicity.

CONSTITUTIONS

The internal governance rules of an organisation are those rules which regulate the activities of the organisation and the relationships within it; as such, these rules usually deal with the following matters:[2]

- the objects of the organisation;
- admission to and limitations on membership;
- the rights and powers of members;
- the appointment and powers of officers;
- the dissolution of the organisation and distribution of its assets.

The content of an organisation's internal governance rules is therefore a significant, if not critical, determinant of the extent to which that organisation is able to respect and embody indigenous cultural practices. These rules may for example impose practices on indigenous communities which may be inconsistent with indigenous cultural practices and traditions. Consequently, it is important to allow the indigenous corporations to adopt internal governance rules that are tailored to their situation as this would permit such corporations to operate within a Western legal framework, while allowing for practices within the organisation to reflect indigenous culture.

It is, therefore, crucial that legislation allowing for the incorporation of CATSI Corporations does not go too far in embedding Western concepts into the internal management of indigenous corporations at the expense of indigenous values and traditions. When introduced, the *CATSI Act* was intended to 'improve governance and capacity' in the indigenous corporate sector,[3] and aimed to modernise the way Indigenous Australians run their businesses and organisations by providing a legislative framework that 'maximises alignment' where practicable with the *Corporations Act 2001* (Cth), the mainstream legislation governing the regulation of

[1] See for example s 45A of the *Corporations Act 2001* (Cth).

[2] Robert Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (LexisNexis, 14th ed, 2010), 187. The internal governance rules of an indigenous corporation have effect as a contract:

- between the indigenous corporation and each of its members;
- between the indigenous corporation and each of its directors and the corporation's secretary; and
- between each member and each other member of the indigenous corporation.

See *CATSI Act*, s 60-10(1).

[3] Explanatory Memorandum to the Corporations (Aboriginal and Torres Strait Islander) Bill 2005 (Cth), [1.1].

companies in Australia.[4] To that end, the *CATSI Act* 'provides for a system of replaceable rules consistent with the replaceable rules regime of the *Corporations Act*'.[5] Under the *CATSI Act*, the internal governance rules of a CATSI Corporation are constituted by the replaceable rules and the constitution.[6] Further, in contrast with its predecessor (the *Aboriginal Councils and Associations Act 1976* (Cth) (*ACA Act*)),[7] s 66-1 of the *CATSI Act* sadly does not state that an indigenous corporation's internal governance rules or constitution may be based on 'Aboriginal custom'.

An ideal review and amendment of the *CATSI Act* would focus on broadening the replaceable rules to allow more flexibility in the management and running of the corporations. Instead the main replaceable rules remain the same (with some minor addition to accommodate the proposed changes). Further the Registrar has been provided with more power regarding approving the constitution. In addition to the fact that the Registrar has to be satisfied that the constitution complies with the internal governance rules requirement, the Registrar must also believe that the constitution (which under the proposal every corporation must have) must fit for purpose. The Explanatory Memorandum notes that 'fit for purpose' refer to the manner in which the rules are expressed. However, this explanation does not seem to appear in the Bill. The addition of the manner in which the corporation would respond to the rejection of the constitution based on it not being fit for purpose is also very convoluted, burdensome and unnecessary. It is important to note that unlike the CATSI Corporations, companies registered under the *Corporations Act 2001* (Cth) do not have such scrutiny imposed on them. This makes the *CATSI Act* paternalistic in nature.

Additionally the introduction of s 66-10 is unnecessary and confusing. Why is there a need of a section dealing with provisional replaceable rules? Such explanation may be included in s 57-5 which already has these rules in it: the provisions are only relevant if the corporation has chosen to adopt a particular path. Other than that, their presence outside of s 57-5 is confusing and irrelevant. It is an attempt by legislators to explain the obvious and convolute an already complicated legislation. The saying 'less is more' is appropriate in this case.

The requirement that a CATSI Corporations either adopts a model constitution or a constitution of their choice is a diversion from the *Corporations Act 2001* (Cth). While aiming to be helpful, it is paternalistic in nature. Members in CATSI Corporations should be able to set out the rules in their constitutions if they wish so or adopt the replaceable rules if they desire. This requirement also adds an additional burden to CATSI Corporations especially when compared to the fact that majority companies under the *Corporations Act 2001* (Cth) not only have more replaceable rules that they can amend but they do not need to have a constitution.

Additionally, CATSI Corporations may choose to adopt the 'model constitution' as it may be seen as the path of less resistance and this may go in contradiction of their values and beliefs. It is best to have less rules regulating the internal governance rules and not more. Accordingly, I would recommend that this Part in the Bill should be reconsidered: the legislation should be amended to provide CATSI Corporations with more flexibility regarding the way they operate.

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[4] Revised Explanatory Memorandum to the Corporations (Aboriginal and Torres Strait Islander) Bill 2006 (Cth), [1.7].
[5] Explanatory Memorandum to the Corporations (Aboriginal and Torres Strait Islander) Bill 2005 (Cth), [5.63].
[6] *CATSI Act*, ss 57-1, 63-1. The constitution and replaceable rules are discussed in detail in Part II of this paper.
[7] See s 43(4) of the *ACA Act*,

REVIEW OF FINANCIAL REPORTS

The Bill proposes to introduce reviews of financial reports as an alternative to audits. This move is welcomed as it will provide more flexibility in the system. However, one big question mark is there: When is a review appropriate? Can one type of accountability be substituted with another and is it a choice made by the directors? These are all questions that auditors will have to grapple with. Clarification on this point should be present in the Bill and not the Regulation. Further, a choice of whether a corporation should choose a review over an audit or vice versa may be appropriate depending on the classification of the corporation.

SUBSIDIARIES AND OTHER ENTITIES

The Bill proposes to simplify the rules regarding eligible bodies corporate, a move that would usually be welcomed. One of the issues raised in the explanatory memorandum of the Bill is the fact that s 246-5(3) causes an impediment in the creation of eligible bodies corporate.

My suggestion is the following: instead of creating exceptions and complicating to the existing system, the easiest way to tackle this issue is by amending the existing s 246-5(3): 'A majority of directors of the corporation must be members of the corporation'. The question is why is this a requirement? We should empower Indigenous people to choose who they believe are the best people to represent and manage their company. This could be members in the company or outsiders. The key thing is to keep s 246-5(1) into play as it will ensure that CATSI Corporations are managed by a majority of Aboriginal and Torres Strait Islander people.

Further, s 245-5(3) is not really needed: If the members are not happy with the performance of directors, they can remove them.[8] Additionally, there are restriction regarding the duration of the terms of directorship of a person.

Lastly, the requirements regarding directorship in the *Corporations Act 2001* (Cth) are less restrictive. In addition to the fact that they do not have a requirement for directors to be members of the company, there is no restriction regarding number of directors and duration of the terms of directors. A more empowering approach is to provide flexibility to members in the CATSI Corporations to appoint directors without the restrictions imposed in the current legislation as these restrictions do not just add complexity and confusion to the Act but they also disempower Indigenous people.

Furthermore, the addition of s 246-25(2A), just is unnecessary. What is needed is a system that allows the members to decide the duration of directors' appointment and the power to remove such directors without needing to comply with unnecessary paternalistic legislation that creates more complexities than the ones present in the *Corporations Act 2001* (Cth).

Additionally, this approach means that members can appoint independent directors without the need to introduce in the legislation new provisions to encourage such an appointment (such as the ones proposed in Part 13 of the Bill). It is well documented that the presence of independent directors would enhance the performance of a company. Question may also be raised regarding proposed s 246-17: Why are directors appointing independent directors? Members should be the ones doing that. There is no real justification for this move: The proposed provision is in

[8] *CATSI Act,* s 249-10.

contradiction to good governance practices as it diminishes accountability and transparency within the organisation.

MEETINGS AND REPORTING OBLIGATIONS

While the Bill is attempting to provide more flexibility to small CATSI Corporations regarding Annual General Meetings (AGMs), it does not go far enough. In this, once again the *Corporations Act 2001* (Cth) is more flexible. For instance, proprietary companies are not required at all to hold an AGM. If a meeting is needed, members can request for a meeting. Similar provisions may be needed in the *CATSI Act* to allow more flexibility in the running of small corporations. The current proposed provision in the Bill just adds more complexity to the way the organisation is to be run. It is desired to leave it up to the members to decide whether they wish to have an AGM or not. The legislation should give them that flexibility and not set default position that an AGM is needed.

Further the clause that 'the special resolution cannot be passed by circulating resolution' can be draconian in nature for people living in remote areas (proposed s 201-175 (3)). Lastly, clarification is needed regarding what constitute material change in the context of the proposed s 201-185. For a Bill that is designed to make the law more accessible, there are several provisions, including this one, that may result in more questions than answers. Such answers are especially needed as a breach of the proposed s 201-185 is a strict liability offence.

MEMBERS AND MEMBERSHIP

While I do not have any comments on the proposed changes regarding this matter, I would recommend that the rules attached to number of members in the CATSI Corporations should be reconsidered as the current rules are unduly restrictive regarding the minimum number of members that an indigenous corporation needs to have to be able to be registered. Such a restriction is hard to justify especially in the current times when the *Corporations Act 2001* (Cth) only required 1 member to be there for a company to be registered. The same rule is there for both proprietary and public companies. The fact that the CATSI Act is more restrictive highlight once again the paternalistic nature of this legislation.

KEY MANAGEMENT PERSONNEL

The Bill proposes to enable the regulation to require information about key management personnel employment history as well as remuneration to be disclosed. The desire behind such a provision is to increase the level of transparency within a corporation. I find it concerning that the regulation is the one that would be outlining such a requirement. This should be clearly stated in the legislation. Further, declaring the remuneration of key management personnel is definitely something that members should be aware of to enhance transparency, accountability and good governance within an organisation.

However, the employment history is another matter. One would assume that a corporation would hire parties due to a particular expertise that they have. Directors for instance are appointed by members and it is assumed the members would be provided with details about such expertise when voting on this matter. Other personnel would be appointed by the directors

most likely based on their qualifications. There is no need for such a requirement to be added as the move is just too paternalistic. Further would the automatic receipt of such information be a breach of privacy of such employee? Additionally, there is no such requirement in the *Corporations Act 2001* (Cth) and, as such, it is hard to justify in the context of the *CATSI Act*.

INVESTIGATION AND ENFORCEMENT

Part 11 proposes to allow the Registrar to accept enforceable undertakings, a power available to a number of regulators in Australia.[9] An enforceable undertaking can be described as a promise enforceable in court.[10] It takes the form of a settlement in which the alleged offender (who may be called "the promisor") and the regulator (for the purposes of this article, the ACCC and ASIC) start their negotiation in relation to the alleged breach. The regulator usually has wide latitude to negotiate and accept outcomes similar to those remedies available to the Court in many respects, and also remedies not normally within the Court's power, so long as the undertaking is accepted 'in connection with a matter in relation to which' the regulator has a power or function.[11] Further, the statute may allow the Court to make orders to enforce an undertaking that would ordinarily not be within its power to make.[12]

One of the key advantages that enforceable undertakings have over other sanctions is the fact that the sanction can prevent similar breaches from occurring in the future as it attempts to rectify the cause of the conduct. Further, an enforceable undertaking is restorative in nature.

To ensure transparency and accountability in the use of enforceable undertakings, the Bill in the proposed s 439-25 should note that the accepted enforceable undertakings should be made available to the public. This would ensure that ORIC's practices comply with ASIC's practice regarding this matter. It is important to note that other regulators that have this sanction at their disposal have varying attitude toward the disclosure of the enforceable undertaking.

Additionally, it is recommended that ORIC develops guidelines regarding the use of this sanction to ensure that accountability, fairness and transparency are in place when they rely on this sanction.

CONCLUSION

The Bill provides us with an opportunity to fully empower Indigenous people. However, it falls short of this as it makes the existing legislation more complex and convoluted in a number of instances. A more flexible approach to the internal governance rules, membership, directorship and meetings is needed.

Marina Nehme
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[9] Marina Nehme 'Enforceable Undertakings in Australia and Beyond' (2005) 18 *Australian Journal of Corporate Law* 68.
[10] Marina Nehme, 'Enforceable Undertakings and the Court System' (2008) 26(3) *Company and Securities Law Journal* 147.
[11] Ibid.
[12] *Trade Practices Act,* s 87B (4) (a), (d), *Australian Securities and Investments Commission Act,* ss 93AA (4) (a), (d), and 93A (4) (a), (d).